



**JACK SHREVE**  
PUBLIC COUNSEL

**STATE OF FLORIDA**  
**OFFICE OF THE PUBLIC COUNSEL**

c/o The Florida Legislature  
111 West Madison Street  
Room 812  
Tallahassee, Florida 32399-1400  
904-488-9330

March 4, 1996

Blanca S. Bayo, Director  
Division of Records and Reporting  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0850

Re: Docket No. 950495-WS

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are the original and 1 copy of the Supplemental Direct Testimony of Kimberly H. Dismukes on behalf on the Citizens of the State of Florida. Southern States Utilities, Inc., claims that the exhibit discussed in the testimony is confidential. While we disagree with this claim, the testimony and exhibits should be treated as confidential pending a ruling on the claim by the Commission.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

Charles J. Beck  
Deputy Public Counsel

CJB:bsr

Enclosures

cc: (w/o enclosure)  
All Parties of Record

RECEIVED & FILED

FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

02623 MAR-4 96

FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for a rate increase )  
and increase in service availability charges )  
by Southern States Utilities, Inc. )  
\_\_\_\_\_ )

Docket No. 950495-WS  
Filed: March 4, 1996

Supplemental Direct Testimony

of

Kimberly H. Dismukes

On Behalf of the Citizens of the State of Florida



Jack Shreve  
Public Counsel

Office of the Public Counsel  
c/o The Florida Legislature  
111 West Madison Street  
Room 812  
Tallahassee, Florida 32399-1400

(904) 488-9330

Attorney for the Citizens  
of the State of Florida

1 SUPPLEMENTAL TESTIMONY  
2 OF  
3 KIMBERLY H. DISMUKES  
4

5 On Behalf of the  
6 Florida Office of the Public Counsel  
7

8 Before the  
9 FLORIDA PUBLIC SERVICE COMMISSION  
10

11 Docket No. 950495-WS  
12

13 Q. What is your name and address?

14 A. Kimberly H. Dismukes, 5688 Forsythia Avenue, Baton Rouge, Louisiana 70808.

15 Q. Are you the same Kimberly H. Dismukes that prefiled direct testimony in this  
16 proceeding?

17 A. Yes.

18 Q. Do you have an exhibit in support of your testimony?

19 A. Yes. Exhibit \_\_ (KHD-2) contains 1 Schedule that supports my testimony.

20 Q. What is the purpose of your supplemental testimony?

21 A. The purpose of my supplemental is to address the Lehigh Corporation Escrow Letter  
22 between Mr. Ronald Sorenson and Ms. Laura A. Holquist, dated December 14, 1993  
23 and produced by Southern States on February 23, 1995, pursuant to the pre-hearing  
24 officer's Order "Escrow Letter". I have included as Schedule 1 to my exhibit a copy  
25 of this letter.

1 Q. Would you please describe the background of the escrow agreements and the Escrow  
2 Letter?

3 A. Certainly. Lehigh Corporation had approximately \$5.2 million held in an escrow  
4 account under the terms of Escrow and Trust Agreements with Barnett Bank. The  
5 escrow accounts were established pursuant to the direction of the States of New  
6 York and Michigan to ensure the availability of funds for utility connections at the  
7 time the lot owner builds on the property. These funds were never recorded on the  
8 books of Lehigh Corporation, the developer of land owned in Lehigh Acres.  
9 According to the letter from Ms. Holquist, these funds were previously believed to  
10 belong to the lot purchasers and that Lehigh Corporation had no ownership interest  
11 in the funds. Legal research apparently concluded that the funds actually belonged to  
12 Lehigh Corporation and not the lot purchaser. Furthermore, this research concluded  
13 that the funds represented no liability to Lehigh Utilities, Inc. (a/k/a SSU) because the  
14 Commission ruled in March 1993 that the funds did not represent any liability or  
15 impute CIAC. Because of these conclusions, Lehigh Corporation reconsidered the  
16 accounting treatment of these funds.

