

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Proposed Rule 25-30.0371,  
F.A.C., Acquisition Adjustment.

DOCKET NO. 001502-WS  
ORDER NO. PSC-02-0997-FOF-WS  
ISSUED: July 23, 2002

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman  
J. TERRY DEASON  
BRAULIO L. BAEZ  
MICHAEL A. PALECKI  
RUDOLPH "RUDY" BRADLEY

NOTICE OF ADOPTION OF RULE

NOTICE is hereby given that the Florida Public Service Commission, pursuant to Section 120.54, Florida Statutes, has adopted Rule 25-30.0371, Florida Administrative Code, relating to acquisition adjustments for water and wastewater utilities, without changes. The rule was filed with the Department of State on July 15, 2002 and will be effective on August 4, 2002. A copy of the rule as filed with the Department is attached to this Notice.

Since approximately 1983, we have had a policy on acquisition adjustments for water and wastewater utilities that, absent extraordinary circumstances, the purchase of a utility system at a premium or discount shall not affect rate base. An acquisition adjustment is a regulatory convention by which the books of the utility are adjusted to reflect changes in the original cost rate base valuation resulting from purchase prices that differ from original cost rate base valuations. Whether or not an acquisition adjustment is included in rate base is a decision made by the Commission. A positive acquisition adjustment may be recorded when the purchase price of the transaction is above the original cost rate base valuation. If approved, the acquiring utility will then be permitted to earn a rate of return on the amount of the purchase price. A negative acquisition adjustment may be recorded when the purchase price of the utility is below the original cost rate base valuation. If approved, the negative acquisition adjustment reduces the rate base valuation to an amount less than the original cost rate base valuation.

DOCUMENT NUMBER-DATE

07670 JUL 23 02

FPSC-COMMISSION CLERK

We found that our acquisition adjustment policy has produced the intended result of creating incentives for larger utilities to acquire small, troubled utilities in In re: Investigation of Acquisition Adjustment Policy, Order No. 25729, issued February 17, 1992, at pages 1-2:

We still believe that our current policy provides a much needed incentive for acquisitions. The buyer earns a return on not just the purchase price but the entire rate base of the acquired utility. The buyer also receives the benefit of depreciation on the full rate base. Without these benefits, large utilities would have no incentive to look for and acquire small, troubled systems. The customers of the acquired utility are not harmed by this policy because, generally, upon acquisition, rate base has not changed, so rates have not changed. Indeed, we think the customers receive benefits which amount to a better quality of service at a reasonable rate. With new ownership, there are beneficial changes: the elimination of financial pressure on the utility due to its inability to obtain capital, the ability to attract capital, a reduction in the high cost of debt due to lower risk, the elimination of substandard operating conditions, the ability to make necessary improvements, the ability to comply with the Department of Environmental Regulation and the Environmental Protection Agency requirements, reduced costs due to economies of scale and the ability to buy in bulk, the introduction of more professional and experienced management, and the elimination of a general disinterest in utility operations in the case of developer owned systems.

We continue to believe that this policy is appropriate and that there are benefits derived from it.

Chapter 120, Florida Statutes, the Administrative Procedure Act, provides that "[e]ach agency statement defined as a rule by s. 120.52 shall be adopted by the rulemaking procedure provided by this section as soon as feasible and practicable." § 120.54(1)(a), Fla. Stat. (2000). Accordingly, pursuant to this statute, a notice of proposed rule development was published in the November 12, 1999, edition of the Florida Administrative Weekly. A staff workshop was held on December 2, 1999, and a Commission workshop was held on February 7, 2001. At our December 4, 2001, agenda conference, we deferred a decision on the proposed rule in order for staff to conduct an informal workshop in an attempt to resolve the differences between parties. Staff conducted informal workshops on January 31 and February 26, 2002. The parties' differences were partially resolved, but an agreement was not reached on all provisions of the rule. On May 21, 2002, after hearing from the parties, we approved a rule that codifies our existing policy with some exceptions. We are modifying our existing policy to provide an incentive for a purchasing utility to refrain from filing a rate case for a five-year period subsequent to the purchase. In addition, the rule also provides an incentive for a utility to obtain the lowest price possible when negotiating a purchase price lower than book value. We believe that codification of this rule will reduce costs in future proceedings by diminishing some of the controversy over acquisition adjustments and expediting transfer or rate case proceedings.

Rule 25-30.0371 provides that a positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Some of the factors that we will consider in making a determination whether there are extraordinary circumstances justifying a positive adjustment are listed in the rule and include anticipated improvements in quality of service, anticipated compliance with regulatory mandates, anticipated rate reductions, and anticipated cost efficiencies. These factors are listed by way of example, and other evidence may be offered.

As to negative acquisition adjustments, the rule provides that such an adjustment shall not be included in rate base unless there is proof of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value, then it requires the inclusion of a negative acquisition adjustment calculated pursuant

to paragraph (3)(b). Paragraph (3)(a) provides that the entity that believes that a negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. This paragraph also provides an incentive to the purchasing utility company to try and negotiate the best price possible when purchasing below net book value. It provides that only 70 percent of the acquisition adjustment can be booked if extraordinary circumstances are proven. In addition, this paragraph lists examples of the evidence we will consider in determining whether there are extraordinary circumstances justifying a negative adjustment. It includes evidence such as the anticipated retirement of the acquired assets and the condition of the assets acquired, and other evidence may be offered. In addition, the existence of evidence of any one factor alone does not mean that an adjustment will be approved.

