

ORIGINAL



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April 28, 1998

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

Re: Docket No. 960235-WS & 960283-WS

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are the original and 15 copies of Citizens' Brief. A diskette in WordPerfect 6.1 is also submitted.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

*Charles J. Beck*  
Charles J. Beck  
Deputy Public Counsel

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FPSC-RECORDS/REPORTING

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for Transfer  
of Certificate Nos. 404-W and  
341-S in Orange County From Econ  
Utilities Corporation to  
Wedgefield Utilities, Inc. )  
)  
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Docket No. 960235-WS  
Filed: April 28, 1998

In Re: Application for  
Amendment of Certificates Nos.  
404-W and 341-S in Orange County  
by Wedgefield Utilities, Inc. )  
)  
)  
)  
)

Docket No. 960283-WS  
Filed: April 28, 1998

CITIZENS' BRIEF

The Citizens of Florida ("Citizens"), by and through Jack Shreve, Public Counsel,  
file this brief.

Overview

Wedgefield Utilities, Inc. ("Wedgefield Utilities") seeks approval from the Florida  
Public Service Commission ("Commission") to recognize a rate base of \$2,845,394 for the  
assets it purchased from Econ Utilities Corporation ("Econ" or "Econ Utilities").  
Wedgefield Utilities purchased these assets for a cash investment of \$545,000 plus certain  
contingent consideration. No contingent consideration had been paid as of the date of the  
hearing. Wenz, Tr. 186-187.

The Commission often states that it must balance the needs of a utility with the

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needs of consumers, but this proposal by Wedgefield Utilities is so far out of balance that it must be rejected. With the requested rate base, Wedgefield Utilities would secure the opportunity to require customers to pay a return on and a return of \$2,845,394, even though it paid only \$545,000 for these assets.

The testimony of CPA Hugh Larkin, Jr., showed that the utility would receive a pre-tax return of 67.61% if it were allowed to receive a return on \$2,845,391 for its cash purchase price of \$545,000. Larkin, Tr. 263; exhibit 16, schedule 1. The after-tax return would be 41.53% (Larkin, Tr. 263). These calculations assume a capital structure of 50% equity, 50% debt, a debt cost rate of 8%, and an equity cost rate of 11% -- all typical of a water and wastewater utility. It is hardly a surprise that the utility had no cross examination questions, no rebuttal, and no response concerning this outrageous result. Wedgefield Utilities chose to simply ignore these results throughout the case, as if such an outcome had no bearing on this case.

Another example provided in Mr. Larkin's exhibit showed the multiplier effect of allowing a return on over five times the amount of an investment. A certificate of deposit paying 6% would yield 30.83% if a person were allowed to recover a 6% return on an amount of \$2,800,000 after depositing \$545,000. This calculation assumes just a 6% interest rate with no equity investment and does not include the return of \$2,800,000 when the certificate matures. Larkin, Tr. 265; exhibit 16, schedule 2. Again, the utility had no questions nor any rebuttal concerning this calculation.



The company's own documents reflect a startling consequence from the combination of high hook-up fees and a high rate base in this case for its small cash investment of \$545,000. Shortly before signing the purchase agreement, Wedgefield Utilities considered the consequences of purchasing the assets of Econ Utilities for \$545,000 plus one third of the hook-up fees from the area known as the Commons. A memo dated November 22, 1995 (addressed to the chairman of Utilities, Inc.) entitled "Econ Utilities - Updated Recommendation," stated:

"Thereafter the situation only gets better. We would probably not need any additional facilities investment. We would get 100% of an additional 750+ taps (500 remaining in the currently developed area and 2/3 of the 400 lots in the Commons). The after tax cash from these taps would be over \$1.3 million which would be in excess of our purchase price plus our upgrade/expansion investment. **Thus, eventually we could havea (sic) \$0 investment in a utility serving 3,500 customers**" (emphasis added). Exhibit 12, page 7 of 8.

When asked whether "that's quite an incentive to purchase a company," the utility's witness Mr. Wenz responded with the understatement "that is attractive, yes" if these circumstances were met. Wenz, Tr. 207-208

It's plain that the company would receive a phenomenal windfall from its \$545,000 cash investment if the Commission allows the company to ignore its negative acquisition adjustment. Customers get the opportunity to pay Wedgefield Utility a pre-tax return of 67.61% on the company's investment, but receive little else from the company in return. In the period of over two years since Wedgefield Utilities purchased the assets of Econ

Utilities, Wedgefield has invested merely \$124,000 in the company, including both repair work and expenditures planning for future growth. Seidman, Tr. 397-398; Wenz, Tr. 202. It's just business as usual for the utility operations, even under the new ownership. It appears that the Commission's lucrative "incentive" has done little to provide real improvements or benefits for the customers of the utility.

