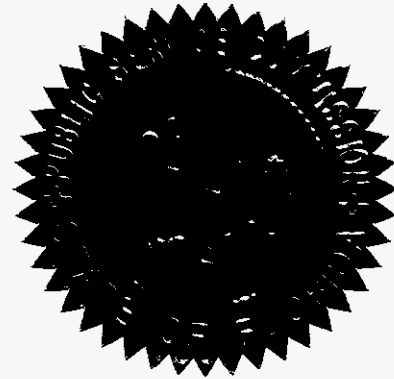


BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of: DOCKET NO. UNDOCKETED

ACQUISITION ADJUSTMENT  
WORKSHOP REGARDING RULE  
25-30.0371, FLORIDA  
ADMINISTRATIVE CODE.

\_\_\_\_\_ /



PROCEEDINGS: ACQUISITION ADJUSTMENT WORKSHOP

COMMISSIONERS  
PARTICIPATING: CHAIRMAN NANCY ARGENZIANO  
COMMISSIONER LISA POLAK EDGAR  
COMMISSIONER NATHAN A. SKOP  
COMMISSIONER DAVID E. KLEMENT  
COMMISSIONER BEN A. "STEVE" STEVENS III

DATE: Wednesday, January 27, 2010

TIME: Commenced at 9:30 a.m.  
Concluded at 11:05 a.m.

PLACE: Betty Easley Conference Center  
Hearing Room 148  
4075 Esplanade Way  
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR  
Official FPSC Reporter  
(850) 413-6732

DOCUMENT NUMBER-DATE

00850 FEB-09

FPSC-COMMISSIONER OF PUBLIC UTILITIES

## P R O C E E D I N G S

1  
2           **CHAIRMAN ARGENZIANO:** Good morning. Let's  
3 call our workshop to order. And if staff would please  
4 read the notice.

5           **MR. SAYLER:** Thank you, Madam Chairman.

6           By notice issued January 8th, 2010, this time  
7 and place were set for this undocketed matter in re:  
8 Acquisition adjustment workshop regarding Rule  
9 25-30.0371, Florida Administrative Code. The purpose of  
10 the workshop is set forth in the notice.

11           **CHAIRMAN ARGENZIANO:** Thank you. Let's take  
12 appearances.

13           Mr. Beck, are you going to start us off?

14           **MR. BECK:** Yes. Thank you, Madam Chairman.  
15 Charlie Beck, Office of Public Counsel.

16           **MR. KELLY:** J.R. Kelly, Office of Public  
17 Counsel. Good morning.

18           **CHAIRMAN ARGENZIANO:** Good morning.

19           **MS. BRUCE:** Bruce May with the Holland and  
20 Knight law firm appearing for Aqua Utilities. And with  
21 me today is Troy Rendell with Aqua.

22           **CHAIRMAN ARGENZIANO:** Good morning.

23           **MR. MAY:** Good morning.

24           **MR. WILLIAMS:** Good morning. I'm John  
25 Williams. I'm Director of Governmental Affairs for

1 Utilities Incorporated.

2 **CHAIRMAN ARGENZIANO:** Thank you.

3 **MR. SAYLER:** My name is Erik Sayler. On  
4 behalf of Commission staff we have Cindy Miller, Greg  
5 Shafer, Jessica Hilgendorf, and other staff as needed.

6 **CHAIRMAN ARGENZIANO:** Okay. And, Jessica, I  
7 think you're going to give the presentation?

8 **MR. SHAFER:** Madam Chairman, just a couple of  
9 housekeeping --

10 **CHAIRMAN ARGENZIANO:** Okay.

11 **MR. SHAFER:** -- issues before we get to the  
12 presentation.

13 Good morning, Commissioners.

14 **CHAIRMAN ARGENZIANO:** Good morning.

15 **MR. SHAFER:** The first item is that we have  
16 added a couple of slides to the presentation relating to  
17 an additional acquisition adjustment scenario. Those  
18 slides are contained in the packet that was left in  
19 front of you. Also in front of you should be a packet  
20 labeled Tab 3, which is a substitute for the order that  
21 was in the original notebook, and this one conveniently  
22 has the even pages as well as the odd pages.

23 (Laughter.)

24 **CHAIRMAN ARGENZIANO:** That does help.

25 **MR. SHAFER:** And, finally, there are copies on

1 the table behind me of the entire packet, also copies of  
2 the new slides, and copies, several copies of the order  
3 that has been corrected. The corrected order is in the  
4 packets behind me already. Also, there are agendas  
5 available there if those in the audience are interested.

6 Before Ms. Hilgendorf begins her presentation,  
7 I'd like to just quickly walk you through the notebook  
8 to sort of describe its purpose and content. What we  
9 wanted to try to do is give some context to the entire  
10 issue of acquisition adjustments, and I think that  
11 starts with how much jurisdiction -- or where in the  
12 state the Commission has jurisdiction.

13 Tab 1 has a map that shows the counties as  
14 well as a list of those counties that the PSC has  
15 jurisdiction in. And then Tab 2 has a list of those  
16 jurisdictional utilities sorted by utility class, A, B,  
17 and C, and, then descending order according to 2008  
18 revenues. And I think that gives some reasonable  
19 context about the industry that the Commission has  
20 oversight over.

21 Tab 4 -- or Tab 3, excuse me, is a 1992 order  
22 that stated the Commission's policy on acquisition  
23 adjustments at that time, and Tab 4 is the notice and  
24 proposed rule that -- for the rule that is currently in  
25 place. Tab 5 is the current rule, and Tab 6 is a

1 section-by-section analysis of that rule with some  
2 examples. And then Tabs 7, 8, and 9 show sort of the  
3 results of a number of acquisition cases both before the  
4 order and subsequent to the order to give you a flavor  
5 for the dollar impacts and so forth that have been --  
6 that have been experienced as a result, both before and  
7 after the rule.

8 Tab 10 is a PSC staff white paper on  
9 acquisition adjustment policy that was produced in 2001,  
10 and I think the main value of that white paper is to  
11 give you some background as to the positions of the  
12 various parties that have been part of this process over  
13 the years, and some of the benefits, both real and  
14 perceived, of the policies in either direction.

15 Tab 11 is a 50-state survey of acquisition  
16 policy compiled by the National Association of Water  
17 Companies, and we pulled that off of their website. It  
18 was as of summer 2009.

19 And, finally, Tab 12 is the responses to  
20 questions that were sent out in the notice. We had two  
21 companies file responses prior to -- soon enough to give  
22 us time to include them in the notebook.

23 And with that, I will turn it over to Ms.  
24 Hilgendorf.

25 **CHAIRMAN ARGENZIANO:** Thank you.

1           **MS. HILGENDORF:** Good morning.

2           **CHAIRMAN ARGENZIANO:** Good morning.

3           **MS. HILGENDORF:** I'm Jessica Hilgendorf, and I  
4 just have a brief presentation about the history and  
5 development of the current acquisition adjustment rule  
6 that we have.

7           **CHAIRMAN ARGENZIANO:** Thank you. You can  
8 proceed.

9           **MS. HILGENDORF:** Okay. First of all, I'm just  
10 going to go over a little bit of terminology relating to  
11 acquisition adjustments. First of all, I have a simple  
12 explanation of what an acquisition adjustment is.  
13 Basically, it's when an adjustment is made to account  
14 for a difference between the purchase price and the net  
15 book value of a utility being acquired. Then on the  
16 next slide I have the more technical definition.

17           Following that, the definition for net book  
18 value, which is what they use to determine rate base.  
19 Net book value is an asset's original price minus  
20 depreciation and amortization. The example that I have  
21 here is a company with \$100,000 of utility plant in  
22 service and a physical life of ten years will have a net  
23 book value of \$100,000 minus 10,000 per year in  
24 depreciation. So after the first year, it would have a  
25 net book value of \$90,000.

1           There are two possible types of acquisition  
2 adjustments. One would be a positive acquisition  
3 adjustment which may occur when a utility purchases a  
4 system at a premium or pays more than the net book  
5 value. And the second is a negative acquisition  
6 adjustment which is when a utility is purchased for less  
7 than the net book value.

8           Now I'm going to go into the background a  
9 little bit and the development of the acquisition  
10 adjustment policy. If I could please direct your  
11 attention to Tab 2 in your notebooks. It's a list of  
12 all the various utilities, water and wastewater  
13 utilities that are regulated by the Public Service  
14 Commission. There are a little bit over 150. Even  
15 still this is only less than five percent of the total  
16 water and wastewater consumers in the state of Florida.

17           The different utilities are divided into  
18 classes; A, B, and C. The As are companies with annual  
19 revenues of over a million dollars. The Bs are greater  
20 than 200,000, but less than a million. And the Cs,  
21 which are the vast majority, over 100 of them are Class  
22 C systems. The annual revenues are less than or equal  
23 to \$200,000. Many of these systems are smaller. They  
24 have annual revenues of \$50,000 or less, and they may  
25 have only 500 or 1,000 customers.

1           Now I'll talk a little bit about the history  
2 of acquisition adjustments. In the 1920s and '30s, rate  
3 base used to be determined on purchase price of  
4 utilities and some companies used that to their  
5 advantage to sell utility companies back and forth  
6 between each other and each time inflating the purchase  
7 price so that rate base would be set higher. So the  
8 utility regulators determined that they needed a  
9 nonbiased number to use when determining rate base and  
10 they settled on net book value. In 1983 the Florida  
11 Public Service Commission stated their policy that there  
12 would not be any acquisition adjustments without  
13 extraordinary circumstances.

14           In 1989 OPC file a petition requesting either  
15 a rulemaking or an investigation. The PSC conducted an  
16 investigation and then determined that they would not  
17 make any changes to their stated policy and released an  
18 order. You can find that order in Tab Number 3. And,  
19 basically, that just restated the policy that there  
20 would not be any acquisition adjustments minus  
21 extraordinary circumstances.

22           The case that kind of brought the acquisition  
23 adjustment into the spotlight was when Wedgefield  
24 Utilities, Inc., filed a petition to purchase Econ  
25 Utilities. That was in 1996, and this was a big deal



1 because of the difference between the net book value and  
2 the purchase price. Econ was purchased for a little bit  
3 over 500,000, and it was worth nearly 3 million. In  
4 October of 1996, the Commission approved the transfer  
5 and went ahead and set rate base at net book value.

6 The case was then protested by OPC and they  
7 held a hearing. A number of consumers came to the  
8 hearing to try to convince the Commission that there  
9 were extraordinary circumstances, and there should, in  
10 fact, be a negative acquisition adjustment. They cited  
11 things like poor water quality and inconsistent service,  
12 but in the end the Commission did not determine that  
13 there were any extraordinary circumstances or gross  
14 negligence on the part of management, so they still set  
15 rate base at net book value and denied the negative  
16 acquisition adjustment. However, this case did raise  
17 awareness of the policy, and they determined that they  
18 might want to formalize their policy.

19 So I've begun describing the environment that  
20 precipitated the creation of the rule. There were a  
21 couple of things that contributed to this environment.  
22 Small water and wastewater systems were experiencing  
23 increased strain from aging utility infrastructure and  
24 increasingly stringent regulations from federal and  
25 state regulators, including in 1986 the Safe Drinking

1 Water Act was passed. The Commission wanted to balance  
2 the need for acquisition incentives with sensitivity to  
3 rate impacts.

