

VIA AIRBORNE EXPRESS

January 29, 2001

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

Re: Docket No. 001502 WS
Proposed Rule 25-30.0371 – Acquisition Adjustments

Dear Ms. Bayó:

Enclosed per the Commission's request are United Water Florida Inc.'s responses to questions regarding the above referenced docket.

If you have any further questions or require additional information, please contact me at 201-986-4990.

Very truly yours,



Al Candelmo
Senior Rate Analyst

Enclosure

cc: D. DeNagy
M. Gennari
W. Hill
G. Moseley
G. Roupp
S. Schildberg

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**UNITED WATER FLORIDA INC.'S
RESPONSES TO FLORIDA PUBLIC SERVICE COMMISSION'S QUESTIONS
RE: DOCKET NO. 001502-WS
PROPOSED RULE 25-30.0371 - ACQUISITION ADJUSTMENTS**

Q. 1. What goals do you believe the Commission should be trying to achieve through a water and wastewater industry acquisition policy?

A. 1. The goal of the Commission should be to increase the health and efficiency of the regulated water and wastewater industry. To this end the Commission should promote and facilitate the acquisition of unhealthy or inefficient utilities by healthier and more efficient ones.

Q. 2. Should the Commission still be promoting acquisitions?

A. 2. Yes. The increasingly stringent water quality standards and the associated capital investments and technical requirements have created a continued need for consolidation. It remains in the public's best interest for unhealthy and inefficient utilities to be acquired by healthier more efficient ones.

Q. 3. Is there a need for different policies for (1) large utilities acquiring large utilities, (2) large utilities acquiring small utilities, or (3) small utilities acquiring small utilities?

A. 3. There are different considerations depending on the acquiring and target utilities' size. These considerations do not necessarily mean that there should be different policies depending on the utility's size. The important policy is for the Commission to remain flexible enough to promote efficiency. Any combination could be beneficial if conditions are right. Two large utilities merging would attain critical mass that could lead to customer benefits and increased operational efficiency. A large utility acquiring a small could lead to efficiencies through shared services, increased financing capacity, and technical expertise. The merger of two small utilities would not seem to create the critical mass required for efficiencies; however, if the systems are complementary it could be a beneficial transaction. The most important aspect of Commission policy is the ultimate benefit to the consumer, and providing the incentives necessary to produce those benefits.

Q. 4. Should the Commission be looking at different incentives to encourage acquisitions, such as rate of return (i.e. modification of the equity leverage graph), in place of or in conjunction with the current acquisition policy?

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A. 4. *The Commission should explore other options in conjunction with its current policy. While a positive acquisition adjustment should be the mainstay of acquisition policy, it should not rule out other mechanisms to promote the acquisition of inefficient utilities depending on circumstances. Positive acquisition adjustments should be allowed if the utility can show some benefit to the consumer. It is the most objective and rational method of facilitating acquisitions. Each case should stand on its own to determine the need for and the amount of an acquisition adjustment. Other factors such as the need for additional capital improvements, increased maintenance expense, current rate differentials and the expected timing of a base rate case should all be considered in developing an equitable mechanism which would allow a beneficial acquisition. Such incentives could include a premium on rate of return, a surcharge, or a phase in of rates. Further examples, which are employed by the NYS PSC and the PA PUC, can be found in the Commission's notice of the workshop.*

Q. 5. Should the Commission be addressing the accounting treatment for acquisition adjustments? Should the amortization period for acquisition adjustments relate to the composite remaining life of the assets purchased?

A. 5. *Yes, the Commission should address the accounting and ratemaking treatment of the acquisition adjustment at the time an acquisition is approved. The accounting treatment of the acquisition adjustment is a major consideration of any transaction in which a premium over book value is considered. If the negotiation is conducted at arms length and the combined entity provides a benefit it should be allowed. The composite remaining life should be a consideration but not the deciding factor. In the case of long-lived plant, the amortization period should generally be shorter. UWF's composite depreciation rate is 2.54%, which translates to approximately a 40-year amortization period.*

Q. 6. With respect to negative acquisition adjustments, would it be appropriate to recognize the unamortized acquisition adjustment balance in rate base with the amortization expense recognized below the line at the time the utility files a request for a rate increase, as an alternative to the present policy?

A. 6. *Under the Florida Uniform System of Accounts, a Company purchasing the assets of an existing utility at below historical book cost is required to book the difference between the net book cost and the purchase price as a negative acquisition adjustment. The reason for the reduced purchase*

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price must be understood. This would usually occur with a financially distressed utility with poor quality of service. If the acquiring utility will benefit customers, it should not be burdened with a negative incentive such as a reduction in rate base below book value of the assets purchased. However, amortization of the acquisition adjustment below the line will increase the net income of the Company, further encouraging the acquisition. The Commission must look at the overall impact to existing customers and the customers of the target utility. The incentive must be balanced against the benefits.

Q. 7. With respect to the positive acquisition adjustments, should the acquiring utility have to prove that the synergies caused by the acquisition more than offset the acquisition adjustment?

A. 7. No. While the acquiring utility should be required to prove some benefit to new or existing customers in exchange for a positive acquisition adjustment, synergies greater than the acquisition adjustment should not be the standard. Other considerations include: operational efficiencies such as improved source of supply, improved water quality, improved customer service, future cost containment, future growth possibilities and increased financing capacity for needed capital improvements. Many of these benefits are difficult to quantify, but still of real value to current and future customers. Current synergies or rate reductions are only a small part of the benefit from acquisitions.

Q. 8. What should the future acquisition policy of this Commission be?

A. 8. The future acquisition policy of the Commission should be a flexible approach to encourage and facilitate the acquisition of inefficient utilities by stronger more efficient ones that can provide some benefit to consumers. UWF suggests as a model or example the Acquisition Incentive Mechanisms employed by the NY PSC and PA PUC, which are included in the Commission's notice of the workshop.