Residents of Wedgefield are already paying extremely high rates. The monthly rate for 6,800 gallons of water and wastewater is currently \$68.27, compared to rates ranging from \$32.64 in Maitland and \$33.36 in Oviedo, up to 54.23 in Winter Garden, for the same usage from other private utilities in the area. Exhibit 2; Deacon, Tr. 17-23. The rate for 10,000 gallons of usage in Wedgefield is currently \$84.23 and is likewise much higher than the rate charged by similar private utilities located in the same general area. Exhibit 2. Over the past 18 years, customers' bills have increased sharply, by as much as 600%. Exhibit 3; Finley, Tr. 26.

If the Commission approves a rate base of more than five times Wedgefield's investment, there is good reason to believe that the utility will file a rate case to begin recovering its windfall return. The customers of Wedgefield Utilities are fully aware that such a rate base determination would lay the foundation for a rate case by the company. Nathan, Tr. 61. With rates already much higher than other nearby private utility systems, the impact on the residents of Wedgefield would be severe.

During the course of negotiations for the purchase of Econ Utility Corporation, Wedgefield Utilities offered Econ a fixed cash purchase price of \$400,000 plus a substantial additional bonus predicated on Econ and Wedgefield jointly filing a rate case and obtaining a rate increase from the Commission. For a 40% rate increase, Wedgefield would have provided Econ a \$300,000 cash bonus; for a 100% rate increase, Wedgefield would have provided Econ a \$600,000 bonus. Exhibit 12, page 5 of 8; Wenz, Tr. 204. There was no mention of the fact that a 100% increase for a customer already paying \$84.23 for 10,000 gallons would result in a monthly water/wastewater bill in excess of \$165.00 per month. If Wedgefield would provide a cash bonus to Econ for obtaining a rate increase, surely the company will not hesitate to file a rate case on their own if the Commission allows them a rate base of over \$2.8 million for their cash investment of \$545,000.

The Florida Public Service Commission should consider the consequences of its action before approving a rate base equal to an amount of more than five times the cash purchase price of this utility. The Commission's "policy" concerning acquisition adjustments, which has never been adopted by a rule, is not something that operates in a vacuum. It has real consequences for hundreds of customers in this case. Local communities pay for the incentives. Nathan, Tr. 72. It defies common sense to approve a rate base that would allow the monopoly utility company an opportunity to earn an annual pre-tax return of 67.61%. If the Commission truly believes that Wedgefield deserves an incentive for purchasing this utility, even though Wedgefield has spent little



improving the system in the past two years, it should provide the incentive in some other way. See Nathan, Tr. 72

As explained later in this brief, the facts and circumstances in this case meet the "extraordinary circumstances" test described in Commission orders dealing with the purchase of other water and wastewater utilities. This unadopted rule policy, however, is not binding on this proceeding. All of the facts and circumstances presented in this case, along with the inevitable consequences of the Commission's actions, must take precedence over unadopted rule policy if the Commission decides that the "extraordinary circumstances" test has not been met in this case. A Commission order will be upheld on appeal, even if inconsistent with officially stated agency policy or prior agency practice, if the deviation from the policy or practice is explained by the Commission. Section 120.68(7)(e)3, Florida Statutes (1997).

#### Position on Issues

Issue 1: What was the condition of the assets sold to Wedgefield Utilities, Inc.?

Position: The assets were in poor condition because of the lack of any preventative maintenance program by Econ Utilities.

Discussion: During the year preceding the sale of assets from Econ Utilities to

Wedgefield Utilities, studies were performed by the Orange County Public Utilities Division and by John B. Webb & Associates, Inc., reviewing the condition of the assets at Econ.

The study performed by Orange County noted repeatedly that there had been no preventative maintenance program in effect at Econ Utilities. It made this observation about the water supply system (exhibit 5, page 6 of 55), the water treatment system (exhibit 5, page 7 of 55), the water distribution system (exhibit 5, page 7 of 55), the wastewater collection system (exhibit 5, page 10 of 55), and the wastewater treatment plant (exhibit 5, page 10 of 55). In addition, the study observed significant inflow/infiltration problems in the wastewater collection/transmission system (exhibit 5, page 10 of 55).