4 And now if I could please direct your  
5 attention to Tab Number 7 that lists the transfers that  
6 took place before the rule went into effect. Between  
7 1986 and 2000 there were 113 total transfers. There  
8 were only four positive and four negative acquisition  
9 adjustments, and I also have listed here kind of the  
10 range in dollar amounts of both positive and negative  
11 acquisition adjustments.

12 Now, I'm going to go into the actual  
13 development of the rule that we have and an explanation  
14 of the Commission's current rule. In May of 1999, at  
15 Internal Affairs the Commissioners directed staff to  
16 proceed with a rulemaking process to codify the existing  
17 policy where rate base was always determined by net book  
18 value absent extraordinary circumstances. There were  
19 several workshops, and then staff proposed a draft rule  
20 reflecting the current policy, and also proposed an  
21 alternative rule based on input from the various  
22 parties.

23 Over the next few years, staff and the parties  
24 continued to negotiate through workshops and agendas,  
25 and then in May 2002, they determined that they would go

1 with the alternative rule, and it was approved by the  
2 Commission and a notice of rulemaking was released.

3 Now, if I could please direct your attention  
4 to Tab Number 9 that goes over the transfers that  
5 occurred since the rule has gone into effect. Between  
6 2002 and 2009, there were six negative acquisition  
7 adjustments, and two of which the purchase price was  
8 above 80 percent of net book value, so they did not  
9 actually need to be a negative acquisition adjustment.  
10 There were no positive acquisition adjustments, and  
11 there were 11 transfers where the rate base was equal to  
12 the purchase price or it was not established at the time  
13 of the transfer.

14 The general purpose of the rule, and there's  
15 more information on that in Tab 5, is to encourage the  
16 purchase of smaller often troubled systems by larger  
17 more established utilities to mitigate consumer rate  
18 shock and keep rate increases to a minimum, and also to  
19 diminish some of the controversy over acquisition  
20 adjustments like they had in the Wedgefield/Econ case.

21 In the rule that we have now, the policy on  
22 positive acquisition adjustments was not changed. We  
23 still do not do positive acquisition adjustments unless  
24 there are extraordinary circumstances, and the burden is  
25 on the company to prove that there are, in fact,

1 extraordinary circumstances.

2           These can be things like commitments to  
3 improve quality of service, promise of future rate  
4 reductions, and compliance with state and federal  
5 regulatory mandates. The rule does, however, change the  
6 way that negative acquisition adjustments are handled.  
7 The rule states, "A negative acquisition adjustment  
8 shall not be included in rate base absent proof of  
9 extraordinary circumstances or where the purchase price  
10 is less than 80 percent of net book value. If the  
11 purchase price exceeds 80 percent of net book value, net  
12 book value is still what is used to determine rate base.  
13 However, if the purchase price is below 80 percent, then  
14 the difference is amortized evenly over five years."

15           I have also listed here a few of the reasons  
16 to encourage small system acquisitions. The larger  
17 utilities can achieve economies of scale; they can get  
18 loans at more favorable terms; they have greater access  
19 to staff and technical and managerial expertise; and  
20 they are often more able to protect water resources.

21           Now, I'm going to go into a couple of examples  
22 just to show amortization tables and give some actual  
23 numerical circumstances. The first one you can find in  
24 Tab Number 6, it's going to be Example Number 3, and the  
25 scenario is a small retirement community has its own

1 wastewater treatment plant. The owner can no longer  
2 afford to maintain it. They need upgrades to  
3 infrastructure and repairs. The net book value is  
4 \$100,000, but they have agreed to sell it for 30,000.  
5 Rate base immediately reflects the \$30,000 purchase  
6 price, plus the 20 percent allowance, so \$20,000. The  
7 remaining difference, which is \$50,000, would be  
8 recognized as a negative acquisition adjustment and  
9 amortized over five years at a rate of \$10,000 per year.  
10 And here I have these same numbers just listed out in a  
11 list format. And then here is an amortization schedule.

12 Now, we have an additional example just to  
13 illustrate the fact that it is not always a large  
14 utility purchasing a small struggling utility. There  
15 are situations, like in this case, where a developer  
16 simply does not wish to be in the utility business, so  
17 he's willing to sell his utility for sometimes  
18 substantially less than the net book value.

19 In this case, the net book value of the  
20 utility is 500,000, but the developer sells it for only  
21 \$100,000. Rate base immediately reflects the \$100,000  
22 purchase price plus the 20 percent of net book value, so  
23 \$100,000. The remaining difference, the negative  
24 acquisition adjustment is \$300,000, and it is amortized  
25 over the following five years. And then I have it again

1 listed out. And then finally I have an amortization  
2 schedule.

3 In Tab, let me see, Tab Number 11 has a list  
4 from the National Association of Water Companies with  
5 acquisition adjustment policies in all 50 states. I'm  
6 just going to highlight the acquisition adjustments in a  
7 couple of states that I found particularly interesting.

8 In Pennsylvania, positive acquisition  
9 adjustments are included in rate base because purchase  
10 price is thought to be a reasonable estimation of a  
11 utility's values. The Pennsylvania Commission does have  
12 some flexibility to determine that the positive  
13 acquisition adjustment would be in the public interest,  
14 and the utility who is receiving the positive  
15 acquisition adjustment also has to comply with several  
16 different conditions relating to the size, service, and  
17 rates.

18 In California, in 1997, the legislature passed  
19 the Public Water System Investment and Consolidation Act  
20 to encourage consolidation of the water and wastewater  
21 utilities there. Fair market value is what is used to  
22 determine rate base in California, and fair market value  
23 is usually the purchase price whenever the purchase is  
24 done without urgency on the seller or the buyer's part.  
25 Again, the Commission has some flexibility to make sure

1 that the positive acquisition adjustment will be fair  
2 and reasonable.

3 Finally, there was a case in 2004 in North  
4 Carolina where Aqua America filed a petition to obtain  
5 Heater Utilities (phonetic). They were allowed to  
6 realize an \$18 million positive acquisition adjustment.  
7 The funds had to be accounted for in a particular way,  
8 and they had to promise to acquire some other struggling  
9 utilities in North Carolina.

10 And that concludes my presentation. I will be  
11 happy to answer any questions.

12 **CHAIRMAN ARGENZIANO:** Thank you very much.  
13 That was a very good job. Thank you.

14 Commissioners? Commissioner Skop.

15 **COMMISSIONER SKOP:** Thank you, Madam Chair.

16 I just wanted to turn to, I guess, what was  
17 handed out as the revised Tab 3. I know I was missing  
18 pages when I looked through it, but I think this is a  
19 complete copy. I would hope. And at the bottom of that  
20 page, it speaks to the Commission's acquisition  
21 adjustment policy. And starting with the last sentence  
22 on that page, continuing on to Page 2 of the order, the  
23 purpose of this policy, as stated in the PAA order  
24 listed there, has been to create an incentive for larger  
25 utilities to acquire small troubled utilities. I

1 believe this policy has done exactly what it was  
2 intended to do.

3           Clearly, as staff has correctly stated with  
4 respect to the operation of the rule for negative  
5 acquisition adjustments is to encourage large utilities  
6 to come in and buy troubled companies and to provide an  
7 incentive for the large companies to do so vis-a-vis the  
8 operation of the negative acquisition adjustment as  
9 shown on the various scenarios.

10           I think that the purpose of having -- to hold  
11 the workshop to revisit this rule is to -- if you could  
12 put Scenario 2 back up on the slide show, please. And  
13 Scenario 1 really, to me, wasn't a real world example.  
14 Scenario 2 is more indicative of a situation that the  
15 Commission more recently faced. And that is what  
16 predicated my concern. Because the rule as written is  
17 intended to encourage large utilities to buy up small  
18 delapidated systems and bring them up to current  
19 standards.

20           Where the rule fails to account for all  
21 situations is in the case where you have a developer  
22 that sells at a fire sale or bankruptcy type price to a  
23 large company for a new system and they still obtain the  
24 benefit of the rule. And so my central premise here is  
25 the prescriptive application of the rule in Scenario 2



1 leads to an unintended windfall not contemplated by the  
2 rule. The rule was not intended to reward this  
3 situation. Okay.

4 Now, the windfall to the company -- if you  
5 could go to the next slide -- the slide there, is that  
6 the negative acquisition adjustment amortizes over five  
7 years. But as you can see from the rate base is that if  
8 the company bought an asset, a good asset, a brand new  
9 asset for \$100,000, and it was operating at a revenue  
10 requirement deficit, i.e., rates were not compensatory,  
11 and there were other additions that would have to come  
12 into play somehow some way, that by purchasing that  
13 asset at a distressed price for a good system for which  
14 the rule is not intended, immediately overnight the  
15 company has made over 100 percent return on equity on  
16 its investment. That's a windfall. I don't believe  
17 that the rule was intended for that situation in  
18 Scenario 2.

19 Is the rule a good one? Absolutely. Has the  
20 rule worked properly historically for negative  
21 acquisition adjustments? Absolutely. But in this one  
22 particular scenario the rule fails. And I'm not sure  
23 what the appropriate safeguards would be, but certainly  
24 the rule was adopted as a result of legislative intent.  
25 We went through rulemaking and we adopted the rule, but

1 the rule, again, has -- I don't think this situation was  
2 contemplated by the rule, and I think that somehow some  
3 way the Commission needs discretion to say no when this  
4 situation arises.

5 I mean, if the company wanted to have its rate  
6 base set, then it should be set at the purchase price in  
7 that situation. The company should not get a windfall  
8 on a situation like this. And clearly, you know, they  
9 don't capture the intrinsic value of the negative  
10 acquisition adjustment completely, but certainly no  
11 shareholder in the world would frown upon making 100  
12 percent return on equity overnight, or return on  
13 investment, and that's what happens here.

14 If you look at beginning in year one, I mean,  
15 the day after the Commission approves a negative  
16 acquisition adjustment, suddenly the asset they just  
17 purchased for 100,000 is worth 200,000 in terms of a  
18 rate case. If you move on, you continue to enure the  
19 benefit of the negative acquisition adjustment as seen  
20 in the bottom row of that chart. And finally by year  
21 five you are back up to the rate base.

22 So basically you are capturing approximately  
23 \$400,000 in intrinsic value over the course of four  
24 years over and above what you paid, notwithstanding the  
25 other things that drive rates. So in this particular

1 situation by prescriptive application of the rule, I  
2 think that the company gets a result that was not  
3 intended by the legislature or the rule.

4 And, again, when we get to the comment  
5 section, from Public Counsel, the company, and certainly  
6 I would like to hear a little bit more on what could be  
7 done. Maybe it's as simply as giving the Commission  
8 discretion to depart from the rule when we see a  
9 situation that the rule did not contemplate.

10 But clearly the intent of the rule was to  
11 encourage large companies to buy small distressed  
12 companies that were having trouble maintaining water  
13 quality and such like that. Scenario 2 recently before  
14 the Commission was not a case.

15 **CHAIRMAN ARGENZIANO:** Commissioner Klement.

16 **COMMISSIONER KLEMENT:** Well, the rule does  
17 provide for extraordinary circumstances. Would this be  
18 such a case, perhaps?

19 **MR. SHAFER:** That's an excellent question.  
20 The way it has been explained to me on the negative  
21 acquisition adjustment side is that it is a statutory  
22 test in terms of being able to waive a rule that doesn't  
23 provide for a specific type of waiver. And the  
24 extraordinary circumstances applies to the positive  
25 acquisition adjustment, but not to the negative is my

1 understanding.

