

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Joint application for approval of acquisition by Philadelphia Suburban Corporation of stock of AquaSource Utility, Inc., and resulting transfer of controlling interest of Arrendondo Utility Company, Inc., Crystal River Utilities, Inc., Jasmine Lakes Utilities Corporation, Lake Suzy Utilities, Inc., and Ocala Oaks Utilities, Inc.

DOCKET NO. 021023-WS
ORDER NO. PSC-03-0163-FOF-WS
ISSUED: February 3, 2003

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman
J. TERRY DEASON
BRAULIO L. BAEZ
RUDOLPH "RUDY" BRADLEY
CHARLES M. DAVIDSON

ORDER APPROVING ACQUISITION OF AQUASOURCE UTILITY, INC. BY
PHILADELPHIA SUBURBAN CORPORATION

BY THE COMMISSION:

AquaSource Utility, Inc. (AquaSource), a Texas corporation, is a subsidiary of AquaSource, Inc., which is a subsidiary of DQE, Inc., a Pennsylvania based energy service company. AquaSource directly, or indirectly through subsidiaries, owns and operates water and wastewater systems in twelve states. In Florida, AquaSource furnishes regulated water service in portions of Highlands, Lake, and Polk counties and regulated wastewater service in portions of Lake, Lee and Polk Counties. AquaSource's five regulated Florida subsidiaries are Arrendondo Utility Company, Inc., Crystal River Utilities, Inc., Jasmine Lakes Utilities Corporation, Lake Suzy Utilities, Inc., and Ocala Oaks Utilities, Inc. All six corporations (AquaSource and its five regulated

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Florida subsidiaries) will collectively be referred to as the "Regulated Companies."

On October 7, 2002, Philadelphia Suburban Corporation (Philadelphia Suburban), along with the Regulated Companies filed a joint application for approval of acquisition of the stock of AquaSource and the resulting transfer of controlling interest in Arrendondo Utility Company, Inc., Crystal River Utilities, Inc., Jasmine Lakes Utilities Corporation, Lake Suzy Utilities, Inc., and Ocala Oaks Utilities, Inc. The Purchase Agreement was executed on July 29, 2002, with provisions for the closing to be contingent upon Commission approval pursuant to Section 367.071(1), Florida Statutes. The closing, which is contingent upon multi-state regulatory approvals, is intended to occur in the second half of 2003. The application states that the stock of AquaSource is currently owned by DQE, Inc. Philadelphia Suburban intends to purchase this stock, with the result that it will become the corporate parent of AquaSource Utility, Inc. and the corporate grandparent of the five Florida AquaSource utility subsidiaries.

The application as filed and amended is in compliance with the governing statute, Section 367.071, Florida Statutes, other pertinent statutes and provisions of the Florida Administrative Code, and our Order No. PSC-02-1627-PAA-WS, issued November 25, 2002, in this docket, which granted a waiver or variance of certain rules regarding the content of the application and noticing requirements. The application contained the correct filing fee prescribed for such filings by Rule 25-30.020, Florida Administrative Code.

Noticing

The application contains proof of compliance with the noticing provisions set forth in Rule 25-30.030, Florida Administrative Code, and the variance approved by Order No. PSC-02-1627-PAA-WS which simplified the noticing format by not requiring a full legal description for all the Regulated Companies. Three letters from customers were timely received but none of the customers specifically requested a hearing. Our staff sent a follow-up letter responding to the concerns in the letters and asking for a response by December 16, 2002, if the customers wished to pursue an objection to the application and request a hearing. No response to

any of the follow-up letters has been received. Therefore, there are no pending objections to the application.

Financing

Rule 25-30.037(3)(e) and (g), Florida Administrative Code; requires the application to contain a statement describing the financing of the purchase, a list of entities providing funding to the buyer, and an explanation of the manner and amount of such funding. On July 29, 2002, Philadelphia Suburban, Acquisition Corporation, DQE, Inc., and AquaSource, Inc., entered into a Purchase Agreement in which Philadelphia Suburban will acquire all of the issued and outstanding shares of common stock and a majority of the shares of preferred stock of AquaSource; all of the issued and outstanding shares of common stock of AquaSource Development Company (a Texas corporation which does not conduct business in Florida); and all of the issued and outstanding shares of common stock of The Reynolds Group (an Indiana water utility holding company also not conducting business in Florida). In addition, Acquisition Corporation will purchase certain non-regulated assets, consisting largely of contract operating agreements with various water and wastewater service providers. As a result, AquaSource's five regulated Florida subsidiaries will remain first tier subsidiaries of AquaSource and will become second tier subsidiaries of Philadelphia Suburban.

The Purchase Agreement provides for a target cash purchase price of approximately \$205 Million. The final purchase price may be increased by up to \$10 Million or decreased by up to \$25 Million as various purchase price adjustments are applied. Such adjustments will relate to the achievement of certain operating performance criteria, involving revenue, rate base and project customer connections as detailed in the Purchase Agreement. Philadelphia Suburban and Acquisition Corporation intend to fund the purchase with cash from a combination of short-term debt, long-term debt, common stock and/or securities convertible into common stock. The ultimate funding decision will be driven by financial market conditions existing at the time the acquisition is consummated. According to its 2001 Annual Report, Philadelphia Suburban's goal is to maintain an equity ratio adequate to support its current Standard and Poors corporate credit rating of "A+" and its senior secured debt rating of "AA-." As of December 31, 2001,

Philadelphia Suburban's long-term debt was \$531,455,000, at an average interest rate of 6.96%, and its stock equity was \$473,833,000.