17

18 The letter from Ms. Holquist describes the various rationales for assuming that Lehigh  
19 Corporation has little or no obligation to future customers as they connect to the  
20 system. It was concluded that:

21 ...we have determined that any significant water and  
22 sewer reimbursement obligation that might exist from

1 sales representation would be binding only  
2 onto the original lot purchasers. We have  
3 further determined that the average age of  
4 these lot purchasers when the reimbursement  
5 obligation could potentially be incurred would  
6 be greater than 86 years. Thus it appears that  
7 due to natural life-span constraints, minimal  
8 reimbursement, if any would actually be paid  
9 under our assumption that an obligation exists.  
10 We have concluded that no liability should be  
11 recorded for this potential exposure. [Escrow  
12 Letter.]

13  
14 Lehigh Corporation stopped short of recording no liability for the escrowed funds  
15 because of its intent to negotiate access to these funds, which it successfully did.  
16 Lehigh Corporation also negotiated a supplement to the developers agreement  
17 between itself and SSU. This supplemental developers agreement provides that, with  
18 the release of the escrow funds, Lehigh Corporation would install utility facilities,  
19 including transmission and distribution lines, collection lines, water and wastewater  
20 treatments plants, and other major utility assets, and sell these facilities to SSU. If the  
21 facilities are not used and useful within 10 years, the plant will be contributed to SSU.  
22 According to Ms. Holquist, installation of water and sewer lines toward New York

1 and Michigan purchasers' lots would spur development and increase the value of the  
2 lots, presumably those still to be sold by Lehigh Corporation. In related  
3 correspondence Bill Livingston, of Lehigh Corporation wrote:

4 A conceptual plan for providing water and sewer  
5 service will then be prepared for each service area.

6 Each plan will provide for spending all available  
7 escrow funds, as well as projected future receipts, in  
8 a manner that will extend water and sewer lines as  
9 close as possible to the contributing lots and also  
10 provide sufficient plant capacity to serve those lots.

11 Careful consideration will also be given to benefiting  
12 Lehigh Corporation owned property as much as  
13 reasonably possible. (Emphasis Added.)

14  
15 In her letter, Ms. Holquist noted that because Lehigh Corporation's management  
16 intends to offer a credit associated with the escrowed money, an obligation may be  
17 created in the near future. Accordingly, Lehigh Corporation estimated this obligation  
18 so that it could be recorded on its books. Using present value analysis and projections  
19 of when New York and Michigan lots would be expected to connect to the central  
20 utility services, it was determined that the present obligation is approximately  
21 \$662,000. The remainder, or approximately \$4.5 million was recorded as income.  
22 Because of the purchase agreement between Lehigh Acquisition Corporation and the

1 Resolution Trust Corporation, the income tax liability associated with the income, or  
2 escrow funds recorded prior to 1991, was to be included on the tax returns of  
3 Resolution Trust Corporation, not Lehigh Corporation. Income taxes on escrow  
4 money and interest earned after the acquisition are to be recorded on the books of  
5 Lehigh Corporation.

6 Q. Did Lehigh eventually record the funds on its books?

7 A. Yes. According to the Company's response to the Citizens' interrogatory 241, in 1994  
8 Lehigh Corporation recorded approximately \$5.2 million of escrowed funds held  
9 under offering statements approved by the States of New York and Michigan as a  
10 post-acquisition adjustment. The cash is apparently restricted to Lehigh Corporation  
11 and can only be drawn to construct major utility facilities. Under the provisions of  
12 various agreements between SSU and Lehigh Corporation, Lehigh Corporation is to  
13 develop water and wastewater utility facilities using these escrowed monies and sell  
14 them to SSU under a refundable advance. Lehigh Corporation is to be paid for these  
15 assets based upon future connections.

16  
17 As part of the agreement with the states of New York and Michigan, Lehigh  
18 Corporation agreed to grant a credit to lot owners for future connection fees in the  
19 amount of escrowed funds attributable to their specific lot as of March 31, 1994.  
20 Consequently, these customers will no longer receive the benefit of interest being  
21 earned on money they gave to the developer to construct utility assets. Based upon  
22 projected future connection dates, a deferred liability equal to the present value of this

1 projected liability was recorded by Lehigh Corporation, totaling \$700,000. In order  
2 to access the cash for construction, SSU agreed to guarantee the future credits to  
3 customers through a reduction of the approved CIAC tariff at the time the customers  
4 connect to the Lehigh plant. These credits, plus an administration fee, are to be billed  
5 to Lehigh and paid to SSU at that time.

