

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 001502-WS

IN RE: PROPOSED RULE 25-30.0371, ACQUISITION ADJUSTMENTS

COMMENTS OF AQUASOURCE UTILITY, INC.

ORIGINAL

RECEIVED-FPSC  
01 JAN 31 AM 10:54  
RECORDS AND REPORTING

MARTIN S. FRIEDMAN  
ROSE, SUNDSTROM & BENTLEY, LLP  
2548 Blairstone Pines Drive  
Tallahassee, Florida 32301  
(850) 877-6555

SUBMITTED JANUARY 31, 2001

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

The overall goal should be to approve mergers, consolidations, and acquisitions that promote the public interest. It should be recognized that the public's interest will improve if investors are allowed an opportunity to recover a fair return on investment while leaving acquired ratepayers better off through lower rates, better service or both. Additionally, the public interest can be served through greater environmental compliance, infrastructure improvements, long term financial stability, etc.

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

Yes. The Commission should promote acquisitions anytime there is a public interest in doing so.

APP  
CAF  
CMP  
COM  
CTR  
EGR  
LEG  
OPC  
PAI  
RGO  
SEC  
SER  
OTH

RECEIVED & FILED

*Man*  
FPSC-BUREAU OF RECORDS

*Done 2/05/01*

DOCUMENT NUMBER-DATE

01000 JAN 31 01

FPSC-RECORDS/REPORTING

**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?**

Perhaps, only if it is apparent why policies that are in the public interest would differ depending upon the size of the acquiring and/or acquired firm.

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

Yes. Incentives like premium returns, amortization of acquisition costs, inclusion of acquisition adjustments and the recognition of “intangible” benefits such as customer service, financial stability, greater environmental compliance, etc. are all tools the Commission should consider in order to encourage worthwhile acquisitions.

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

Yes. Currently, the Commission does not recognize acquisition adjustments for stock purchases. All else remaining equal, this encourages asset as opposed to stock acquisitions. This policy encourages higher than necessary transaction costs because of the higher tax liability placed on sellers under an asset transfer. Many states, such as Indiana and Kentucky, do recognize that there can be acquisition adjustments that result from a stock purchase as well as an asset purchase and do not distinguish between the two for ratemaking purposes. Further, an asset purchase leaves the environmental and business liabilities with the seller which may drive the price even higher or make it impossible for the transaction to occur. The Commission’s policy should be modified to treat 100% stock and asset purchases similarly to avoid creating unintended disincentives for worthwhile acquisitions.

Additionally, the Commission should allow utilities to recognize its full cost of acquisition and associated amortization expense for financial reporting purposes in the Annual Reports. Failure to do so will result in an overstatement of earned returns because efficiencies/synergies will automatically be reflected in reported O&M expenses. As a consequence utilities will be reluctant to pursue acquisitions at net book, even where synergies are immediate and substantial, because of the threat from a show cause to lower base rates.

Regarding the amortization period for an acquisition adjustment, the Commission should consider adopting a policy that allows for maximum flexibility. For instance, the acquisition adjustment can be amortized over the remaining life of the assets, the period of time cost synergies are realized, a period of time that has a minimal impact on earning or rates, etc.

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

Yes. Recognition of negative acquisition adjustments is a disincentive for the acquisitions of utilities below original cost, which could result in money not spent on needed improvements.

- 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?**

The Commission should certainly require that a purchaser identify ratepayer benefits, including synergies. However, sole reliance on measurable synergies would discourage advantageous acquisitions because things like service quality are hard to measure

precisely. Ignoring non-quantifiable or hard to measure benefits might hinder the Commission's flexibility to provide sufficient incentives for utilities to acquire financially distressed or troubled utilities.

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

At a minimum, the Commission should adopt the accounting policy recommendations address in number 5 above concerning the treatment of stock and asset purchases and annual reporting. Allowing these practices will save time and expenses for Staff, the utility, and the ratepayers by establishing a "don't file don't litigate" policy for acquisition adjustments. Said another way, the acquisition adjustment should be allowed accounting treatment only and a decision on ratemaking treatment deferred until the next formal rate proceeding.

A formal acquisition policy established by the Commission should be flexible enough to allow the Staff to establish an evaluation process where a full or partial acquisition adjustment can be recovered. The evaluation should include tangible as well as intangible criteria. Suggested criteria can be:

- 1). The purchase price was established upon arm's-length negotiations.
- 2). Operational economies can be achieved through the acquisition.
- 3). The purchase price of the utility and non-utility property can be clearly identified.
- 4). The purchase will result in overall intangible benefits in the financial, service, and environmental areas.
- 5). Cost savings can offset the amortization and associated return of acquisition adjustment either partial or total.

6). The allowable portion of acquisition adjustments on utilities with little or negative rate bases can be determined by a formula based on net income, a percentage margin on expenses, owners compensation or a combination of two or more.

7). Certain minimum dollar amounts or percentages of the acquisition adjustment can be allowed based on the number of intangible benefits identified as discussed in number 4 above.