2 **MR. SAYLER:** Excuse me. Erik Saylor,  
3 Commission legal staff. The extraordinary circumstance  
4 exception that is provided for in the rule is a very  
5 heavy burden for a company to prove. And in this  
6 particular situation, it is my understanding that if the  
7 Commission were to depart from the rule making a finding  
8 of extraordinary circumstances, there would be a burden  
9 that either an opposing party would have to carry -- I  
10 don't know if the Commission would sue sponte find  
11 extraordinary circumstances, because I'm sure there are  
12 other situations where, in my mind, a developer getting  
13 out of the business and selling a utility at a fire sale  
14 doesn't necessarily constitute extraordinary  
15 circumstances, but that is a finding of fact the  
16 Commissioners would have to make a determination, and  
17 that might be something best done after an evidentiary  
18 hearing which is costly in rate case expense to the  
19 eventually acquired utility system.

20 So extraordinary circumstances -- and the  
21 reason why we didn't really do positive or negative  
22 acquisition adjustments in the past prior to the rule  
23 was because extraordinary circumstances was a very, very  
24 high bar to pass, and it just provided a level playing  
25 field.

1                   **CHAIRMAN ARGENZIANO:** Commissioner Skop.

2                   **COMMISSIONER SKOP:** Thank you, Madam Chair.

3                   And to Mr. Sayler's point, again, clearly the  
4 situation that prompted this workshop was not intended  
5 by the rule. And I think what happened was that the  
6 rule says what it says, and by prescriptive operation of  
7 the rule, or application of the rule and the operation  
8 of the rule you end up with the windfall shown on that  
9 table. And, you know, equity demands when you make an  
10 acquisition that is already subject to a revenue  
11 requirement deficit, it can only mean one thing, rates  
12 have to go up.

13                   And instead of getting a windfall, you know,  
14 there were alternative options in terms of maybe  
15 splitting the acquisition adjustment or creating some  
16 sort of situation where you could use the remaining  
17 portion of a negative acquisition adjustment to make  
18 improvements to systems or something like that, but  
19 that's not the way the situation or the scenario played  
20 out. It's like, no, we want it because the rule says we  
21 get it.

22                   And in that one isolated situation which may  
23 never repeat itself, the rule fails because it clearly  
24 provides a result that was not intended and is very much  
25 contrary to the intent of why we have a negative

1 acquisition adjustment, and that is to encourage large  
2 companies to buy poor decrepit systems. Not for a  
3 company to go in and buy a brand new system at a low  
4 price and realize \$400,000 of intrinsic value,  
5 effectively, over the course of five years over which  
6 half of that is recognized overnight. I mean, that's  
7 just a windfall to shareholders.

8 And so to Mr. Sayler's point, you know, maybe  
9 there needs to be some tightening of the language that  
10 allows the rule to continue to operate as it normally  
11 does, because it has worked very well. We don't allow,  
12 typically, positive acquisition adjustments. We do  
13 allow negative acquisition adjustments to encourage  
14 those utilities to buy the poor, decrepit systems. But  
15 when you had this scenario, there is nothing to stop the  
16 utility from saying, oh, we get the same thing, and  
17 that's not the intent of the rule, as I read it. It's  
18 not the intent of the Legislature from the statutory  
19 provision, as I read it. So, again, we need to figure  
20 out a way to address that.

21 **CHAIRMAN ARGENZIANO:** Commissioners?

22 Okay. Mr. Beck.

23 **MR. BECK:** Thank you, Madam Chairman and  
24 Commissioners. Charlie Beck with the Office of Public  
25 Counsel.

1           And, Commissioners, I don't have any, really,  
2 prepared remarks. I simply wanted to make a few  
3 comments looking at it from our point of view, at least,  
4 about the effect of the acquisition adjustment policy on  
5 customers.

6           And I'd like to start with the example that  
7 was on Page 23 of the staff's handout where you have a  
8 net book value of \$100,000 and a purchased price of 30.  
9 And what the Commission's acquisition adjustment does is  
10 immediately upon that acquisition adjustment the company  
11 receives a rate of return on \$50,000.

12           **CHAIRMAN ARGENZIANO:** Mr. Beck, hang on one  
13 second. Just give us a second to get to that.

14           **MR. BECK:** I'm sorry.

15           **MR. SHAFER:** I think he's referring to Slide  
16 23.

17           **CHAIRMAN ARGENZIANO:** Thank you. I just  
18 wanted to make sure we have the handout and the book.  
19 We're okay now. Thank you.

20           **MR. BECK:** Okay. Thank you.

21           I think staff has an excellent example here of  
22 how the current rule works. And here you have a  
23 purchase price of \$30,000, but the purchasing company  
24 immediately gets a rate base of \$50,000. And the impact  
25 on customers is that the customers will have to pay a

1 rate of return on a \$50,000 investment even though the  
2 company only paid \$30,000, plus depreciation, which is  
3 included in expense on the income statement. There will  
4 be depreciation on \$50,000 of investment, even though  
5 the company only paid 30,000.

6 The other effect of the rule is that over time  
7 the rate base starts building back up again, so that at  
8 the end of five years in this example the rate base is  
9 \$100,000. So at that point customers forever more are  
10 paying the company a rate of return on \$100,000 and  
11 depreciation expense on \$100,000 even though the company  
12 only paid \$30,000. So I think we just simply want to  
13 make sure the Commission is aware that the acquisition  
14 adjustment policy has a real impact on customers.  
15 Because the companies, in essence, are being provided a  
16 higher than reasonable and fair rate of return in order  
17 to provide this incentive for the companies to buy  
18 systems.

19 One of the real impacts that's not mentioned  
20 in here is the Aqua Utilities case that we recently  
21 finished. In that case there is a \$2.7 million  
22 acquisition adjustment, which the Commission affirmed in  
23 that case. I don't want to reargue that issue, but I do  
24 want to point out that the Commission's decision has the  
25 impact of allowing the company to earn a return on



1 \$2.7 million that they didn't invest in the company and  
2 then they get to depreciate that, as well. So the  
3 impact is customers' rates are higher, and the fact is  
4 that Aqua on that investment earns more than a fair rate  
5 of return. That's the impact of the Commission's  
6 policy.

7 Commissioner Skop, you mentioned some  
8 alternatives. One of the alternatives we put forth to  
9 the Commission back in the prior proceeding about nine  
10 years ago was a splitting of a negative acquisition  
11 adjustment, a 50/50 policy. We did that somewhat as a  
12 compromise in that case. The benefits compared to the  
13 current policy is, first of all, it's a continuing  
14 benefit for both the company and the customers. The  
15 customers get benefit of half of it, but the company  
16 gets the benefit of half of it. So they are earning a  
17 rate of return that is higher than fair rate of return,  
18 yet the customers get half of it, as well. And it  
19 continues. The Commission's current policy wipes out  
20 that benefit over time so that the customers get none of  
21 that. After five years it's all gone. The company gets  
22 the entire benefit of it.

23 We have got copies of the comments we filed.  
24 Again, this was nine years ago. We still think it's  
25 viable. We would simply throw it out there for your

1 consideration.

2 **CHAIRMAN ARGENZIANO:** Can someone help?

3 Thank you, Marshall.

4 **MR. BECK:** I think one last point and then  
5 I'll try to conclude. The companies when they buy a  
6 system that has been run down -- and, again, we have  
7 discussed the acquisition policy -- the companies also  
8 get on top of that a return on everything they do to  
9 bring the company up to standards. So it's kind of like  
10 a double whammy on customers from our point. The  
11 customers have to pay for investments that the company  
12 didn't make, but then they also get to pay for all the  
13 extra investments that have to be made to bring the  
14 system up to standards. So there are some very real  
15 impacts on customers from the Commission's current rule.

16 And with that, I will conclude for now. Thank  
17 you much.

18 **CHAIRMAN ARGENZIANO:** Any questions for  
19 Mr. Beck?

20 Commissioner Skop.

21 **COMMISSIONER SKOP:** Thank you, Madam Chair.

22 And to Mr. Beck, I know that you mentioned a  
23 sharing, and I think that in the scenario that is  
24 presented I think that that situation was suggested, but  
25 was not embraced by the acquiring company.

1           How would a sharing work? And, again, you  
2 know, from my perspective, the Commission policy and the  
3 legislative policy is to provide an incentive to  
4 encourage that acquisition strategy of buying up small  
5 systems that are decrepit by larger companies so you can  
6 bring operational efficiencies, economies of scale,  
7 improve water quality, but there is a cost of doing  
8 that, as you mentioned, because the consumers are asked  
9 to pay more.

10           And the negative acquisition adjustment comes  
11 on top of any needed capital improvements. So typically  
12 when you have a system that's run down, you're getting a  
13 benefit for the acquisition, but then consumers are  
14 still going to have to be responsible for paying the  
15 increased costs associated with the capital improvements  
16 necessary to bring that system up to compliance with  
17 regulations, or DEP regulations, or water quality, or  
18 what have you.

19           Oftentimes that cost can be substantial to the  
20 extent that if you have a small water and wastewater  
21 provider, say a mobile home park, and you only have 50  
22 residents and you need to put \$100,000 of capital  
23 improvements into that project, that has a tremendous  
24 impact on rates as I think that we have recognized. And  
25 that has been part of the problem in Florida is that in

1 most cases municipalities are the low-cost high quality  
2 producer, and certainly private companies -- I'm for  
3 private companies, but oftentimes the rates are becoming  
4 unaffordable for Floridians.

5 So when you have a case of pursuing an  
6 acquisition strategy that comes in and captures  
7 windfalls and seeks to drive -- or to already -- I'm  
8 trying to think of the right word. Comes in -- you have  
9 an acquisition strategy that comes in and has further  
10 impact on a global basis of driving rates because you  
11 are acquiring a high cost system, one that is already  
12 operating at a revenue deficiency, which means only one  
13 thing can happen, rates for that system have to go up.  
14 But then it also has a spillover effect to the company  
15 as a whole.

16 Again, I think that a sharing concept, not  
17 necessarily being able to apply it prescriptively, but  
18 to have the ability to apply it on a case-by-case basis  
19 where it's necessary to give the Commission some  
20 discretion to look at the totality of the situation on  
21 how things are operating, I think that that has a lot of  
22 merit. And, again, that's one of the things that I  
23 think that was proposed to address the situation of  
24 Scenario 2 in a good faith effort, but was unilaterally  
25 rejected by the company on the premise of it would be an

1           unequitable departure from the rule. So if you could  
2           just briefly respond to how the sharing might go to  
3           further allow a company to make capital improvements  
4           that are needed for those type of systems for which the  
5           rule was intended without having to pass those costs on  
6           to the consumers.

7                     **MR. BECK:** Sure. Thank you, Commissioner.

8                     The question is how much is enough incentive,  
9           I think, many times. And there's no scenario where the  
10          company doesn't earn a fair return on its investment. I  
11          mean, even if the Commission recognized the entire  
12          acquisition adjustment, the company receives a fair  
13          return on what they invested to buy the system, and they  
14          receive a fair return on all improvements that are  
15          needed. You know, the companies can file forecasted  
16          test years.