6  
7 Because of these various agreements and negotiations, Lehigh Corporation recorded  
8 income totaling \$4.5 million and a deferred payable to SSU of \$.7 million--this latter  
9 item is the present value of the estimated liability for refunds of deposits made by  
10 Michigan and New York lot purchasers.

11 Q. Is Lehigh Corporation an affiliate of SSU?

12 A. Yes. Lehigh Acquisition Corporation is the sole stockholder of Lehigh Corporation,  
13 Topeka Group, Inc. (TGI) owns 100% of the stock of SSU and approximately 80%  
14 of the stock of Lehigh Acquisition Corporation. Minnesota Power owns 100% of the  
15 stock of TGI. In essence, Minnesota Power controls the operations of the regulated  
16 SSU and the nonregulated Lehigh Corporation. This control was made especially  
17 evident in some correspondence related to this issue. In a memorandum from Mr.  
18 Scott Vierima of SSU to Mr. Bert Phillips, then president of SSU, and to other  
19 officers of SSU, Mr. Vierima expressed the desire of Minnesota Power with respect  
20 to these funds:

21 LAC [Lehigh Acquisition Corporation] is finalizing  
22 modifications proposed by State authorities in NY and



1 MI, and has asked SSU to be prepared to  
2 execute the supplements within the next two  
3 weeks in order to ensure the ability to book  
4 related earning in MP's first quarter.

5 In reviewing various memorandum and correspondence concerning these escrowed  
6 funds it is apparent that the final treatment of these funds was structured such that  
7 they would have no positive affect on the customers of SSU and that all of the  
8 positive benefits, i.e., income, would inure to Minnesota Power's unregulated  
9 operations.

10 Q. What significance does this have to the Commission?

11 A. The Commission should consider whether the utility customers of SSU have been  
12 treated fairly with respect to these funds and their treatment on the books of SSU and  
13 Lehigh Corporation. Because of the manner in which the various agreements have  
14 been structured, there is no benefit to customers associated with these escrowed  
15 funds. Yet there is a significant benefit to Minnesota Power's unregulated operations.  
16 Minnesota Power was able to recognize a windfall profit of \$4.5 million in 1994  
17 because of money contributed by future customers of SSU. In addition, Lehigh  
18 Corporation will construct, and has constructed, water and wastewater assets in the  
19 Lehigh Acres development that will increase the value of the developer's lots. The  
20 developer will be reimbursed by SSU for water and wastewater facilities, through  
21 CIAC collected from near term customers, for which it has contributed nothing to  
22 increase the value of its lot inventory. This will in turn accrue to the benefit of

---

1 Minnesota Power in the form of higher profits for land sold by Lehigh Corporation  
2 much of which was brought about by the use of money collected from future  
3 customers and assets paid for by near term customers. Normally, the construction of  
4 utility lines by developers are contributed to the utility. However, in the instant case,  
5 no such contribution is being made. Instead, the money is being advanced by future  
6 customers and then the assets are being paid for by near term customers in the form  
7 of CIAC.

8 Q. What do you recommend?

9 A. In my opinion, the Commission should impute CIAC associated with all facilities  
10 constructed by Lehigh Corporation as future customers connect to the system.  
11 According to the Company's response to the Citizens Interrogatory 241, for the  
12 projected test year ending 1996, SSU will have repaid Lehigh Corporation for  
13 \$769,000 for assets that Lehigh Corporation constructed. These used and useful  
14 assets are included in SSU's rate base. By imputing CIAC on these assets and future  
15 assets constructed by Lehigh Corporation the Commission can ensure that customers  
16 are not harmed by the various agreements and negotiations entered into by SSU and  
17 Lehigh Corporation that do nothing but enrich Minnesota Power, because of the  
18 *contribution made by customers.*

19 Q. Are there any other factors the Commission should consider when addressing this  
20 issue?

21 A. Yes. The Commission should realize that much of the plant and facilities that are  
22 being constructed by Lehigh Corporation are non-used and useful. I addressed this in

1 my direct testimony and I proposed an adjustment to Lehigh's transmission,  
2 distribution, and collection facilities to ensure that current customers do not bear the  
3 cost of these non-used and useful assets. But the Commission also needs to be aware  
4 of the future problems that may arise because of Lehigh Corporation's construction  
5 activities.