The condition of the asbestos cement pipe in the system was an item of special concern in the Orange County study. Econ Utilities, in a manner consistent with its lack of a preventative maintenance program, told the County that the pipe only needed to be replaced when a section breaks – a plan of action which had cost the utility approximately \$25,000 per year (exhibit 8, page 2 of 10). Orange County saw the situation differently. In their experience, severe deterioration is a common problem in older gravity sewer systems constructed with asbestos cement pipe. When the pipe fails, infiltration becomes a problem. Orange County noted the existence of that type of problem at Econ (exhibit 8, page 6 of 10). With its systems, Orange County takes a more proactive approach to maintenance than did Econ Utilities (exhibit 8, page 7 of 10). Orange County noted that



as a system approaches the end of its useful life, an increase in main breaks is likely, and historical costs will not accurately predict future costs (exhibit 8, page 7 of 10).

These observations are pertinent to the purchase of Econ by Wedgefield Utilities. Wedgefield experiences infiltration problems, a symptom associated with pipe failing. Repair expenses will likely become higher as the pipe continues to deteriorate, and the customers of Wedgefield Utilities will be responsible for these increased expenses. This is an "extraordinary circumstance" warranting a rate base equal to the purchase price instead of a rate base equal to more than five times the purchase price.

John B. Webb & Associates, Inc., a professional engineering firm, prepared a report in June, 1995, entitled "Capital Improvement Plan and Utility Rate & Impact Fee Analysis of Water and Wastewater Systems." The report envisioned substantial capital improvements necessary to serve existing customers, as well as other improvements needed to provide service to additional customers in the future. To replace the asbestos cement pipe serving existing customers, the firm estimated a cost in excess of \$550,000 (exhibit 17, page 10 of 17). Additional costs to serve existing customers included \$50,000 for a 760 gpm softener, \$15,000 for a 1,000 gpm well and pump, and \$80,000 for a chemical handling / storage building, plus another 25% for contingencies, engineering, permitting, and administration (exhibit 17, page 9 of 17). Conditions that would lead Econ's engineering firm to estimate costs of this magnitude to continue serving existing customers are additional "extraordinary circumstances."

Wedgefield Utility's internal analyses made at the time of negotiating the purchase of Econ's assets confirm the need to repair assets at Econ. Although Wedgefield Utility believed they could complete the necessary work more cheaply than estimated by Webb & Associates, a memorandum dated July 5, 1995 concluded that Econ Utilities would soon need to expand its supply / pumping / treatment capacity as well as its storage capacity to be able to meet fire flow requirements (exhibit 12, page 2 of 8). The same memorandum noted that "there appears to be inflow and infiltration problems which will require upgrades to manholes and lift stations" (exhibit 12, page 3 of 8). The author estimated that Wedgefield Utilities would have to invest approximately \$800,000 in improvements over the first three years, presumably for both repairs and expansion. *Id.*

Although Wedgefield attempted to minimize the importance of these deficiencies, the company's testimony nevertheless contains significant concessions about the poor condition of the plant. For example, Mr. Wenz testified:

"Q. Did he (Mr. Rasmussen) make you aware of the condition of the systems?

A. Yes. He found that they were not in the best of condition, but they were not in *extremely* poor condition, either." (emphasis added).

Wenz, Tr. 172. In addition, the company admitted that the prior owner performed maintenance only on an "as needed" basis (Seidman, Tr. 341), capital improvements were often deferred (Seidman, Tr. 342), things should have been done maintenance-wise

(Seidman, Tr. 355), there were indications of significant inflow infiltration problems (Seidman, Tr. 356), and that there was corrosion at the base of the wastewater treatment plant (Seidman, Tr. 356). Mr. Seidman further testified that he would not be surprised if Econ Utilities had no preventative maintenance program in effect and that he found no records indicating that Econ Utilities had any preventative maintenance program (Seidman, Tr. 384-385).