17                    So under the bottom scenario, the companies  
18          receive a fair return. The question is how much more  
19          than that do you want to give them. Under the 50/50  
20          concept, there would be a split between the company and  
21          the customers. And it would be continuing, so that it  
22          wouldn't phase out as it does under the current rule.  
23          That's what we argued to the Commission nine years ago.  
24          You could make it, I imagine, and this is just reacting  
25          to your comments, where the companies have to come in

1 and prove why they should not recognize a negative  
2 acquisition adjustment and make the Commission decide it  
3 based on the merits of each case. That might be one way  
4 to handle it. I suspect the companies wouldn't be  
5 excited about that because they would have to come in  
6 and prove their case before they get it.

7 **COMMISSIONER SKOP:** Okay. And just briefly in  
8 terms of the sharing of a negative acquisition  
9 adjustment, again, if it's shared, or not fully  
10 amortized, or a portion of it is put away for future  
11 improvements -- I'm trying to think of the right word.  
12 It's losing me this morning. But contributions in aid  
13 of construction, I think, might be a good pigeonhole for  
14 part of it. That way any capital improvements would be  
15 absorbed or offset by that portion of the negative  
16 acquisition adjustment that would be put in that  
17 regulatory account and, therefore, not passed on to  
18 consumers. So, again, that's where that sharing kind of  
19 comes into play.

20 But the Commission currently doesn't have the  
21 discretion on all instances, which is on Scenario 2,  
22 which drove my significant criticism that, you know,  
23 prescriptive application of the rule by staff was  
24 driving an unintended result and resulting in a  
25 windfall. And ultimately that acquisition did not go

1 through because -- not because of the rule, not the  
2 acquisition adjustment, but because it would have had an  
3 adverse impact on customer rates and subsidy levels.

4 So, again, I do think that the rule is a good  
5 one. It encourages investment. It sends the right  
6 constructive regulatory message, but I think on a  
7 case-by-case basis without overturning precedent we need  
8 the ability to kind of take a look in totality. And so  
9 I think that your suggestion maybe of how staff could  
10 look at modifying the rule is perhaps a good one.

11 I mean, the rule works well now, but not in  
12 all instances. I would say like 90 percent of the time  
13 it probably works exactly as it's intended to do, but  
14 you get these extreme cases and the rule is not designed  
15 to handle those. And, you know, as regulatory  
16 gatekeepers we are supposed to ensure that only fair,  
17 just, reasonable, and prudently incurred costs are  
18 passed on to consumers. And, you know, given that  
19 windfall, it just kind of struck a nerve with me in  
20 light of some of the other rate issues that we have had  
21 in trying to struggle with as a Commission.

22 **CHAIRMAN ARGENZIANO:** I have a question, and  
23 bear with me on this one, because I see both sides of  
24 this issue and I remember the discussion in the  
25 Legislature. If the net book value of a system is

1 100,000 and the company gets it for 30,000, isn't that a  
2 good deal for the company, number one? I mean, let's  
3 put it this way. If they had paid 100,000, the consumer  
4 is going to pay that 100,000 anyway. So I'm not sure  
5 that that isn't the built-in incentive to buy the  
6 delapidated system.

7 And I remember going back and forth on the  
8 issue, because as Commissioner Skop said, it seems to be  
9 a windfall, but I remember some discussion saying, well,  
10 that's what the incentive is in allowing the older  
11 systems to be bought up. And I didn't know what --  
12 well, I would like to know what OPC -- I think you said  
13 the sharing of that lessening the impact on the  
14 ratepayer. And I know there could be kind of a way that  
15 the developer, let's say, in one of the scenarios says,  
16 well, you know what, I know it's worth 100,000, but we  
17 are going to give it to the company for this amount and  
18 get rid of it. I don't want to deal with it anymore,  
19 and the company can recover this money over these years.

20 But what is the difference if they bought it  
21 at 100,000? I mean, if they bought it at what it's net  
22 book value was, then the ratepayer is going to pay that  
23 anyway, aren't they, if they buy it at that?

24 **MR. BECK:** Madam Chairman, if you're looking  
25 at a delapidated system, I mean the reason the purchase



1 is at \$30,000, I think, in that case is because that's  
2 what it's worth.

3 **CHAIRMAN ARGENZIANO:** But that's what, I  
4 guess, I'm asking. The net book value, shouldn't it be  
5 valued as a delapidated system then? Perhaps there is  
6 something wrong in the valuation of the system? Because  
7 my personal opinion is some of the systems, not a lot of  
8 them, but some of the systems I have seen in my own  
9 areas, my districts that I had were so delapidated I  
10 think they should have been just condemned rather than  
11 anybody having to deal with them. That's what I'm  
12 trying to figure out, though.

13 But if the value -- is there something wrong  
14 with the way it is being valued? If it's a delapidated  
15 system, shouldn't it be valued at 30,000 if it ain't  
16 worth any more?

17 **MR. BECK:** Well, I think that's --

18 **CHAIRMAN ARGENZIANO:** I'm sorry. Mr. Beck, if  
19 you want to answer that, and then, Marshall, if you  
20 could.

21 **MR. BECK:** Sure. I think in that case the  
22 fair market value -- I'm making an assumption that if  
23 somebody comes in and buys it for \$30,000 it's because  
24 that's what it's worth. It's probably only worth that  
25 because the system has been run down. It hasn't been

1 maintained, it hasn't been kept up and so forth.

2 Now, if you recognize the full acquisition  
3 adjustment, that company would receive a return on  
4 30,000. And if you didn't recognize it at all, like  
5 that Wedgefield case where the purchase price was around  
6 500,000, but the net book value was 3 million. I mean,  
7 in that case the company received a return on and of  
8 \$3 million for -- I think it was \$545,000 investment.  
9 That is a heck of a deal. I mean, how many  
10 investments --

11 **CHAIRMAN ARGENZIANO:** But my understanding, if  
12 I'm a business person and I get something that's  
13 worth -- the net book value is worth 3 million and I get  
14 it for \$100,000, I'm a pretty smart businessman.

15 **MR. BECK:** Oh, yes. Look at the return you  
16 really get.

17 **CHAIRMAN ARGENZIANO:** Commissioner Stevens.

18 **COMMISSIONER STEVENS:** But there's a risk  
19 associated with that, and I believe that risk associated  
20 with that acquisition exceeds the risk we see with  
21 current utility operations. And I'm a beginner at this,  
22 so I need to absorb this a little bit more, but I think  
23 there's a risk associated with that acquisition that we  
24 are not paying attention to, and I'm trying to get where  
25 we are.

1                   **CHAIRMAN ARGENZIANO:** Well, maybe Marshall,  
2 and then Commissioner Skop. Hang on, Commissioner Skop.

3                   Marshall, if you could help us there. I guess  
4 one of my issues is and has been, even before I was on  
5 this Commission, was why are some of these systems even  
6 being acquired when they really should be dumped and  
7 started anew. I mean, it didn't take somebody with too  
8 much wastewater experience to know that the systems were  
9 really defunct or decrepit, and why does that happen?  
10 Tell me again how the value is assessed.

11                   **MR. WILLIS:** Is arrived at?

12                   **CHAIRMAN ARGENZIANO:** Yes.

13                   **MR. WILLIS:** Well, let me first start out by  
14 saying a lot of these systems being purchased are small  
15 systems. A lot of them may be on the verge of either  
16 going bankrupt or being abandoned because the current  
17 owner has no ability whatsoever to go out and obtaining  
18 financing to fix the environmental problems associated  
19 with the system. The system itself could be in  
20 deplorable shape.

21                   And I would bring you back to the rule because  
22 this is the question that Commissioner Klement had and  
23 Commissioner Skop started on at the very beginning here.  
24 It talks about extraordinary circumstances. The rule  
25 addresses extraordinary circumstance in both cases, a

1 positive and negative. If you look at, I believe it's  
2 Section 3, it talks about extraordinary circumstances,  
3 but it goes down to Section 3(a) for a negative. It  
4 talks about what do you do when you have extraordinary  
5 circumstances in a negative acquisition adjustment, and  
6 the things that were contemplated were the fact that a  
7 company did come in and pick up a system that had to be  
8 completely revamped, completely replaced. It was in  
9 deplorable shape. So really what the company got was  
10 the value of the system and that's why you got such a  
11 good purchase price was because what you were buying  
12 really was indicative of the value. That was the actual  
13 value. It was the value at that point.

14 In those cases, and believe me it wouldn't be  
15 the company who would be coming in saying give me a  
16 negative acquisition adjustment. In those cases it  
17 would be Public Counsel, or staff, or another party  
18 coming in saying we believe there is an extraordinary  
19 circumstance here. This plant, if you look at it, is  
20 completely devalued, that was the reason they got such a  
21 good purchase price, therefore the negative acquisition  
22 adjustment should be implemented.

23 If you go back and look in the past, we have  
24 done that as a Commission. The Commission has done that  
25 in a couple of cases where a company came in. One of

1 those was a Southern States where they picked up a  
2 wastewater system and the wastewater system basically  
3 had to be go in and replace the majority of it. In that  
4 case the Commission implemented the negative acquisition  
5 adjustment.

6 We have looked at it, but according to the  
7 rule it takes a challenge. It takes a challenge to  
8 prove that what they bought was delapidated. Now, as  
9 far as what Commissioner Skop is talking about, if you  
10 go out and buy a brand new facility, or a facility that  
11 is in excellent running shape even though it's small,  
12 there's nothing deplorable about the system. You just  
13 went out, Chairman, just like you said, and got one heck  
14 of a deal.

15 The incentive is there. That's exactly what  
16 you were talking about. The rule itself creates an  
17 incentive. It creates the incentive because if you can  
18 go out and get a decent deal, the Commission with this  
19 rule will reward you. If there's nothing wrong with the  
20 plant you are buying, the rule rewards you for going out  
21 and buying that plant by giving you a higher rate of  
22 return on that plant just because the negative  
23 acquisition is not going to be applied.

24 Is there a problem with the rule? Well,  
25 that's why we're here today. I understand Commissioner

1 Skop's concern in that second example. It seems to me  
2 there is a tremendous windfall in that example. Is that  
3 the incentive that the Commission wishes to give a  
4 company? Maybe after this, when we hear all parties,  
5 comments on it, maybe there's something that the  
6 Commission desires staff to do.

7 Do we need to go back and revamp the rule for  
8 situations like this, or is this just an extraordinary  
9 sample of something that happened? I think staff is  
10 here at this workshop today to try and get direction  
11 from you as far as what the Commission would like us to  
12 do.

13 **CHAIRMAN ARGENZIANO:** All right. I can  
14 understand that. I'm just trying to make sure I  
15 understand how things are really valued at the value. I  
16 can understand with the delapidated systems. The new  
17 systems, I understand Commissioner Skop's point very  
18 well. I just also understand if I was a business person  
19 and I happened to get a good deal on something, and if  
20 the result was the same, that I bought it at the net  
21 book value, I don't understand. I'm not sure then what  
22 the incentive is to buy it, or if I bought it what is  
23 the difference. I mean, I understand the ratepayers'  
24 impact, but what's the difference -- let's say I didn't  
25 get it at 30,000. I did pay 100,000 of what it's worth.