6  
7 Certain scenarios could develop that would further enrich Minnesota Power at the  
8 expense of customers. For example, assume that after enough customers connect to  
9 these new lines, SSU determines that it must construct additional water and  
10 wastewater treatment facilities to serve these additional customers. SSU may  
11 construct such facilities larger than necessary arguing that its less expensive to build  
12 a larger plant now, than several smaller plants over time. Under this scenario, SSU  
13 will likely argue that because of the prudence of the economies of scales associated  
14 with building a larger plant now, the entire plant should be considered 100% used and  
15 useful. This is an argument routinely made by SSU and often adopted by this  
16 Commission. If such a scenario evolves, and the Commission does not recognize the  
17 plant as non-used and useful, customers will pay for non-used and useful plant with  
18 the beneficiaries being SSU and Lehigh Corporation. Because of the negative  
19 potential impact on customers, the Commission should warn the Company today that  
20 current customers will not be saddled with the cost of non-used and useful assets  
21 resulting from the construction activities of Lehigh Corporation.

22 Q. Should the Commission evaluate this issue in conjunction with any other issues in this

1 proceeding?

2 A. Yes. The Citizens' witnesses Larkin and DeRonne are recommending that the  
3 Commission recognize a negative acquisition adjustment with respect to the Lehigh  
4 system, as well as others. As I noted in my direct testimony, the Citizens were not  
5 successful at persuading the Commission in the last rate case involving Lehigh  
6 Utilities, Inc. which is now SSU, that a negative acquisition adjustment should be  
7 made. I believe the Commission should carefully reconsider its decision concerning  
8 the negative acquisition adjustment for Lehigh.

9  
10 In the last Lehigh rate case SSU argued that the entire discount from book value  
11 associated with the acquisition of a consortium of Lehigh companies should be  
12 entirely attributed to the nonregulated operations of the purchased assets. Part of this  
13 argument was based upon the declining value of land in the area. Despite this  
14 assertion, Minnesota Power has recognized significant income associated with the sale  
15 of land by Lehigh Corporation--in fact, it reported a return on its equity investment  
16 in Lehigh Acquisition of 56% in 1994. In addition, due to the contributions of SSU's  
17 customers, Minnesota Power stands to enhance its profits in the future from land  
18 sales. The Commission should seriously question SSU's assertion that the discount  
19 from book value, associated with the purchase of the Lehigh consortium of  
20 companies, should be related solely to the nonutility assets purchased by TGI. In my  
21 opinion, the Commission should recognize the unusual relationship between SSU,  
22 Lehigh Corporation, TGI, and Minnesota Power and give the customers of Lehigh a

1           portion of the benefit associated with this acquisition by recognizing the negative  
2           acquisition adjustment recommended by Mr. Larkin and Ms. DeRonne.

3    Q.     Does this complete your supplemental testimony prefiled on March 4, 1996?

4    A.     Yes, it does.

**EXHIBIT**  
**OF**  
**KIMBERLY H. DISMUKES**

Docket No. 950495-WS  
Kimberly H. Dismukes  
Exhibit No. \_\_\_(KHD-2)  
Schedule 1

**Southern States Utilities, Inc.**  
**Escrow Letter Cover Page**

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RUTLEDGE, ECENIA, UNDERWOOD, PURNELL & HOFFMAN

PROFESSIONAL ASSOCIATION  
ATTORNEYS AND COUNSELORS AT LAW

STEPHEN A. ECENIA  
KENNETH A. HOFFMAN  
THOMAS W. KONRAD  
R. DAVID PRESCOTT  
HAROLD F. X. PURNELL  
GARY R. RUTLEDGE  
R. MICHAEL UNDERWOOD  
WILLIAM B. WILLINGHAM

POST OFFICE BOX 551, 32302-0551  
215 SOUTH MONROE STREET, SUITE 420  
TALLAHASSEE, FLORIDA 32301-1841

TELEPHONE (904) 681-6788  
TELECOPIER (904) 681-6515

GOVERNMENTAL CONSULTANTS:  
PATRICK R. MALOY  
AMY J. YOUNG

February 23, 1996

NOTICE: CONFIDENTIAL DOCUMENTS ATTACHED

RECEIVED

HAND DELIVERY

FEB 23 1996

Charles J. Beck, Esq.  
Office of Public Counsel  
111 West Madison Street  
Room 812  
Tallahassee, FL 32399-1400

Office of  
Public Counsel

Re: Docket No. 950495-WS

Dear Charlie:

As indicated in Southern States Utilities, Inc.'s ("SSU") Eleventh Motion for Temporary Protective Order filed and served in the above-styled docket on this date, I am providing to you the following document which SSU believes to have a colorable claim of confidentiality:

(1) Letter dated December 14, 1993 from Laura A. Holquist to Ronald Sorenson.