Ms. Vicki Bruno, who recently moved to Wedgefield to take care of her father, experienced the effects from the lack of maintenance just before last Christmas when her water service went out for a number of days. She testified:

"I talked to the people from your utility, who properly told me the reason we couldn't get it fixed is that the previous owners, or whoever, had decided that when something broke they would just not fix it properly. Every time they went to fix the pipe it broke. It was like -- how did he put it -- the pipes were so brittle that every time you put pressure on them to fix them, they were just shattering. The whole system, I was told, needs to be replaced. It's not worth anything." Bruno, Tr. 87.

**Issue 2:** Was Econ Utilities Corporation a "troubled" utility?

**Position:** The company was not a "troubled" utility. The company met standards by providing maintenance on an emergency basis.



**Discussion:** Despite the fact that Econ Utilities had no preventative maintenance program in effect, the company was able to meet regulatory requirements by providing maintenance on an emergency basis. A Florida Public Service Commission staff engineer's report found that some of the facilities were in a state of disrepair and that improvements were needed, but the engineer also spoke with two persons at the Department of Environmental Protection about the ability of the system to meet DEP requirements. According to the staff engineer's report, the engineer was told that "there was no problem with the drinking water part of the utility" and that "everything is fine with the wastewater utility." Larkin, Tr. 267-268.

Econ Utilities had an incentive to make sure that the plant met environmental standards, even if it did not have an incentive to engage in preventative maintenance. As a developer of lots in Wedgefield, it wanted to make sure that DEP would not impose a moratorium on new hook-ups. Larkin, Tr. 268-269. Indeed, the very high hook-up fees of \$3,000 per lot were an attractive source of cash for the operation and expansion of the utility system.

There are any number of reasons for the decision of Econ Utilities to sell the system, but it appears that they simply wished invest their capital in home development and construction rather than in the operation of a utility. In fact, the sales contract was drafted in a way that it provides the owners of Econ Utilities an incentive to build additional houses in the "commons" area by paying Econ an amount equal to every other hook-up

fee in the commons. See Larkin, Tr. 267-270.

**Issue 3:** Are there any extraordinary circumstances which warrant an acquisition adjustment to rate base, and if so, what are they?

**Position:** Yes, the vast disparity between Econ's net book value for the plant and Wedgefield's purchase price, together with the poor condition of the assets, is an extraordinary circumstance.

**Discussion:** The Commission has previously found that lack of maintenance by the seller utility can be an "extraordinary circumstance" that warrants recognition of a negative acquisition adjustment. In the case of Jasmine Lakes Utilities Corporation (PSC order no. PSC-93-1675-FOF-WS issued November 18, 1993), the evidence showed that the utility was in bad shape prior to the purchase, that the utility had not been maintained in seven years, and that the previous owner had neglected the utility for a long time. The citizens argued that recognition of the negative acquisition adjustment would insulate ratepayers from failures or negligence by the prior utility management.

The majority of the Commission agreed with this position. The Commission found that it would be "patently unfair and unjust to customers of this utility, for the investors to receive a return on that portion of the original purchase price that was less than rate base.

In reaching this conclusion, we have relied on customer testimony, the need for repairs and improvements to the system at the time of the transfer, and the lack of responsibility in management."<sup>1</sup>

In the case of Wedgefield Utilities, there is not only evidence of a lack of preventive maintenance by the prior owner; there is also the huge disparity between the rate base of \$2,845,394 and the cash purchase price of \$545,000. Together, these two factors make an even more compelling case than in *Jasmine Lakes Utility* to recognize the negative acquisition adjustment.

**Issue 4:** How should the Commission treat the contingent portion of the purchase price for rate base purposes?

**Position:** The contingent portion of the purchase price should be recognized only if and when actual payments are made. In addition, the decision whether to recognize any of the contingent payments should be reviewed after the utility begins serving the area known as the Commons. If provision of service to this area increases the cost to provide

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<sup>1</sup> The order noted that at the time of the transfer, the utility was already purchasing 80 percent of its water from Pasco County, yet had earned a return on the water plant components for the past two years. It further noted that in the initial transfer docket, rate base was adjusted to reflect repairs and improvements that needed to be made to the wastewater plant. The *rationale* for recognizing the negative acquisition adjustment, however, was plainly the lack of maintenance by the prior owner, as evidenced in the provided quote from the order.



water or wastewater service to existing customers, the contingent payments should not be recognized in rate base.

**Issue 5:** What is the net book value for the water and wastewater systems?

**Position:** The net book value carried on the books of Econ Utilities Corporation as of December 31, 1995, was \$2,845,394.