1 They are going to be paying that in the rate base  
2 anyway.

3 **MR. WILLIS:** And, Chairman, you're exactly  
4 correct. That was the reason why the rule was written  
5 this way, because if this company came out and purchased  
6 this system for exactly rate base, nobody would be  
7 discussing anything. If they went out and bought a  
8 deplorable system and nobody came forward and said this  
9 plant is in such poor shape, you should have paid less  
10 for it, you still would get rate base. It could be  
11 argued, maybe the 590 million plant you went out and  
12 bought was really only worth 300 million, but if nobody  
13 argues that and nobody sees there are problems with the  
14 plant, they're going to still be paying the \$590 million  
15 in rate base.

16 But the incentive is there. I mean, the  
17 customers, the whole point -- getting back to the  
18 customers, the idea of the negative acquisition  
19 adjustment is are the customers harmed in that great of  
20 detail, because customers will be paying the higher rate  
21 base regardless if the system is not sold. If the  
22 system is sold and rate base stays the same, nothing  
23 happens. If you get a good deal on it, yet the  
24 customers continue to pay the rate base, there's still  
25 not a problem. If you buy a deplorable system and that

1 situation happens and rate base has to be increased  
2 because you're putting in a tremendous amount of plant  
3 improvements to correct problems, yes, customers may be  
4 harmed. And that's one of the reasons why the  
5 extraordinary circumstance portion is in there.

6 **CHAIRMAN ARGENZIANO:** Thank you.

7 Commissioner Skop.

8 **COMMISSIONER SKOP:** Thank you, Madam Chair.

9 And to your point about why historically we  
10 look at the net book value or rate base, Marshall, can  
11 you elaborate on the Chairman's point there to the  
12 extent that don't we use a historical book value or  
13 historical rate base value to get to that instead of  
14 actually setting the rate base at the purchased price  
15 like a --

16 **MR. WILLIS:** Yes. Yes, we do. We always --

17 **CHAIRMAN ARGENZIANO:** I think there is  
18 something wrong with the historical values, then.

19 **COMMISSIONER SKOP:** See, this is -- I guess,  
20 the situation I was struggling with is that, you know,  
21 from a valuation analysis perspective, you can look at  
22 the acquisition price as the true value of the system  
23 and set it accordingly, or you can, by operation of this  
24 rule, set it at historical net book value. And, you  
25 know, the issue -- or actually what the rate base is --



1 you look at the negative acquisition adjustment to get  
2 it back to where it should be by operation of the rule.  
3 And I think that that was what I was struggling with in  
4 Scenario 2 is that, you know, the company is getting a  
5 good deal. You need to look at it not only from a  
6 customer's perspective, from the company's perspective,  
7 from the regulatory perspective, but the shareholder's  
8 perspective.

9 A lot of times companies drive their stock  
10 price through acquisitions and growth, and so you want  
11 to go do a good acquisition. And that in itself, if you  
12 could double your money overnight on an acquisition,  
13 your shareholders would be ecstatic. They would  
14 probably give the CEO a big bonus. And that is what  
15 happens here in Scenario 2. Overnight you have doubled  
16 your money. You paid 100,000 and it is worth 200,000.  
17 Hold on for a second. I'm not done yet.

18 So, again, the company clearly was getting a  
19 good deal. The shareholders were clearly getting a good  
20 deal. The company is growing, pursuing an acquisition  
21 strategy. The company is winning. The shareholders are  
22 winning. From a regulatory perspective and the  
23 consumers' perspective, you have to do a further  
24 analysis to see who wins and who loses. If you have a  
25 system, a brand new system that's being bought for

1       \$100,000 whose book value is 500,000, and the company is  
2       getting that type of windfall on its investment, and  
3       that system is operating at a revenue deficit which  
4       means rates have to go up because rates are not  
5       currently compensatory, that means at the bare minimum  
6       that once this thing comes in for a rate case, consumers  
7       are already going to have to pay more on top of the  
8       negative acquisition adjustment because rates are not  
9       yet compensatory.

10               So, again, that's -- you need to look at these  
11       things in the totality, but in this one isolated  
12       situation the rule resulted in an unintended windfall  
13       that was not contemplated by the Legislature or by the  
14       design of this rule. And I think that's where we need  
15       the flexibility to be able to put the brakes on  
16       something like that to protect consumers.

17               Because if the company would have just said,  
18       hey, we're going to come in and rate base is exactly  
19       what we paid, \$100,000, we wouldn't be having the  
20       discussion today. If the company would have compromised  
21       and done a splitting, as Mr. Beck had suggested, which I  
22       suggested myself, we wouldn't be having this discussion,  
23       but they said, no, we want it all. We want it in  
24       accordance with the rule, and how dare you deny us  
25       something pursuant to your own rule.

1           And the rule was never intended -- by express  
2 language in our orders, the rule was intended to  
3 encourage large companies to acquire small delapidated  
4 companies. That is why they get the incentive. They  
5 are not supposed to get the incentive for going in and  
6 buying a brand new company at a bargain basement price.

7           **CHAIRMAN ARGENZIANO:** Commissioners.

8           **MR. SAYLER:** Madam Chairman.

9           **CHAIRMAN ARGENZIANO:** Where are we? There we  
10 go.

11           **MR. SAYLER:** Erik Sayler for Commission staff.  
12 Just for the benefit of our new Commissioners, whenever  
13 we have a transfer where one system purchases another,  
14 whether it is a larger company with many systems  
15 purchasing a smaller company, or just Bob buying the  
16 system from John, at the time -- our transfer statute  
17 and our transfer rules, we just set the rate base, but  
18 the rates in place at that time stay the same. Whether  
19 the company is losing money or making money those rates  
20 don't change. And in a scenario where you have a  
21 negative acquisition adjustment and there is a potential  
22 for that negative acquisition adjustment, the company  
23 that is purchasing that system does not realize any  
24 extra return until at some point in the future when they  
25 come in for a rate case itself.

1           And that company could the day after the  
2 purchase come in for a rate case, or they could wait the  
3 full five years and wait for the negative acquisition  
4 adjustment to amortize off. But until that time, for  
5 the customers of the acquired system it's status quo.  
6 Their rates don't increase, they stay the same. Their  
7 rates won't change until sometime later when they come  
8 in for a negative -- or until they come in for a rate  
9 case, and then depending upon what year they come in for  
10 the rate case, if it is year two they only get two years  
11 of amortization. If it's year five, then they get that  
12 full entire benefit.

13           Now, Commissioner Skop, to your point earlier  
14 about a sharing. When it comes to the rules section, or  
15 Section 120.68, Subsection 7, requires that the  
16 Commission applies its rules that have been duly  
17 promulgated or be subject to reversal on appeal. And if  
18 the Legislature changes our statutes, which kind of are  
19 our bedrock for our rules, if the Legislature changes  
20 our statutes, then if we still have duly promulgated  
21 rules, we still need to follow those rules, or institute  
22 rulemaking to change our rules to change the application  
23 to conform to the new legislative mandate, or make some  
24 sort of determination that our rules still apply despite  
25 the change in the legislative mandate. Or if the

1 Commission is not satisfied with the application of our  
2 rule, we can't change the playing field at that  
3 particular time. We can institute rulemaking and change  
4 it going forward, but we can't go and do retroactive  
5 rulemaking to basically find a situation that we don't  
6 like -- the Commission doesn't like and try to go  
7 backwards. Change the rule and then apply that new rule  
8 backwards.

9           However, if there is a situation -- and there  
10 were a couple of instances in our notebook, if you turn  
11 to Page 8, or Tab 8, where there were negative  
12 acquisition adjustments that were reached through  
13 settlement. And so if there was a negative acquisition  
14 adjustment reached through settlement either between the  
15 utility and OPC, or if the utility was willing to forgo  
16 the application of the rule, then they can do that. But  
17 the Commission cannot basically force the company to  
18 accept something that is contrary to our rule because  
19 otherwise if they were to take it to appeal, we would be  
20 in jeopardy of being reversed.

21           **COMMISSIONER SKOP:** Okay. So what you are  
22 telling me there, Mr. Saylor, is that there is a problem  
23 with the existing rule, because how am I, as a  
24 regulator, supposed to allow a company to achieve a  
25 windfall for which the rule was never intended? Okay.

1           Now, if we want to talk about the rule, and  
2 I'm an attorney, so I know better -- probably as well as  
3 you what would happen on appeal if we don't apply the  
4 rule. But the last time I checked, statute trumps rule.  
5 And if we were to look at Florida Statute 367.071(5)  
6 that deals with the sale, assignment, and transfer of  
7 certificate of authority facilities or control, (5), the  
8 Commission may order -- the Commission by order may  
9 establish the rate base for a utility or its facilities  
10 or property when the Commission approves the sale,  
11 assignment, or transfer thereof, except for any sale,  
12 assignment, or transfer to a government authority.

13           In this case there was a transfer. There was  
14 a sale, okay? So what I'm saying is notwithstanding the  
15 rule that failed to -- actually the rule failed in this  
16 scenario. Defaulting back to the statute where statute  
17 trumps rule, I have the ability to set rate base. And  
18 it would seem to me that I don't have to follow the rule  
19 when the rule gives a windfall result for which the  
20 Legislature never intended, because I'm sure I can find  
21 the statutory provision that the rule was promulgated  
22 under where the legislative intent was to provide and  
23 incentivize companies, large companies to buy poor  
24 delapidated systems, not to provide a windfall for a  
25 large company buying a brand new system.

1           So, to get to my point, again, if I had to  
2 look at trying to remedy the situation and following the  
3 rule prescriptive blindly and jumping off a cliff and  
4 allowing a bad thing to happen versus falling back to  
5 the statute that gives me the statutory authority to set  
6 rate base at a sale, I would merely say the rate base is  
7 equivalent to the acquisition price, market-to-market.

8           **MR. SAYLER:** Certainly. And so long as there  
9 is competent substantial evidence in the record to show  
10 that rate base is that amount, that would likely survive  
11 appeal. But as far as our current rule and changing it,  
12 we can definitely pursue a rulemaking and institute a  
13 rulemaking workshop at a later date and have a strawman  
14 rule, hopefully with a proposal to address situations  
15 that have been raised here and address the concerns of  
16 the Commissioners that have been raised here today with  
17 regard to a newer system versus an older delapidated  
18 system. But we are not in the posture today really to  
19 have a strawman rule to do proposals for that.

20           (Simultaneous conversation.)

21           **CHAIRMAN ARGENZIANO:** Commissioner Skop. I'm  
22 going to take control again here, okay?

23           Commissioner Skop.

24           **COMMISSIONER SKOP:** Thank you, Madam Chair.

25           Mr. Sayler, again, the difference of opinion

1 here including on Scenario 2, which, again, I understand  
2 what the rule says, but I also understand that the fact  
3 pattern, the specific fact pattern as applied to the  
4 rule leads to a perverse result for which the rule was  
5 never intended. But staff would have the Commission go  
6 blindly following the rule prescriptively and just jump  
7 off the cliff and give the company exactly what it  
8 wants. And that's not -- from a regulatory perspective,  
9 I can't allow that to happen. That was not the intent  
10 of the rule. That may be how the rule operates, but the  
11 rule is clearly broken in this scenario because the rule  
12 fails.

13 **CHAIRMAN ARGENZIANO:** Commissioner Edgar.

14 **COMMISSIONER EDGAR:** I was just wondering if  
15 we -- to add maybe some additional to this discussion,  
16 if we could hear from the others that have come to speak  
17 to us this morning.

18 **CHAIRMAN ARGENZIANO:** Oh, absolutely.

19 What I would to like to ask staff is just, if  
20 we can, any time we are discussing a rule, can we also  
21 have the statutory language in the packet that was  
22 expressed?