SSU requests that the Office of Public Counsel keep these materials confidential and exempt from disclosure under Florida's Public Records Act, pending a decision on the Company's Eleventh Motion for Temporary Protective Order and thereafter once a Temporary Protective Order has been issued.

Sincerely,



Kenneth A. Hoffman

KAH/rl  
Enclosures  
cc: Parties of Record (without enclosures)





Attorney/Client Privileged

December 14, 1993

Mr. Ronald Sorenson  
Briggs and Morgan  
2200 First National Bank Building  
St. Paul, MN 55101

Re: Accounting for the New York and Michigan Escrowed Cash Accounts

Dear Ron:

We have completed our analysis of the Lehigh Corporation accounting treatment for the New York and Michigan escrowed cash accounts. Details on the analysis and our conclusion are provided below.

#### Background

Lehigh Corporation currently has \$5.2 million held in escrow under the terms of Escrow and Trust Agreements with Barnett Bank. The escrow accounts are required by the states of New York and Michigan in order for Lehigh to sell lots in those states. The purpose of the escrow accounts was to protect state residents in the event the developer (Lehigh) cannot fund water and sewer line installations when required under its Density Agreement with the Florida Department of Health and Rehabilitative Services (Density Agreement).

To provide monies for the escrow accounts, the states required Lehigh to charge New York and Michigan lot purchasers an additional amount, ranging from \$1,070 to \$1,470, as part of their lot purchase contracts. Lehigh then agreed, in the Escrow and Trust Agreements, to remit the monies collected to an escrow agent, currently Barnett Bank. Under the terms of the Escrow and Trust Agreements, monies remitted are released to Lehigh if the lot purchaser cancels the purchase contract or when water and sewer lines are installed.

The escrow accounts were established in 1973, and monies currently on deposit, including interest earned to date, total \$4.6 million for New York and \$1.6 million for Michigan.

#### The Problem

The additional amounts charged and collected from the New York and Michigan customers and the cash held in escrow have never been reported in Lehigh's financial statements. Previously it was

New York and Michigan Escrowed Monies  
Accounting Treatment Analysis  
Page 2

believed that the monies belonged to the lot purchasers from whom the monies had been collected and that Lehigh had no ownership interest in the funds. In addition, Lehigh had never included the funds in taxable income.

Last Spring, legal research performed by Briggs and Morgan (see letter at Exhibit 1) concluded that the escrowed monies actually belonged to Lehigh, not the lot purchaser. In addition, the Florida Public Service Commission (FPSC) ruled in their March 1993 Lehigh Utilities, Inc., (LUI) rate order that no liability or imputed CIAC was applicable for the escrowed funds since LUI had no access to the funds and was not a party to the escrow agreements. A copy of the related pages in the rate order are included at Exhibit 2.

Based on these events, it is prudent to reconsider the current accounting treatment for the monies.

#### Analysis

In July 1991, when Lehigh Acquisition Corporation acquired Lehigh, it was believed that the escrowed monies belonged to the lot purchasers. Based on review of FASB 5 "Contingencies," the monies would have been technically classified at acquisition as contingently impaired assets. The contingency would have been a form of customer deposit liability. As stated above, recently it has been determined that the escrowed monies actually belong to Lehigh and there is no imputed CIAC applicable to the monies. Therefore, there is no "customer deposit" liability, the asset is no longer contingently impaired, and the escrowed monies need to be reported on Lehigh's financial statements.

FASB 38 "Accounting for Preacquisition Contingencies of Purchased Enterprises" provides the promulgated accounting treatment for acquisition contingencies. According to FASB 38, "After the end of the allocation period, an adjustment that results from a preacquisition contingency other than a loss carryforward shall be included in the determination of net income in the period in which the adjustment is determined" (FASB 38 pars. 6). For the Lehigh acquisition, the allocation period ended on June 30, 1992, one year after the purchase.

