Marguerite Lockard 060285-SU

From: Marguerite Lockard
Sent: Monday, February 18, 2008 4:18 PM
To: Bob Freeman
Subject: RE: Instructions regarding declassifying portions of Document No. 04174-07

Per this e-mail, i will place copies of declassified Pages 14, 15, and 16 from DN 04174-07 into the public docket file. These pages will remain attached to this e-mail filing. The original declassified pages will remain attached to the confidential document in locked storage. Pages 14, 15, and 16 were declassified per your 2/18/08 memo to the Office of the CommissionClerk.

From: Bob Freeman
Sent: Monday, February 18, 2008 3:58 PM
To: Marguerite Lockard
Subject: Instructions regarding declassifying portions of Document No. 04174-07

Marguerite

In accordance with my memorandum to you dated February 18, 2008, please copy pages 14, 15, and 16 of the redacted copy of the financial statements contained in confidential Document No. 04174-07 and then place those 3 pages in the Clerk's public files.

Thus, Document No. 04174-07 will remain intact and the copies of the needed redacted pages will be given a new document identification number and the 3 pages will become public.

Bob Freeman
Senior Governmental Analyst II
Confidential Documents Coordinator
Division of Regulatory Compliance and Consumer Affairs

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In 2002, in connection with obtaining long term financing, the company hedged the interest rate by entering into an interest rate lock. The loss upon expiration of the hedge, approximately $618,140 (after income taxes of $378,860), was recorded as other comprehensive income and amortized to interest expense over the life of the related long term debt. In 2006, in connection with the acquisition by Hydro Star LLC, the existing long term debt was retired and the unamortized hedge balance was recognized.

RECLASSIFICATIONS

Certain prior period amounts have been reclassified for comparative purposes. The reclassifications did not affect net income or shareholder's equity.

Note 2 - Acquisition of Utilities, Inc.

Hydro Star LLC Acquisition

On April 19, 2006 Global Solutions the sole shareholder of Utilities, Inc. was acquired by Hydro Star LLC. Hydro Star LLC paid   for the shares of Global Solutions.

This process began in May 2005, when Global Solutions entered into a sales agreement with Hydro Star LLC, to sell all the outstanding shares of Utilities, Inc. The transaction was subject to certain regulatory approvals which were received in 2006.

In connection with the sales agreement, officers and certain key employees entered into a Transaction Bonus agreement allowing for these employees to share a pool of funds of approximately $4.2 million. The agreement allowed for 30% to be paid upon execution of the Sales Contract and 70% to be paid upon closing. Approximately $1.3 million was paid in 2005 and $2.2 million paid in 2006. During 2005, the amount paid in 2005 as well as the 2005 accrued portion ($2.2 million) of the remaining amount expected to be paid under the agreement was expensed. Additional sale related costs of $1.7 million and $1.9 million relating to legal, accounting, consulting and other related transaction activities were also expensed in 2005 and 2006 respectively.

Global Solutions Acquisition

In connection with the 2002 acquisition by Global Solutions, certain officers received a Note Payable for a portion of their shares. These notes were due (and paid) in 2006, with interest at 5.50%.

An offsetting Notes Receivable from Global Solutions was recorded, in 2002, to reimburse the Company for principal payments on the Notes Payable to officers. This Notes Receivable From Parent was classified against shareholder's equity. The Note Receivable from Parent was not paid and in 2006 was reclassified to Paid In Capital.

In connection with the March 2002 acquisition, NV Nuon entered into retention agreements with Company officers calling for two payments of $1,325,000 was, each due March 2005 and March 2006 if those officers remain employed on those dates. In 2005, both retention payments were determined to be probable of payment and $2,100,000 for service rendered from March 2002 until December 31, 2004 as accrued. The required payments were made in March 2005 and March 2006. This expense is included within operation and maintenance expense.

NOTE 3 - Capital Contribution from Parent

In July 2006, Hydro Star Holdings made an additional equity contribution of $40 million.

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NOTE 4 - Deferred Charges and Regulatory Assets

	2006	2005
Deferred charges include the following:		
Debt acquisition expense	$ 1,253,709	$ 1,149,378
Maintenance and testing	1,816,422	1,665,659
Other	476,422	252,554
Total deferred charges	$ 3,546,553	$ 3,067,591
Regulatory assets include the following:		
Income tax related	$ 1,888,341	$ 1,494,397
Regulatory expenses, primarily rate cases	5,251,513	2,590,906
Total regulatory assets	$ 7,139,854	$4,085,303

The regulatory asset for deferred income taxes will be adjusted as the amounts reverse and are included in tax expense for regulatory purposes. Other regulatory assets and deferred charges are being amortized to expense generally over periods from 3 to 12 years, corresponding to the period of rate recovery.