23 **MR. SAYLER:** Yes, Madam Chair, we will be sure  
24 to have that next time.

25 **CHAIRMAN ARGENZIANO:** Thank you. That would



1 be helpful. And, Commissioners -- Commissioner Klement.

2 **COMMISSIONER KLEMENT:** Yes. I wanted to ask  
3 whether references made in the handout from the staff  
4 that we were given, Page 11, on Section 10 where it  
5 gives an example of a utility that was purchased for \$5,  
6 and it's giving what sounds to me like an example of  
7 what Commissioner Skop is arguing here, but it's also  
8 defending the need to make all of these expensive  
9 repairs to bring this system up to standards.

10 Is that applicable here, Commissioner Skop?

11 **CHAIRMAN ARGENZIANO:** Commissioner Skop.

12 **COMMISSIONER SKOP:** Which page, again?

13 **COMMISSIONER KLEMENT:** Page 11 of Section 10.  
14 It gives a specific example, Tropical Isles, purchased  
15 for \$5.

16 **COMMISSIONER SKOP:** Okay. In that case that  
17 was likely due to -- and, again, I would have to read  
18 specifically the facts, but based on your representation  
19 there were substantial repairs that would need to be  
20 made in the system. I think that's something that,  
21 again, either the negative acquisition adjustment in  
22 that instance would either be contested or not  
23 contested. If it's not contested, they would get the  
24 negative acquisition adjustment by operation of rule,  
25 and then consumers would have to pay for the capital

1 improvements necessary on top of the acquisition  
2 adjustment.

3 The situation there as opposed to the  
4 situation that I am trying to address is that in that  
5 situation the system was decrepit. In the other  
6 situation it was brand new, and they are buying it at a  
7 low price. So there are no capital improvements needed  
8 for the system that I complain about versus this system  
9 is my understanding from your question. So, I think,  
10 yes, there is a difference.

11 **CHAIRMAN ARGENZIANO:** Mr. Kelly, did you want  
12 to say anything?

13 Okay. Mr. Rendell. Sorry.

14 **MR. MAY:** Madam Chairman, Bruce May. With the  
15 Chair's permission, what we would like to do is perhaps  
16 have Mr. Rendell talk a little bit about the technical  
17 aspects of the rule and how it's applied. And then I'm  
18 going to, with your permission, provide maybe four or  
19 five minutes of additional thoughts for you all to  
20 consider looking at this whole issue from a different  
21 perspective.

22 **CHAIRMAN ARGENZIANO:** Certainly. Mr. Rendell.

23 **MR. RENDELL:** Good morning, Commissioners.  
24 Troy Rendell on behalf of Aqua Utilities Florida. I  
25 appreciate the opportunity to come before you and offer

1 some comments. They will be brief.

2 I wanted to first commend staff of giving a  
3 great summary of the existing rule as well as a history  
4 of the policy which has been many years in the making as  
5 you could tell from the presentation. As mentioned  
6 before, Aqua has filed pre-workshop comments that have  
7 been included in your packet for review, and we look  
8 forward to participating in this and perhaps many more  
9 workshops. As you can tell this morning, there is a lot  
10 of interest, and a lot of opinions, and I'm sure that  
11 there's going to be many other workshops in the future,  
12 and we look forward to participating on those, as well.

13 If the utility -- I mean, sorry. If the  
14 Commission ultimately decides to alter its current  
15 policy on acquisition adjustments, I want to assure the  
16 Commission that Aqua intends to comply with that policy.  
17 However, I would respectfully submit that your current  
18 and existing policy is a good policy, and we will  
19 continue to abide by the existing rules and policies, as  
20 well.

21 The existing rules and policies were based on  
22 thoughtful analysis and balances the interest of the  
23 customers as well as the utilities. For instance, in  
24 the example that's on the screen, the hypothetical  
25 example, in year two, if the utility were to come in for

1 a rate case, there is an automatic execution in the rule  
2 that \$180,000 of negative acquisition adjustment would  
3 be recognized in the rate case.

4 In the subsequent year, if they were to hold  
5 out for three years before they come in for a rate case,  
6 there is an automatic recognition of \$120,000 negative  
7 acquisition adjustment in the rates. So the current  
8 rule was based on comments, as Mr. Beck had indicated,  
9 from OPC as well as the utility. It lasted over several  
10 years, and there was basically a compromise in the  
11 existing rule of the benefits to the customers, but also  
12 provided an incentive for the larger utilities to buy  
13 smaller utilities.

14 Again, Aqua looks forward to participating in  
15 the process and I thank you for the opportunity to share  
16 my thoughts.

17 **CHAIRMAN ARGENZIANO:** Okay.

18 **MR. MAY:** Good morning, again, Madam Chair.  
19 Bruce May, again, with the law firm of Holland and  
20 Knight, and I represent Aqua Utilities. In this  
21 proceeding, I also represent a number of other  
22 stakeholders in the water utility industry.

23 Commissioners, as regulators you are often  
24 called on to deal with complex economic theory and  
25 establishing regulatory policy on such things as return

1 on equity and depreciation schedules. That is  
2 challenging, and I admire you and your staff for the  
3 hard work you are doing in that area.

4 But I'm not here to talk about return on  
5 equity, I'm not here to talk about elasticities of  
6 demand, or rate design, or any other economic theory.  
7 And I'm actually not here to talk about Aqua Utilities.  
8 Troy may get angry with me about that, but I'm going to  
9 ask you to look at this paradigm a little bit  
10 differently.

11 What I would like to share with you is some  
12 information, brief information on something that has  
13 nothing to do with theory. It's about real problems  
14 that are cropping up in this state that I personally  
15 believe your existing acquisition adjustment policy is  
16 designed to address.

17 As I mentioned earlier, I represent a number  
18 of other stakeholders in the utility industry aside from  
19 Aqua. I represent governmental utilities that provide  
20 water; I represent lending institutions that loan money  
21 to utilities. I'm not going to divulge any client  
22 confidences here. The information that I'm about to  
23 discuss with you is on file in a pending docket, Docket  
24 Number 090019. It involves a water and wastewater  
25 utility called Service Management Systems.

1 I currently represent a bank that has loaned  
2 that utility a substantial amount of money. The utility  
3 has not paid the bank and is in material default on the  
4 loan. On behalf of the bank, we have initiated a  
5 foreclosure action on the utility.

6 According to the operator of the utility, the  
7 wastewater plant is not in compliance with DEP  
8 regulations. The water plant is. The utility is in  
9 arrears in paying its operator, and it owes the operator  
10 a substantial amount of money. In fact, a couple of  
11 weeks ago, the operator called me at home and said, "Mr.  
12 May, I understand you represent the bank." I said,  
13 "That's correct." He said, "I'm walking away from this  
14 utility." I said, "Well, you know, we don't have title  
15 to the utility now, it's still in the hands of the  
16 utility company, Service Management." And he said,  
17 "Well, I'm walking away." And I said -- you know, I  
18 asked him to reconsider that, and call the Public  
19 Service Commission in the morning and call me in the  
20 morning after he reconsidered.

21 I talked to him the next day and he has  
22 reconsidered. In fact, the bank subsequent to that  
23 phone call has been working with your staff, it has been  
24 working with the operator, it has been working with the  
25 Office of Public Counsel, and it has been working with

1 the customers to ensure that service is not interrupted  
2 and that the plant is not neglected during the  
3 foreclosure process.

4 Last Friday I spent an hour and a half on a  
5 conference call with your staff, with the OPC, with the  
6 customers, and with the operator to try to arrive at a  
7 plan where we can keep that utility operating providing  
8 service to customers during the pendency of this  
9 foreclosure action, and we're going to make sure that  
10 happens.

11 Here is what the bank intends to do: To  
12 ensure continuity of service, on behalf of the bank, I  
13 have negotiated an agreement with the current borrower  
14 to keep the operator in place through the foreclosure  
15 process. Now, I have scheduled a foreclosure hearing on  
16 February 9th. At that time I expect the bank will get a  
17 judgment of foreclosure. Following the foreclosure  
18 proceeding, there will be an issuance of judgment.

19 **MS. MILLER:** Madam Chairman, I'm not sure if  
20 we're talking about a specific case that is open here.  
21 I'm a little unclear.

22 **MR. MAY:** This is an actual case, and it's a  
23 public record. I will bring this to a closure. I just  
24 wanted to bring some reality to this theoretical  
25 discussion.

1                   **CHAIRMAN ARGENZIANO:** Hold on one second.

2                   **MS. MILLER:** My concern was just if there was  
3 anybody not here who is part of that proceeding, whether  
4 we have any unfairness.

5                   **MR. MAY:** I'm not suggesting -- I'm not going  
6 to disparage anybody. I'm just going to lay out what  
7 the facts are.

8                   **CHAIRMAN ARGENZIANO:** I don't think it has  
9 anything to do with disparagement. I think it has to do  
10 with the fairness of all parties being here.

11                   So, staff, what's the call? We have already  
12 heard --

13                   **MS. MILLER:** I'm not the person that normally  
14 makes recommendations on this. I don't know if you want  
15 to give me five minutes, or if he said he was about to  
16 conclude --

17                   **MR. MAY:** I'll just keep it generic.

18                   **CHAIRMAN ARGENZIANO:** Okay. If you can keep  
19 it generic. I think we have gone -- it's kind of like  
20 half not generic and half generic.

21                   **MR. MAY:** Just to give you a sense of where  
22 the process is, assuming the bank is the successful  
23 purchaser at the foreclosure hearing, the bank will take  
24 title to the property ten days after March 9th, around  
25 March 19th. And once the bank takes title to the



1 property, it's going to make sure that the plant is  
2 operated in accordance with Florida law.

3 However, as I have indicated, the bank is in  
4 the business of lending money. It's not in the business  
5 of providing utility services, and it has no intention  
6 of continuing to operate the utility forever.

7 Instead, the bank is going to sell the utility  
8 as soon as possible. In fact, we have already hired a  
9 consultant to initiate the process to try to find  
10 potential purchasers of this utility. The bank is  
11 looking for the highest responsible bidder.

12 Now, that highest responsible bidder can be a  
13 private utility, some other group, or a governmental  
14 entity. The bank won't discriminate as to who purchases  
15 the utility assets. It is simply going to sell it to  
16 the highest responsible bidder. As of this date, I will  
17 tell you that no local governmental entity has expressed  
18 any interest in acquiring the utility, and neither has  
19 the state of Florida. With the current state of the  
20 economy, I think you know why no local government is  
21 going to step up and buy this utility.

22 Now, there has been some interest from private  
23 utilities. However, before purchasing these assets,  
24 they want some certainty on how they'll be able to  
25 recover the investment. So that's where we are.

1           Commissioners, I would respectfully submit  
2           that the scenario I just described which you are  
3           currently dealing with in a docket before you is  
4           precisely one of the reasons that you adopted this rule  
5           in the first place back in 2002. The rule itself gives  
6           utilities seeking to acquire smaller distressed systems  
7           certainty on how their investment will be treated by  
8           utility regulators and expedites and reduces the cost of  
9           utility transfer proceedings.

10           At the same time, your rule balances the  
11           interest of customers. The rule provides an incentive  
12           for the purchasing utility not to pay -- not to pay an  
13           inflated price for the utility assets. As your staff  
14           has explained, the customers' rates will not change as a  
15           result of the acquisition. And as Mr. Rendell just  
16           explained, the rule is designed to dissuade the  
17           purchasing utility from seeking a future rate increase  
18           when the purchase price is significantly below the net  
19           book value of the utility's rate base.

