

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: March 25, 2008**

REGULAR CONSENT EFFECTIVE DATE _____ N/A _____

DATE: March 12, 2008

TO: Public Utility Commission

FROM: Michael Dougherty

THROUGH: Lee Sparling and Marc Hellman

SUBJECT: OREGON PUBLIC UTILITY COMMISSION STAFF: Report on the Fact Finding on Aegis Round Lake Sewer Company LLC and separation from RL Water LLC.

STAFF RECOMMENDATION:

Staff recommends that no further action be taken in the matter of Aegis Round Lake Sewer Company LLC and separation from RL Water LLC.

DISCUSSION:

At the December 18, 2007, Public Meeting, Staff requested the Commission, to open an investigation, pursuant to ORS 756.515, of the proposed sewer rates of Aegis Round Lake Sewer Company LLC (Aegis) and current water rates of RL Water LLC (RL Water). Aegis and RL Water are located in the vicinity of Klamath Falls, Oregon, have the same owner, and have the same customer base. The Commission directed Staff to conduct a quick fact finding on the separation between the two entities.

Staff's Request for the Commission to Open an Investigation

Staff requested the Commission to open this investigation because Staff believed that there was sufficient indication that the two companies were acting as one entity and were only separated to avoid regulation and allow for cross subsidies. As such, Staff believed that the sewer rates of Aegis may be cross-subsidizing the water rates and may also be subject to the Commission's jurisdiction.

The reasons Staff believed that the two companies were separated to avoid Commission regulation include:

1. Aegis was listed as an inactive entity by the Secretary of State (SOS). Additionally, the SOS's Business Registry listed Aegis as filing an administrative dissolution on August 31, 2007. When Staff contacted the owner of RL Water and Aegis, she was not aware of the inactive status.¹
2. The separation of RL Water from Aegis, after the jurisdiction order (WJ 1, dated March 25, 2005) and RL Water's rate filing (UW 111, dated October 31, 2005), suggested that the two companies were only separated to avoid regulation and allow for cross subsidization of water rates.
3. RL Water's current flat residential rate of \$25 is lower than the Company's proposed rates in UW 111 and most likely lower than a rate that would have been proposed by Staff during a rate case review. As a result, RL Water has not been able to raise its water rates since coming under the Commission's jurisdiction (WJ 1) on March 25, 2005. Based on information provided by the owner, monthly water expenses exceed monthly water revenue.
4. RL Water experienced numerous outages and system quality problems during the summer and fall of 2007. These outages required amongst other things: the provision of bottled water, boiled water notices, installation of a continuous feed chlorinator, installation of the booster pump, installation of a pressure sustaining valve, installation of a strobe light on the reservoir that goes on when the reservoir reaches the 50 percent level, repair of system leaks, increased chemical testing of the system, and numerous system flushing. These numerous problems resulted in the coordinated efforts of Commission Staff, Drinking Water Program Staff, and the Klamath County Department of Public Health to bring the Company into compliance with water quality standards.

Being that all of the above improvements resulted in considerable costs to RL Water and RL Water has not filed for a rate increase, Staff believed that the Company may be subsidizing the water improvements through the increased sewer rate.

5. An increase in the sewer rate from the previous \$42 per month to a new rate of \$55 per month.

Because of Staff's early concern over the two companies, Staff requested advice from the Attorney's General office concerning jurisdiction over wastewater utilities. On

¹ Subsequent to Staff's notification to the Company of the Administrative Dissolution, the Company on November 28, 2007, filed a "Reinstatement Amended" with the Secretary of State (SOS).

January 18, 2006, the assistant attorney general provided a memorandum concerning regulation of wastewater utilities. The memorandum concluded with the following:

In conclusion, the Commission does not generally have authority over a wastewater company that does not also provide water service. Thus, the Commission does not have jurisdiction over separate wastewater companies unless it can demonstrate that the companies are not, in fact, separate but, instead, are one company and only separated to avoid regulation and allow for cross subsidies.

In a letter to the Commission dated December 17, 2007, and at the December 18, 2007, Public Meeting, the Company contended that both companies are operated separately for legitimate business purposes. In addition, the Company stated that there was no indication of what legal authority the assistant attorney general relied upon in rendering the above stated opinion. As a result, the Company opposed the assertion of Commission jurisdiction over Aegis. The Company further explained that the owner separated the water and sewer facilities to pursue separate business opportunities related to the facilities individually. At the Public Meeting, the Company informed the Commission that the owner actually leased the sewer operation to a third party on December 15, 2007. According to the Company, the lessee maintains the operational responsibility of the sewer system; Aegis does not.

Based on the information received at the public meeting, the Commission directed Staff to conduct a quick fact-finding of RL Water and Aegis to determine if the two companies are acting as one entity.

Are the two Companies acting as one or are they sufficiently separated?

On December 28, 2007, Staff sent the owner of the two companies a data request based on the Commission's directive. On January 15, 2008, the Company responded to Staff's data requests. In its response, the Company did not provide requested financial information and stated:

Our understanding is that such financial information was not part of the initial fact finding.

Although Staff vehemently disagrees with the Company on this point, the Company did provide a copy of a signed lease of the sewer system. The lease runs for an initial term of one year with the lessee having the option to renew the lease term for an additional five years. The lease, which is signed by a third party, who is not affiliated with Aegis, is

a triple net, NNN lease² and clearly places the operation of the sewer system on the lessee. The lease states:

Lessee shall be responsible to maintain and upkeep all aspects of the property, pay all expenses incurred on the property which includes, but not limited to, Insurance, Property, Tax, Maintenance, Repairs, Improvements, Security, Management, Reporting, Permits and Licenses, Legal and Accounting, utilities, and/or any other incidental expenses.

The lease clearly demonstrates sufficient separation of the two entities. As a result, the requested financial information would not add or detract from the separation resulting from the lease.

Conclusion

Staff believes that the NNN lease is sufficient to show separation of the entities. As a result, current Commission statutes do not appear to give the Commission authority to assert jurisdiction over Aegis.

However, with that said, when RL Water does file a rate application, Staff will be able to ensure that water rates are based on the company's cost of service that will further ensure against any possible cross-subsidization between the two entities. As a result, Staff recommends that no further action be taken in this matter.

PROPOSED COMMISSION MOTION:

No further action be taken in the matter of Aegis Round Lake Sewer Company LLC and separation from RL Water LLC.

² A triple net (NNN) lease is an agreement that designates the lessee as being solely responsible for all of the costs relating to the asset being leased in addition to the rent fee applied under the lease. The structure of this type of lease requires the lessee to pay for net real estate taxes on the leased asset, net building insurance, and net common area maintenance. The lessee has to pay the net amount of three types of costs.