Proof of Ownership, Tariffs, Certificates

Rule 25-30.037(3) (i), (j), and (k), Florida Administrative Code, requires evidence that the utility owns or has continued use of the land upon which the utility treatment facilities are located, tariff sheets reflecting the change in ownership, and the return of utility certificates for modification. Order No. PSC-02-1627-PAA-WS granted AquaSource's petition for variance from this rule since no changes are taking place at the Regulated Companies level.

Annual Reports and Regulatory Assessment Fees (RAFs)

We have verified that the Regulated Companies are current on annual reports and RAFs through 2001 and that there are no outstanding fees, penalties, or refunds due.

Environmental Compliance

Pursuant to Rule 25-30.037(3) (h), Florida Administrative Code, the application contains a statement that, after reasonable investigation, the utility systems operated by the Regulated Companies appear to be in satisfactory condition and in compliance with all applicable standards set by the Florida Department of Environmental Protection (DEP). Our staff also contacted all the applicable DEP offices. While compliance work and upgrades are being performed at several locations, DEP is satisfied with the Regulated Companies' response and anticipates no enforcement action.

Public Interest

Pursuant to Rule 25-30.037(3) (f), Florida Administrative Code, the application contains a statement describing how the transfer is in the public interest, including a summary of the buyer's experience in water or wastewater utility operations, a showing of the buyer's financial ability to provide service, and a statement that the buyer will fulfill the commitments, obligations, and representations of the seller with regard to utility matters.

Philadelphia Suburban, a Pennsylvania based corporation, is the second largest investor-owned water utility holding company in the United States, serving approximately two million consumers in six states. Philadelphia Suburban's largest subsidiary, Pennsylvania Suburban Water Company (PSW), is engaged in the business of furnishing water and wastewater service to the public throughout Pennsylvania. Substantial additional water and wastewater operations are conducted through other subsidiaries in Illinois, Maine, New Jersey, North Carolina, and Ohio.

Ownership and control of the Regulated Companies by Philadelphia Suburban is intended to produce a stronger water and wastewater utility system by adding strategic focus, financial and human resources, and the necessary size and scope to address the challenges facing the water and wastewater utility industry in a more cost-effective manner. The application further states that Philadelphia Suburban is committed to providing adequate, efficient, safe, and reliable water and wastewater service and believes performance bears this out. As an example, the application indicates that PSW has the lowest customer complaint ratio of any investor-owned water company in Pennsylvania and has never violated a primary maximum contaminant level standard.

It is presently anticipated that local management will remain substantially in place and staffing levels will not be materially disturbed. Philadelphia Suburban also affirmed that the Regulated Companies are expected to continue to operate in much the same manner as they currently do and will continue to be fully subject to all applicable laws, rules, and policies governing the regulation of Florida public utilities.

With regard to financial ability, the application provided a copy of Philadelphia Suburban's 2001 Annual Report which indicates sizable financial resources. According to the Annual Report, Philadelphia Suburban's 2001 operating revenues were \$307,280,000 with operating income available to common stock of \$60,005,000, and total assets of \$1,560,339,000 on a customer base of 602,510 customers or approximately 2,000,000 total consumers. According to the application, Philadelphia Suburban's size, access to capital, and its recognized strengths in system planning, capital budgeting and construction management, uniquely positions it to be able to provide high quality water and wastewater service. Because of its outstanding credit quality, Philadelphia Suburban believes it will be able to access the capital markets on favorable terms.

As the second largest investor-owned water and wastewater utility system in the country, Philadelphia Suburban also enjoys substantial economies of scale and scope through the mass purchasing of certain goods (e.g., chemicals and equipment) and the provision of centralized service (e.g., the system-wide administration of employee pension and benefit plans). The proposed transaction presents an opportunity to further expand these economies and to extend the resulting benefits to customers of the Regulated Companies through consolidation and elimination of duplicative functions in such areas as accounting and record keeping, financial and regulatory reporting, customer billing and accounting, and customer service.

Finally, the application indicates Philadelphia Suburban is totally committed to providing its customers with the highest quality service at the lowest reasonable price. Philadelphia Suburban has worked in partnership with State and local officials to address the problems faced by smaller systems that may lack the financial and/or technical resources needed to comply with evolving water quality and wastewater collection and disposal standards. Since the proposed acquisition offers expanded opportunities to the Regulated Companies' employees for career advancement and professional growth, the applicant believes customers will benefit by Philadelphia Suburban's ability to recruit, develop, and maintain a skilled workforce.

Rate Base

It has been our practice not to establish rate base for transfers of majority organizational control because a stock transfer has no regulatory impact on rate base. Similarly, it has also been our practice not to make an acquisition adjustment for stock transfers.

Rates and Charges

Rule 25-9.044(1), Florida Administrative Code, requires that the rates and charges for a new owner be continued until we authorize a change. Therefore, the rates and charges approved for Regulated Companies shall be continued until we authorize a change in a subsequent proceeding. According to the application, the proposed acquisition is intended to have no immediate effect on the rates charged or service provided by the Regulated Companies.

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Based on all the above, we find that the transfer of majority organizational control of AquaSource Utility, Inc. from DQE, Inc. to Philadelphia Suburban Corporation is in the public interest and is approved. The approved rates and charges of the Regulated Companies shall be continued until authorized to change in a subsequent proceeding.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the transfer of majority organizational control of AquaSource Utility, Inc. from DQE, Inc. to Philadelphia Suburban Corporation is approved. It is further

ORDERED that the approved rates and charges of the Regulated Companies shall be continued until authorized to change in a subsequent proceeding. It is further

ORDERED that the docket shall be closed.

By ORDER of the Florida Public Service Commission this 2nd day of February, 2003.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records and Hearing
Services

(S E A L)

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of the Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water and/or wastewater utility by filing a notice of appeal with the Director, Division of the Commission Clerk and Administrative Services and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.