Having defined the accounting treatment for the escrowed monies, the next step is to determine whether an adjustment has resulted from the preacquisition contingency. As the monies are in the form of cash on deposit with a bank, a recordable asset exists in the amount of \$5.2 million. Is there a recordable liability? It is Lehigh management's opinion that no recordable future obligations or exposures exist regarding the escrowed monies. Management has developed this opinion based on the following:

- (a) *Lehigh has no future obligations or exposures under the Escrow and Trust Agreements beyond the Density Agreement requirements.*

The Escrow and Trust Agreements control the use of the escrowed funds. Under the agreements, the only developer (Lehigh) obligation to the lot purchaser is to fund the extension of utilities in accordance with the Density Agreement. No credits or reimbursements of funds to lot purchasers are required in the agreements. If a lot purchase agreement is canceled or a purchaser trades a lot, the related escrowed monies, including interest earned, are returned to Lehigh. See a copy of the March 26, 1990, Escrow and Trust Agreement at Exhibit 3.

- (b) *Lehigh has no future obligations or exposures related to the escrowed monies under the New York and Michigan agreements for deed and the incorporated offering statements except as relates to Clause C, and this exposure is minimal.*

Agreements for deed and the incorporated offering statements were used as the contracts in the sale of lots to New York and Michigan residents. Copies of the most recently used agreement for deed form and offering statement are included at Exhibit 4 for New York and Exhibit 5 for Michigan.

We have reviewed the forms of agreements for deed and offering statements used by Lehigh. Although the agreements and offering statements varied throughout the years, we found no obligations or exposures related to the escrowed funds, except under Clause C of the agreements for deed.

#### *Clause C*

If a lot purchaser should cancel an agreement for deed, Clause C of the agreement requires Lehigh to refund "the amount, if any, paid in by the buyer (exclusive of interest) that exceeds 15 percent of the purchase price (exclusive of interest) or the actual damages incurred by the Seller, whichever is greater." This wording is unclear as to whether escrow payments are to be included in the refund calculation. However, certain offering statements used over the years for New York residents specified that escrowed monies paid were to be included in the determination of the "amount, if any, paid by the buyer." Other New York offering statements and the Michigan statements did not include this wording.

Assuming that all active agreements for deed required escrow payments to be included in the Clause C refund calculation and that all the agreements canceled, \$483,734 of the \$5.2 million in escrow monies would be subject to refund. Based on cancellation history, however, we know that the probable future refund obligation is substantially less. As you know, we already have a \$2.5 million Clause C refund liability established on the financial statements. The \$2.5 million is reserved against \$32 million in principal payments that

could be subject to refund, i.e., we are approximately 7.8 percent reserved. Experience has shown that the reserve remains more than adequate, as actual contract delinquencies have been significantly less than we projected in the reserve calculation last December.

We have concluded then that, although there is some exposure to a Clause C refund obligation related to the escrowed monies, the exposure can be quantified at less than \$40,000 (7.8 percent of \$483,734). Due to this minor amount and the fact that the obligation best belongs as part of the existing Clause C refund liability, we have determined that a separate refund liability for the escrowed monies is unnecessary.

- c. *Should the escrowed monies be construed as a form of prepaid fee, the potential Lehigh obligation to reimburse funds is minimal.*

The Water Supply and Sewer Disposal sections of the various New York and Michigan offering statements used since 1973 conveyed three basic ideas: i) that central water and sewer services would be extended to purchased lots as specific densities were reached, ii) that the escrowed monies would be used to defray the cost of installing the central services, and iii) that septic systems and wells would be permitted until central services were installed. Other than these basic ideas, the offering statement representations varied widely, particularly in their disclosure of the purchaser's further obligations to pay for central facilities, line extensions, and hookup/tap fees. In addition, the representations were generally inconsistent with current utility regulation and ratemaking. Copies of Water Supply and Sewer Disposal sections of select offering statements are provided at Exhibit 6.

Lehigh management believes that, beyond the Density Agreement requirements, no obligation to the lot purchasers exists as a result of the water and sewer representations made in the offering statements. However, using today's utility ratemaking philosophies and utility accounting treatments, the escrowed monies could be construed as a form of prepaid fee and the fees may be reimbursable to lot purchasers after they connect to central facilities and pay a connection charge. We analyzed any exposure that could result from this possible scenario as follows:

*Potential Obligation Does Not Transfer in Sale of Property*

First we determined that the deeds issued in transferring lots to New York and Michigan purchasers did not include mention of the water and sewer related escrowed monies nor did they provide for any obligations regarding the monies. Therefore, we know that any possible reimbursement obligation is not attached to the property and could only be construed from interpretation of the sales documents.