20           In summary, Commissioners, I believe that the  
21           underlying policy of the existing rule, which is to  
22           encourage well-run utilities to acquire smaller systems,  
23           is just as valid today as it was when the rule was first  
24           promulgated back in 2002, perhaps even more so.  
25           Unfortunately, with the current state of the real estate

1 development market being in shambles, the troubled  
2 utility scenario that you are dealing with in Docket  
3 Number 090019 is not going to be an isolated incident.

4 So what am I suggesting? I'm suggesting that  
5 while you explore your existing policy in these workshop  
6 proceedings you allow the existing rule to operate as it  
7 was intended. After these workshops you have the  
8 discretion -- certainly have the discretion to decide to  
9 move on to formal rulemaking with the idea of altering  
10 your existing rule. I don't believe that is needed, but  
11 it is certainly your prerogative to do that. And if you  
12 ultimately decide to do that, my clients are certainly  
13 going to abide by whatever policy you finally  
14 promulgate.

15 However, again, in the interim while you  
16 conduct these workshops, I am respectfully suggesting  
17 that you clear up the uncertainty out there and send a  
18 clear message that you will continue to honor and apply  
19 your existing rule on acquisitions while you explore  
20 your policy going forward.

21 And I know that Commissioner Skop has  
22 identified an anomaly and a very interesting scenario  
23 there. I would respectfully submit that your existing  
24 rule has an extraordinary circumstance exception, and  
25 that's in Rule 25-30.031 -- excuse me, .0371(3). It

1 says a negative acquisition adjustment shall not be  
2 included in rate base unless there's is proof of  
3 extraordinary circumstances, or where the purchase price  
4 is less than 80 percent.

5 So I'm suggesting to you that your existing  
6 rule gives you the discretion that in a situation like  
7 Commissioner Skop has outlined that you could recognize  
8 some sharing of a negative acquisition adjustment. I  
9 think your existing rule gives you that flexibility, and  
10 I don't think you need to throw the baby out with the  
11 bath water. Thank you.

12 **CHAIRMAN ARGENZIANO:** Thank you. Questions?  
13 Commissioner Skop.

14 **COMMISSIONER SKOP:** Thank you, Madam Chair.  
15 And thank you, Mr. May, for your comments. I do  
16 appreciate that.

17 I think that the situation with the operation  
18 of the rule, and as Mr. Sayler expressed, is that in  
19 this instance under (3)(b) of the Commission rule that  
20 you referenced, this was an uncontested situation, and  
21 so staff prescriptively applied the rule basically  
22 resulting in the unintended windfall which, you know,  
23 struck my ire. And I think that, you know, looking at  
24 this rule, this rule was promulgated by a couple of  
25 statutes. But, more importantly, by Florida Statute

1 367.071(5), which was what I cited to earlier, that the  
2 Commission by order may establish the rate base for a  
3 utility or its facilities or property when the  
4 Commission approves a sale.

5           Again, my fallback position for redressing the  
6 path that staff had put the Commission upon with  
7 granting that windfall -- which, again, I took great  
8 exception to, which is why we are all here today --  
9 would have been to fallback on the statute to say that I  
10 have the ability at the Commission to set rates or the  
11 rate base upon the sale.

12           And to avoid that windfall from happening in  
13 that situation for which the operation of the rule was  
14 never intended, I would have respectfully sought to set  
15 rate base at the acquisition price of \$100,000. Not to  
16 penalize the company, but in that case it's clearly  
17 articulated by the Commission orders that implemented  
18 the rule and discussed the application of the rule.

19           The rule was intended to encourage companies  
20 to purchase delapidated systems. And that's exactly the  
21 operation of the rule that we both agree upon  
22 completely. That is what I want to continue.  
23 Delapidated systems, absolutely let's apply the rule.  
24 When sharing -- to address Chairman Argenziano's  
25 perspective and OPC's, you know, on a case-by-case basis

1 maybe we would have to take a look at that in the  
2 totality of the situation of the proposed sale or  
3 transfer. But this specific situation where the  
4 prescriptive application of the rule yields an  
5 unintended result and a windfall to the company, I can't  
6 let happen, and I think that's the source of the  
7 controversy.

8 I very much agree with you that the rule as  
9 intended is to encourage and incentivize Florida  
10 utilities to acquire delapidated systems. I have no  
11 doubt that that should remain in place. But what I am  
12 looking for, and I'm not so sure that that extraordinary  
13 circumstance provision that you mentioned actually  
14 works, because staff pretty much just went down the rosy  
15 path of allowing the acquisition until I had to get in a  
16 serious fistfight to try and stop what I felt was an  
17 injustice to the ratepayers. So if you would just  
18 briefly elaborate on that.

19 **CHAIRMAN ARGENZIANO:** Mr. May.

20 **MR. MAY:** Commissioner Skop, I respect that  
21 position. And what we are talking about here,  
22 Commissioners, is the utility system called Jumper  
23 Creek. I think that's the sample, or that is the  
24 example that we are all discussing here. And I welcome  
25 the opportunity, Commissioner Skop, for you and I to

1 have this dialogue because of -- you know, because of  
2 ex parte we're not able to communicate with you, so I  
3 think rulemaking -- the rulemaking process like this is  
4 a healthy process. And I respect Mr. Beck's comments,  
5 and I respect staff. I think it's good to have these  
6 discussions, because it gives you perspectives from a  
7 lot of different angles.

8 The Jumper Creek scenario, Commissioner Skop,  
9 is not quite what you portray there. The owner of that  
10 system now is nowhere to be found. It was not a  
11 well-run, well-funded utility system. Unfortunately, my  
12 client is still operating that system trying to find the  
13 prior owner, and we'll be coming back to you to discuss  
14 that issue at some later time.

15 But hindsight is 20/20. If the utility  
16 company that I represented understood your concerns at  
17 the front end of the process, Commissioner Skop, I think  
18 we have structured this transaction much differently.  
19 We would have paid, you know, close to full purchase  
20 price. But we read the rule as the -- that's where  
21 the -- I think, Commissioner Stevens, there are risks  
22 for a company coming in to operate a smaller utility  
23 where the current operator is going to vanish.

24 And to entice or incentivize larger companies  
25 to come in, this rule provided the discount. It

1 provided the utility the opportunity to continue to earn  
2 based upon net book value, even though they might have  
3 paid below. Now, whether that's a good policy today,  
4 that's for you to decide. I think it is. I think there  
5 needs to be some incentive, in light of my experience  
6 with this real-life example I just recounted to you. We  
7 are having a hard time getting people to step up to the  
8 plate here, Commissioners. Local governments aren't  
9 coming up. We have gone to local governments. Are you  
10 willing to buy this? No. It's too far out. We don't  
11 have the money. We're cutting our budgets right now.

12 So I would ask you to look at it from that  
13 perspective, as well. And balance the interests of the  
14 ratepayers. But in the interim, send a signal out there  
15 that this rule will continue to be applied. And you  
16 have the discretion with this extraordinary  
17 circumstances, I think, clause to address the anomalies  
18 that are up there in that sample amortization schedule.

19 Thank you.

20 **CHAIRMAN ARGENZIANO:** Thank you.

21 Commissioner Skop.

22 **COMMISSIONER SKOP:** Thank you, Madam Chairman.

23 And I do agree, Mr. May, that having the  
24 opportunity to have a workshop provides a constructive  
25 dialogue where we can play by the rules and gain a



1 better appreciation and perspective of the position of  
2 the parties.

3 You mentioned the example in Scenario 2, and,  
4 you know, looking back on history, your client alleges  
5 that it detrimentally relied on the rule and that the  
6 rule would be applied as it was written. And you stated  
7 in your most recent comments that had you known that  
8 there was going to be this concern, that they would have  
9 paid close to net book value for the assets as opposed  
10 to the deal they got.

11 And I guess I would turn the tables and play  
12 devil's advocate on that statement. It seems to me that  
13 from a shareholder perspective, that the company -- the  
14 better course to pursue growth and acquisitions which  
15 drives stock price and is good for the company, the  
16 better practice, contrary to what you just represented,  
17 would have been to get a good deal on the asset for a  
18 brand new plant and to not seek a negative acquisition  
19 adjustment under the rule. Trying to be fair and say,  
20 hey, we know that the rule is predicated upon the  
21 Commission's desire to incentivize the acquisition of  
22 small delapidated systems, and this one really is trying  
23 to put a square plug in a round hole. So that's the  
24 company's discretion, which it had the discretion to do,  
25 but it sought the acquisition adjustment and fought

1 tooth and nail to get it. I know, because we were  
2 involved in that debate.

3 The bad deal, as you suggested, would have  
4 been to pay book value for an asset that you could have  
5 got cheaper because your shareholders were there  
6 overpaying, even though you get better regulatory  
7 treatment and avoid the negative acquisition adjustment  
8 altogether.

9 It seems to me the better course of practice  
10 would have been what is fair is fair. You make a good  
11 deal where you are able to make a good acquisition at a  
12 bargain basement price, and you add to the growth of  
13 your company, but then you use some discretion or tact  
14 as to how far to push the envelope. Whether you're just  
15 going to prescriptively apply the rule and get a  
16 windfall, versus taking a more disciplined approach and  
17 a sharing, which I suggested at hearing and was  
18 unilaterally rejected.

19 So, again, in retrospect things could have  
20 probably been achieved differently, but my problem is  
21 the way the company was relying on the rule and saying  
22 the rule applies and there is no extraordinary  
23 circumstances. This is uncontested, and brimstone and  
24 fire, we're getting our negative acquisition adjustment  
25 because we relied upon the rule as written. Well, you

1 know, that's the situation that got us here today. And  
2 in that case I would respectfully suggest, based on the  
3 Commission's policy of trying to encourage the  
4 acquisition of delapidated companies, that what the  
5 company tried to achieve was not consistent with the  
6 intent of our rule. It may have met the letter, but it  
7 wasn't in the spirit. And so that's my heartache there.

8 **CHAIRMAN ARGENZIANO:** Mr. May, do you want to  
9 respond?

10 **MR. MAY:** I didn't want to -- yes, ma'am. I  
11 guess I didn't want to leave you with the impression  
12 that the company was thumbing the nose at the  
13 Commission. What I was suggesting to you, Commissioner  
14 Skop and Commissioners, is had we known now -- had we  
15 known then what we know now, I think we would have  
16 addressed this entire acquisition much differently.

17 You have raised some valid points. But what  
18 the company -- you know, putting yourself back in the  
19 position of the company at that time, this rule had been  
20 consistently applied this way. When the company  
21 structured its acquisition, it structured it based upon  
22 the rule, and they felt strongly that based upon  
23 precedent that was the way the Commission would react  
24 and vote.

25 Obviously we were wrong, and we admit we were

1 wrong. I think where we are today is we are here today  
2 to talk about the rule to see how where we go -- you  
3 know, how we can move forward constructively, and that's  
4 why we are here.

5 **CHAIRMAN ARGENZIANO:** Briefly, Commissioner  
6 Skop.

7 **COMMISSIONER SKOP:** Thank you.