NOTE 5 - Current Maturities of Long-term Debt & Other Credit Arrangements

In July 2006 a Master Note Purchase Agreement in the amount of $, issuable in series was signed. The initial issuance of . 6.58% notes was received in July 2006 (the "new facility"). The new facility is subject to principal payments in the amount of $) beginning in 2017 through 2036. Interest is payable semi-annually in January and July, with the first interest payment due January 2007.

The common stock and indebtedness of subsidiary companies have been pledged as collateral for the long-term debt.

In April and July 2006, all of the then existing long term debt was retired. Costs associated with the debt retirement, (representing a make-whole provision associated with one of the notes, unamortized debt acquisition costs and the remaining balance of an interest rate lock), approximately $7.2 million, pre-tax, were expensed in 2006.

In addition, we have credit facilities with banks totaling $40,000,000 and $17,000,000 of which we have $0 and $3,926,000 in loans outstanding as of December 31, 2006 and 2005, respectively.

NOTE 6 - Fair Value of Financial Instruments

The carrying amounts of current assets and current liabilities reported in the balance sheet approximate their fair values. The fair value of the long-term debt has been determined by discounting the future cash flows using current market interest rates for similar financial instruments of the same duration.

The carrying amounts and fair value of long-term debt at December 31, 2006 and 2005 are as follows:

	Carrying Value	Fair Value
December 31, 2006	$180,000,000	$191,518,764
December 31, 2005	$135,285,191	$141,519,078

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NOTE 7 – Employee Benefit Plans

A Money Purchase Pension Plan (Plan) is available to all employees meeting certain minimum eligibility requirements. Under this Plan, the Company contributes an amount based on a percentage of an eligible employee's salary. The contribution is invested, by a professional money manager, on behalf of the participants who, upon retirement, will receive the amount accumulated in their individual investment accounts, subject to the provisions of the Plan. Pension contributions are expensed as incurred and were approximately $456,000 and $442,000, in 2006 and 2005, respectively.

A non-matching 401(k) plan is also available to all employees meeting certain minimum eligibility requirements. Under this plan an employee may defer from 1% to 100% of their salary up to the maximum allowed by ERISA. The Company may also make an annual contribution to this plan. The annual contribution is determined by the Board of Directors and is discretionary. Contributions are expensed as incurred and were approximately $605,000 and $409,000 in 2006 and 2005, respectively.

Trustees for the Pension Plan are certain key officers of the Company. The trustee for the 401(k) plan is AMVESCAP.

A non-qualified benefit plan to the officers of Utilities, Inc. is also provided. This plan is unfunded. As of December 31, 2006 and 2005 the obligation was approximately $2,442,000 and $1,966,000, respectively, and such amounts are included in Other Deferred credits in the accompanying balance sheet. Expense in the amount of approximately $476,000 and $409,000 was recognized for 2006 and 2005, respectively. In January 2007 $1,646,000 was paid out to a former officer of Utilities, Inc.

NOTE 8 – Contingencies and Legal Proceedings

In connection with certain property acquisitions, potential payments to developers are contingent upon the number of customers added to the systems of the various operating companies. The potential payments are up to $1,592,000 and $1,575,000 at December 31 2006 and 2005, respectively. In the opinion of management, payment will be made from amounts collected from additional customers.

Additionally, in connection with the purchase of one subdivision, the Company has agreed to purchase additional plant under development for $303 per connection, which in total is expected to range from $300,000 to $600,000.

The Company is subject to legal proceedings and claims arising out of the ordinary course of its business. Management is of the opinion that resolution of the lawsuits will not have a material adverse effect on results of operations or financial condition.

NOTE 9 – Acquisitions and Dispositions

During 2006, the transactions to acquire two non regulated businesses for approximately were completed. Additionally, contingent consideration of . was paid related to a previous acquisition.

During 2006 and 2005, assets or systems were sold with a combined net book value of and , respectively, for proceeds of million and $ respectively. The ongoing operating revenue and expense impact associated with these sold systems was not material.