We then reviewed the language used in the agreements for deed and the water and sewer offering statement representations, and we found that the agreements and associated

obligations survived the deeding of the property. However, according to Clause M, the agreements could not be assigned without Lehigh's written consent. While purchasers were still paying on their accounts, Lehigh provided this consent, although it was rarely requested. After lots were deeded, the consent to assign was not given. Thus we concluded that any obligations under the sales documents would terminate when the associated lot transferred owners. Note that of the 3,291 agreements under which current escrowed monies have been collected, deeds have been issued for 2,634, more than 80 percent.

*Few New York and Michigan Purchasers Will Ever Connect to Central Services*

Lehigh sales statistics show that over the last 20 years the average lot purchaser has been about 55 years old. We did an age analysis of the agreements for deed related to the escrowed monies and found that the agreements were entered into an average of 13 years ago. As a result, the average New York and Michigan purchaser is 68 years old today.

Our next step was to obtain a list of escrowed monies summarized by the land sections in which the associated purchased lots are located. The list is included as Attachment 1. We then compared the land sections on the list with i) a listing of current section densities prepared by Southern States Utilities (SSU) in June (see Attachment 2) and ii) an absorption table included in the Lehigh Acres Wastewater Master Plan showing expected buildouts through 2011 (see Attachment 3). The master plan was completed in July 1993 by Holes, Montes & Associates, Inc., for SSU. Based on these comparisons (see results at Attachment 4), we determined that the lots associated with the escrowed funds are located in sparsely populated land sections that are not expected to reach densities that would require water and sewer line extensions until after 2011. In other words, extensions would not be required within the next 18 years. Since the average New York and Michigan lot purchasers are 68 years old today, they would be, on average, 86 years old in 2011.

*No Liability*

In conclusion, we have determined that any significant water and sewer reimbursement obligation that might exist from sales representations would be binding only onto the original lot purchasers. We have further determined that the average age of these lot purchasers when the reimbursement obligation could potentially be incurred would be greater than 86 years. Thus it appears that due to natural life-span constraints, minimal reimbursements, if any, would actually be paid under our assumption that an obligation exists. We have concluded then that no liability should be recorded for this potential exposure.

The analysis at (a) through (c) above determined that Lehigh has no recordable liability associated with the escrowed funds. With this conclusion, it appears that a \$5.2 million income adjustment

has resulted from the preacquisition contingency. According to FASB 38, this amount should be included in 1993 net income. However, another factor must be considered:

*Management's Intent Regarding the Escrowed Monies*

Prior to the Lehigh acquisition, the due diligence team had identified the escrowed monies. Bill Livingston, a member of the team and the current president of Lehigh Corporation, had had prior experience dealing with such funds with Deltona Corporation. Bill had successfully amended Deltona's escrow agreements through discussions with the states of New York and Michigan and had obtained release of Deltona's funds from escrow. As part of the amended agreements, Deltona was allowed free use of the funds, that is, they were not required to use the escrowed funds for utility installation. However, Deltona did agree to provide those lot purchasers who had balances remaining on their lot purchase contracts credits against their final bills for their portion of the escrow account balance. At that time, many of the purchase contracts were paid in full, in which case no credit or refund was required.

Based on his experience, then, Bill knew that from the standpoint of both the customer and Lehigh it was prudent to negotiate access to Lehigh's funds. Installation of water and sewer lines toward New York and Michigan purchasers' lots would spur development and increase the value of the lots. On deposit, the funds were benefitting only the bank. As a result, Bill put together a plan to present to New York and Michigan regarding Lehigh's monies. Bill described his plan in an October 27, 1992 memo (see Attachment 5).

Generally, the memo provides that Lehigh plans to use the escrowed monies to install water and sewer infrastructure near sections of land where New York and Michigan purchased lots are located. It also states that Lehigh would assign a credit, based on monies in escrow today, to each New York and Michigan purchased lot. The credit would be recorded as part of the deeded land and would be given when the lot is connected to water and sewer service.