Paragraph (3)(b) outlines our treatment when the purchase price is less than 80 percent of net book value. It requires that the amount that exceeds 20 percent of net book value will be recognized for ratemaking purposes as a negative acquisition adjustment as an incentive for the utility not to file for a rate increase. The paragraph also establishes an amortization period for the acquisition adjustment of five years. If the utility does not file for a rate increase that will be effective during the amortization period, then the negative acquisition adjustment is not booked or recognized for any review of earnings. If the utility does file for a rate increase that will be effective during the amortization period, the unamortized negative acquisition adjustment is booked and used to test the earnings level and the need for a rate increase. The 20 percent that was not booked as a negative acquisition adjustment would not be recognized.

Subsection (4) requires us to establish an amortization period for any approved positive or negative acquisition adjustment except for one booked under (3)(b) above. Factors that we will take into consideration when establishing the amortization period are listed in the rule.

Subsection (5) of the rule authorizes subsequent modification of a positive or negative acquisition adjustment, except for one made pursuant to paragraph (3)(b), if the circumstances that initially justified it do not materialize, or if they are

eliminated or changed within five years. We believe that five years is a reasonable time in which to evaluate the circumstances justifying an adjustment. We took this action in a docket involving Chesapeake Utility Corporation. We approved a positive acquisition adjustment for Central Florida Gas Company to reflect expected savings from the company's acquisition by Chesapeake in Order No. 18716, issued January 26, 1988, in Docket No. 870118-GU. In a subsequent rate review, we found that the predicted savings never materialized and removed the acquisition adjustment from rate base. Order No. 23166, issued July 10, 1990, in Docket No. 891179-GU.

The rule we adopt implements section 367.071(5), Florida Statutes, which authorizes the Commission to establish the rate base for a utility when it approves a sale, assignment, or transfer, and section 367.081(2)(a), Florida Statutes, requiring the Commission to fix rates and to consider the cost of providing service including a fair return on the investment of the utility in property used and useful in the public service. In addition, sections 367.121(1)(a) and (b), Florida Statutes, provide the Commission with the power to prescribe fair and reasonable rates and charges, and to prescribe a uniform system and classification of accounts for all utilities.

This docket is closed upon issuance of this notice.

By ORDER of the Florida Public Service Commission, this 23rd day of June, 2002.

BLANCA S. BAYÓ, Director  
Division of the Commission Clerk  
and Administrative Services

By: Kay Flynn  
Kay Flynn, Chief  
Bureau of Records and Hearing  
Services

( S E A L )

CTM

25-30.0371 Acquisition Adjustments.

(1) Definition. For the purpose of this rule, an acquisition adjustment is defined as the difference between the purchase price of utility system assets to an acquiring utility and the net book value of the utility assets. A positive acquisition adjustment exists when the purchase price is greater than the net book value. A negative acquisition adjustment exists when the purchase price is less than the net book value.

(2) Positive Acquisition Adjustments. A positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Any entity that believes a full or partial positive acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipated rate reductions or rate stability over a long-term period, and anticipated cost efficiencies.

(3) Negative Acquisition Adjustments. A negative acquisition adjustment shall not be included in rate base unless there is proof

of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value then the inclusion of a negative acquisition adjustment shall be calculated pursuant to paragraph (b) below.

(a) Contested. Any entity that believes a full or partial negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. Under no circumstance, however, shall the purchaser be required to record on its books more than 70 percent of a negative acquisition adjustment. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as the anticipated retirement of the acquired assets and the condition of the assets acquired.

(b) Uncontested. If the purchase price is less than 80 percent of net book value, then the amount of the difference in excess of 20 percent of net book value shall be recognized for ratemaking purposes as a negative acquisition adjustment. The negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings review unless the purchaser files for a rate increase pursuant to section 367.081(2),

367.0814, 367.0817 or 367.0822, F.S., that will be effective during the amortization period. The negative acquisition adjustment shall be amortized over a 5-year period from the date of issuance of the order approving the transfer of assets.

(4) Amortization Period. In setting the amortization period for a Commission approved acquisition adjustment pursuant to (2) or (3) (a) above, the Commission shall consider evidence provided to the Commission such as the composite remaining life of the assets purchased and the condition of the assets purchased. Amortization of the acquisition adjustment shall begin on the date of issuance of the order approving the transfer of assets.

(5) Subsequent Modification. Any full or partial acquisition adjustment, once made by the Commission pursuant to (2) or (3) (a) above, may be subsequently modified if the extraordinary circumstances do not materialize or subsequently are eliminated or changed within five years of the date of issuance of the order approving the transfer of assets.

Specific Authority: 350.127(2), 367.121(1)(f), FS.

Law Implemented: 367.071(5), 367.081(2)(a), 367.121(1)(a)(b), FS.

History: New 08/04/02.