**Issue 6:** Should a negative acquisition adjustment be included in the rate base determination, and if so, what is the appropriate amount?

**Position:** Yes, a negative acquisition adjustment should be included in rate base. The negative acquisition adjustment is \$2,300,394, calculated by subtracting the actual cash purchase price of \$545,000 from the net book value of \$2,845,394 carried on the books by Econ Utilities Corporation.

**Issue 7:** What is the rate base for the water and wastewater systems, for the purpose of this transfer?

**Position:** The rate base should be the acquisition price of \$545,000.

**Discussion:** The purchase price paid by Wedgefield Utilities, Inc., for the assets of Econ Utilities Corporation reflects the lack of maintenance conducted on the system. It was an arm's length transaction accurately reflecting the value of the assets. See Wenz, Tr. 189; Larkin, Tr. 274,286. Customers will be saddled with additional capital costs and maintenance costs in the future to make up for the years of neglect by the predecessor company. Providing Wedgefield a rate base equal to what it paid for the utility is fair to the company and to customers. Providing Wedgefield a rate base of more than five times what it paid for the utility is unfair to customers and provides an unearned windfall to Wedgefield.

**Issue 8:** Who has the burden of proving whether an acquisition adjustment should be included in the rate base?

**Position:** The utility has the burden of justifying why its actual purchase price should not be used to establish its rate base.

**Issue 9:** Must extraordinary circumstances be shown in order to warrant rate base inclusion of an acquisition adjustment?

**Position:** No, extraordinary circumstances need not be shown, although such circumstances exist in this case. The Commission has no rule regarding acquisition adjustments, nor any rule requiring a showing of extraordinary circumstances.

**Discussion:** Section 120.54, Florida Statutes (1997) states in part:

**120.54 Rulemaking.-**

**(1) GENERAL PROVISIONS APPLICABLE TO ALL RULES OTHER THAN EMERGENCY RULES.-**

(a) Rulemaking is not a matter of agency discretion. Each 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.

1. Rulemaking shall be presumed feasible unless the agency proves that:

a. The agency has not had sufficient time to acquire the knowledge and experience reasonably necessary to address a statement by rulemaking;

b. Related matters are not sufficiently resolved to enable the agency to address a statement by rulemaking; ...

Since the Commission does not have a rule regarding acquisition adjustments, it cannot have in place a policy that requires a showing of "extraordinary circumstances" in order to warrant recognition of an acquisition adjustment. If the Commission had such a policy, the Administrative Procedure Act would require the Commission to have a rule reflecting that policy. Unless the Commission is blatantly violating the Administrative Procedure Act, either (a) the Commission has not acquired the knowledge and experience reasonably



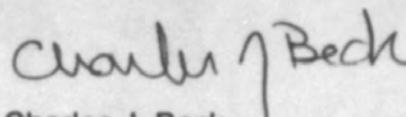
necessary to address a statement about acquisition adjustments by rulemaking, or (b) the Commission has not sufficiently resolved related matters to enable the Commission to address a statement by rulemaking. Section 120.54(1)(a)1, Florida Statutes (1997).

The Commission should therefore not require a showing of extraordinary circumstances in order to recognize the negative acquisition adjustment in this case. Extraordinary circumstances have been shown by the combination of a lack of maintenance by the prior owner of the utility and the magnitude of the difference between the net book value and the purchase price. However, there is no need to make this showing. A Commission order will be upheld on appeal, even if inconsistent with officially stated agency policy or prior agency practice, if the deviation therefrom is explained by the

Commission. Section 120.68(7)(e)3, Florida Statutes (1997). The fair action in this case to both customers and the utility alike is to grant Wedgefield Utilities a rate base equal to its actual purchase price, but no more.

Respectfully submitted,

JACK SHREVE  
PUBLIC COUNSEL



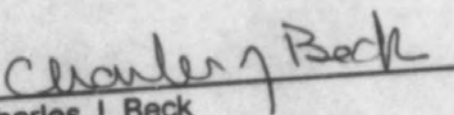
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Attorney for the Citizens  
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**CERTIFICATE OF SERVICE**  
**DOCKET NOS. 960235-WS and 960283-WS**

I HEREBY CERTIFY that a copy of the foregoing has been furnished by  
U.S. Mail or hand-delivery to the following parties on this 28th day of April, 1998.

  
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