8 And, Mr. May, I appreciate that. And, again,  
9 I think the rule is a good one as written. It's just on  
10 that rare exception where the company used its  
11 discretion to do something that basically was  
12 inconsistent with the intent of the rule that would have  
13 clearly benefited the company, it got to be a little bit  
14 egregious to me, and that's where we have the difference  
15 of opinion.

16 But as far as the rule works today on  
17 encouraging the acquisition of delapidated systems, I'm  
18 fine with the rule in that regard. It's just that one  
19 scenario where it caused an unintended windfall that,  
20 you know, I cannot in good faith as a regulatory  
21 commissioner allow the ratepayers to absorb that. You  
22 guys got a good deal. I commend you for that  
23 acquisition that you tried to make. I think where the  
24 mistake was is trying to push the envelope further and  
25 leverage the rule for unintended purposes.

1                   **CHAIRMAN ARGENZIANO:** And, Commissioner Skop,  
2 I agree with that, but if the rule allows it, then --  
3 you know, if the rule is there, then it's up to us to  
4 change the rule or to make sure, because you can't  
5 really blame the company for going what the rule allows.  
6 I understand your point, and it's a good one, and well  
7 taken. But if the rule allows it, you can't -- you  
8 know, you can't say, hey, you didn't follow the rules.

9                   So there's a need then to be discussing the  
10 changes that need to take place in the rule. And, you  
11 know, with all due respect, I agree with you, I really  
12 do, and I think the company just said the same thing,  
13 but I can't beat on the company for following the rule.  
14 It's when you don't follow the rule that I want to beat  
15 up on you.

16                   But would you like to make some comments,  
17 please?

18                   **MR. WILLIAMS:** Thank you, Chairman.

19                   I am Director of Governmental Affairs for  
20 Utilities, Incorporated, which is a national water and  
21 wastewater company. We provide service in 15 different  
22 states. We serve over a million people throughout the  
23 country. We have been in Florida for more than  
24 30 years. We have 15 subsidiary companies. Our state  
25 headquarters is in Altamonte Springs, and we currently

1 employ more than a hundred people in the state.

2 I, too, would like to commend staff. I think  
3 they have put together a very good historical  
4 presentation and tried to lay out the scenarios that  
5 kind of give you examples of how it works. And I  
6 compliment them.

7 One of the points -- I agree with a lot of the  
8 things that the Aqua folks said. It's clear the rule  
9 isn't perfect. It was a compromise at the end of the  
10 three years of hearings and workshops that the OPC gave  
11 a little, the companies gave a little and came up with  
12 something, and the staff all worked together, and came  
13 up with something they thought would be better than the  
14 previous 15 or 20 years of no acquisition adjustment  
15 either way, unless there was extraordinary  
16 circumstances.

17 So this was a compromise that did require a  
18 negative if it was a large difference, but it did have  
19 the five year stay-out incentive in there. So it was a  
20 quid pro quo that gave the OPC something, gave the  
21 company something. Nobody was happy at the end of the  
22 day, but everybody thought they could live with it.

23 And it has worked pretty well. If you look at  
24 the cases that have occurred since the rule was put in  
25 place, you haven't seen any radical shift over the way

1 acquisition policy has gone on in Florida, which kind of  
2 indicates to me it's working. Again, it's probably not  
3 perfect. It could maybe take some tweaking, but let's  
4 hope it won't be a three-year process. Thank you.

5 **CHAIRMAN ARGENZIANO:** Yes, let's hope so.

6 Commissioners, any other comments?

7 Commissioner Skop.

8 **COMMISSIONER SKOP:** Just briefly. Again, I  
9 would echo the comments made. Again, the rule is a  
10 compromise rule. It's a very good one, and I'm fine  
11 with the rule so long as the rule is not taken advantage  
12 of. And we all know what the intent of the rule is. It  
13 is very clear that it is intended to incentivize  
14 companies, large companies to acquire small delapidated  
15 systems. Not to get a windfall, but to do that one  
16 particular task. And they should be incentivized and  
17 rightfully so for doing that, and that's a policy I  
18 agree with.

19 So for whatever reasons, the extraordinary  
20 circumstances under the rule under Section 3 somehow was  
21 not enough to prevent staff from trying to roll this  
22 through. And, again, I think that's where the rule  
23 has -- I won't call it a loophole, but in a certain fact  
24 pattern the rule fails to operate in the manner in which  
25 the rule was intended, and so long as the companies

1       respect how the rule is supposed to operate, I don't see  
2       any foreseeable problem. But it would be nice to have  
3       some latitude within the rule to prevent this from  
4       reoccurring, and that's Commissioner Argenziano's point  
5       of changing the rule.

6                 But at the end of the day, I think what  
7       simultaneously controls is the statute, which is  
8       367.071(5), which gives the Commission the statutory  
9       authority to establish the rate base for a utility when  
10      the Commission approves a sale. And I would have relied  
11      on that statute to prevent that problem from going  
12      forward, had I had to do so.

13                I was looking to compromise, because I see  
14      win/win. I'm a win/win type of guy. But, again, I  
15      think enough has been said that we know that the rule is  
16      not perfect, and if there are some constructive ways to  
17      change the rule without going through a lengthy process  
18      to do so, I'm all for it. Thank you.

19                **CHAIRMAN ARGENZIANO:** And I think that is what  
20      we are here for, and I think that is what we could do.

21                Commissioner Klement.

22                **COMMISSIONER KLEMENT:** Well, to that point, I  
23      just wanted to inquire. What is the best course of  
24      action? Is it to instruct staff to come up with the  
25      tweaks that might alleviate Commissioner Skop's concerns



1 and still preserve the rule?

2 **CHAIRMAN ARGENZIANO:** Well, I think that's  
3 exactly what we would have to do. If staff understands  
4 what the concerns were today, if we can take a stab at  
5 it. Especially, and I think -- Commissioner Skop, jump  
6 in here, when relating to the new acquisitions of a new  
7 plant and how we prevent the windfall, but not removing  
8 the incentives that are built in there that have worked  
9 well in acquiring the older systems. I think that's  
10 what the statute really is, the heart of the statute.

11 Commissioner Skop, do you want to add anything  
12 to staff? Commissioners, anything to the staff?

13 **COMMISSIONER SKOP:** Yes. Thank you, Madam  
14 Chair.

15 I think under the existing rule for  
16 acquisition adjustments under Subsection 3, I mean, the  
17 change could be as simple as specifying the intent, or  
18 reiterating the intent of why negative acquisition  
19 adjustments -- you know, I don't know if we can do that  
20 within the course of the rule, but certainly adding a  
21 sentence to that rule that gives the Commission the  
22 ability to say no in one of these oddball situations for  
23 which the rule was never intended, I think, should be  
24 sufficient enough to prevent reoccurrence of the  
25 problem.

1                   **MR. SHAFER:** Commissioners, I might suggest  
2 that we solicit comments from the industry and OPC in  
3 regard to any suggestions they may have on language for  
4 that particular narrow purpose. That would be helpful  
5 to us.

6                   **CHAIRMAN ARGENZIANO:** That would be the  
7 perfect scenario.

8                   And, Commissioner Edgar.

9                   **COMMISSIONER EDGAR:** I think Mr. Shafer just  
10 primarily took the comment I was going to make. Very  
11 generally, there are few rules or statutes in any  
12 substantive area that are probably perfect in every  
13 single scenario, both real and hypothetical. So if we  
14 have had a rule that was a compromise at one point in  
15 time and has worked, and I have heard the number 90  
16 percent of the situations in helping to implement the  
17 policies that were intended, then I have to say that's  
18 probably pretty good.

19                   But with that, of course, the opportunity to  
20 improve and learn from experience is also part of our  
21 process and one that I embrace. So I would just say  
22 that when we have rule changes or looked at potential  
23 rule changes in the past, I have found it very helpful  
24 to have actual suggested rule change language  
25 specifically from all interested parties. And similar

1 to what Mr. Shafer suggested, I would ask that we  
2 solicit that and then look forward to the further  
3 analysis.

4 **CHAIRMAN ARGENZIANO:** That is always, I think,  
5 a given and real important, to hear the screaming and  
6 yelling when it doesn't work right, but when you suggest  
7 some fixes for us all to look at as well our own  
8 suggestions. I know I have some in regards to that, and  
9 I would like to see everybody's suggestions incorporated  
10 into this change, or tweak, or whatever we want to call  
11 it.

12 Commissioner Skop.

13 **COMMISSIONER SKOP:** Thank you, Madam Chair.

14 And I couldn't agree more. I mean, it's a  
15 collaborative process. And, you know, constructive  
16 regulation involves, you know, taking the input from  
17 each of the respective stakeholders and trying to  
18 fashion something that is workable. I think in this  
19 case it is just a quick tweak that would be necessary.

20 And I do want to commend Aqua and Utilities,  
21 Inc. for coming forth today and expressing their  
22 concerns. Mr. May, it's always a pleasure to be able to  
23 exchange ideas, and I think this has been constructive  
24 in terms of redressing my concerns.

25 **CHAIRMAN ARGENZIANO:** And I couldn't agree

1 more with Commissioner Edgar, nothing is ever perfect.  
2 The statutes are written, and then years later you  
3 find -- or the day later after it is passed you find,  
4 oops, we made a mistake, or there is a loophole, or  
5 something is created. And the same thing with rules.

6 So I think it has been very beneficial today.  
7 Staff, is there anything, any other matters that we need  
8 to discuss today? Or, Commissioners, I'll ask finally,  
9 any other questions, or any other matters to come before  
10 us on the workshop?

11 **MR. SAYLER:** The only question I have is do we  
12 want to have the parties or interested persons submit  
13 post-workshop comments with suggestions for the rule, or  
14 if they want to do any here on the spot? I would  
15 probably suggest post-workshop in writing, and then we  
16 can file that and go forward.

17 **CHAIRMAN ARGENZIANO:** I think that works. Is  
18 that okay with everybody else?

19 **MR. SAYLER:** And we need a time frame for  
20 that. Mr. Shafer, do you have a suggested time?

21 **CHAIRMAN ARGENZIANO:** Some type of reasonable  
22 time frame.

23 **MR. SHAFER:** Thirty days.

24 **CHAIRMAN ARGENZIANO:** I'm sorry?

25 **MR. SHAFER:** Thirty days.

1                   **CHAIRMAN ARGENZIANO:** Commissioners?

2                   **MR. SHAFER:** Does that give the companies or  
3 parties enough time?

4                   **CHAIRMAN ARGENZIANO:** Is that good for  
5 everybody? Okay. I think we can do that.

6                   And, anything else? Commissioner Skop.

7                   **COMMISSIONER SKOP:** Just to address Mr. May's  
8 concern in terms of some certainty. Again, my intent is  
9 to follow the rule as it's intended to be applied. So  
10 that should relieve any regulatory uncertainty. But in  
11 those situations that I took exception before, again,  
12 that would be a situation where I would have a problem.

13                   **CHAIRMAN ARGENZIANO:** Great. Okay. If  
14 nothing else before us, we're adjourned. Thank you very  
15 much.

16                   (The Commissioner Workshop concluded at 11:05  
17 a.m.)

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STATE OF FLORIDA        )  
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COUNTY OF LEON        )

CERTIFICATE OF REPORTER

I, JANE FAUROT, RPR, Chief, Hearing Reporter Services Section, FPSC Division of Commission Clerk, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 8th day of February, 2010.

  
\_\_\_\_\_  
JANE FAUROT, RPR

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