A subsequent change to the plan presented in the memo is that Lehigh currently intends to transfer completed water and sewer facilities to Lehigh Utilities (now SSU) under the existing developer's agreement, whereby SSU would reimburse Lehigh the cost of the facilities as customers connected. Lehigh would essentially "sell" the facilities to SSU. The developer's agreement allows improvements to become "contributed plant" to SSU if not "used and useful" within five years. Due to the long-term nature of the improvements intended with the escrowed monies, the developer's agreement will be modified to extend the "used and useful" period to ten years.

Based on Lehigh management's intent to offer a credit associated with the escrowed monies, it appears that, although no current obligation exists regarding the monies, an obligation may be created in the near future. This factor should be considered in recording the preacquisition contingency and needs to be quantified.

To quantify the future obligation, an analysis was performed to determine when New York and Michigan lots would be expected to connect to central utility services. This was done by obtaining the Wastewater Master Plan graphic depicting where transmission mains are planned to be installed through 2011. On the graphic, the land sections where New York and Michigan lots are located were identified (see Attachment 6, shaded areas). Using population data included in the master plan and the densities projected through 2011 (see Attachment 4), the average years until appropriate densities would be reached to install water and sewer services for New York and Michigan land sections were estimated. The densities are 25 percent for water and 50 percent for sewer. The estimate by land section of average years to connect is provided at Attachment 7.

Finally, the future obligation was calculated by discounting the escrowed monies by land section over the estimated average years to connect, using an 8 percent discounting factor. The result was an obligation of \$662,000. The 8 percent factor is appropriate considering the fluctuations in the cost of money over time. The obligation would be reassessed annually and adjusted accordingly.

#### Income Taxes

The legal research performed by Briggs and Morgan that concluded that the escrowed monies belong to Lehigh also concluded that the monies should have been included in the determination of income taxes at the time the monies were collected. The conclusion was based on the fact that Lehigh "owned" the funds at the point of collection and the funds were not a form of refundable advance.

The 1991 purchase agreement between Lehigh Acquisition Corporation and the Resolution Trust Corporation for the purchase of Lehigh included an indemnity clause indemnifying LAC against preacquisition errors in reporting income taxes. Under this indemnity clause, LAC claimed that Lehigh had inappropriately reported preacquisition taxable income related to the New York and Michigan escrowed monies. The issue was resolved as part of the December 1992 Settlement Agreement with the RTC, whereby the RTC agreed to include the escrowed monies and related interest earned in taxable income for their 1991 short period tax return that was yet to be filed. We were informed by Arthur Andersen - Denver that they were working on the RTC's 1991 short period return and the return was to be filed by October 15.

Escrowed monies collected and interest earned on the accounts since the acquisition have been included in LAC's 1991 and 1992 income tax calculations.

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Conclusion

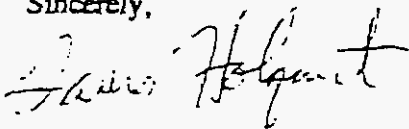
Our research has determined that the New York and Michigan escrowed monies were preacquisition contingently impaired assets and the contingency no longer exists. As a result, the monies need to be recorded on Lehigh's financial statements.

In analyzing how to record the monies, it was determined that \$5.2 million in restricted cash should be recorded, offset by a \$.7 million contingent future obligation and a \$4.5 million adjustment to net income. The future obligation could result from Lehigh management's plan to access the escrowed monies and would be reassessed annually.

We discussed the accounting treatment of the escrowed monies with our independent accountants (Price Waterhouse), and they agree with our conclusions except as relates to the "event" that relieved the contingent impairment of the asset. They believe that the reactions from the states of New York and Michigan to our plan to access the monies are significant events, and, to be conservative, Lehigh should defer recording the income adjustment until the states' reactions are known. As we intended to move forward immediately in approaching New York and Michigan regarding the funds, we decided to defer recording the adjustment until the reactions are received.

In late November and early December letters were sent to New York and Michigan requesting modifications to the Escrow and Trust Agreements that would allow access to the escrowed monies. Copies of the letters are included as Attachments 7 and 8. No reactions have been received as of the date of this letter.

Sincerely,



Laura A. Holquist

Enclosures

cc: Mark A. Schober  
William I. Livingston  
W. Don Whyte