State of Florida

# Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

## -M-E-M-O-R-A-N-D-U-M-

**DATE:** JULY 9, 1998

**TO:** DIRECTOR, DIVISION OF RECORDS AND REPORTING (BAYÓ)

**FROM:** DIVISION OF LEGAL SERVICES (BRUBAKER, REYES)
DIVISION OF WATER AND WASTEWATER (WALKER)

**RE:** DOCKET NO. 960235-WS - APPLICATION FOR TRANSFER OF CERTIFICATES NOS. 404-W AND 341-S IN ORANGE COUNTY FROM ECON UTILITIES CORPORATION TO WEDGEFIELD UTILITIES, INC.

DOCKET NO. 960283-WS - APPLICATION FOR AMENDMENT OF CERTIFICATES NOS. 404-W AND 341-S IN ORANGE COUNTY BY WEDGEFIELD UTILITIES, INC.
COUNTY: ORANGE

**AGENDA:** 07/21/98 - REGULAR AGENDA - POST HEARING DECISION - PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF

**CRITICAL DATES:** NONE

**SPECIAL INSTRUCTIONS:** NONE

**FILE NAME AND LOCATION:** S:\PSC\LEG\WP\960235.RCM

## CASE BACKGROUND

On February 27, 1996, Wedgefield Utilities, Inc. (Wedgefield or utility) filed an application with this Commission for the transfer of Certificates Nos. 404-W and 341-S from Econ Utilities Corporation (Econ) to Wedgefield. Wedgefield is a wholly-owned subsidiary of Utilities, Inc. Utilities, Inc. focuses on ownership and operation of small systems, and provides centralized management, accounting and financial assistance to small utilities that were commonly built by development companies. On March 5, 1996, Wedgefield filed an application for amendment of Certificates Nos. 404-W and 341-S to include additional territory in Orange County.

In Order No. PSC-96-1241-FOF-WS, issued October 7, 1996, this Commission, by final agency action, approved the transfer and granted the amendment of the certificates to include the additional territory requested. By that same Order, the Commission, by proposed agency action, established rate base for purposes of the transfer.

The Office of Public Counsel (OPC) timely protested the Order. Accordingly, by Order No. PSC-96-1533-PCO-WS, issued December 17, 1996, this matter was scheduled for an April 29, 1997 hearing in Orange County. By Order No. PSC-97-0070-PCO-WS, issued January 22, 1997, the matter was continued and the hearing rescheduled for August 19, 1997. By Order No. PSC-97-0953-PCO-WS, issued August 11, 1997, the hearing on the matter was again continued, and pursuant to Order No. PSC-97-1041-PCO-WS, issued September 2, 1997, the hearing on this matter was rescheduled for March 19, 1998.

The Prehearing Conference was held on August 4, 1997, in Tallahassee, Florida. At the conference, the parties and staff identified nine issues to be addressed at the formal hearing. Prehearing Order No. PSC-97-0952-PHO-WS, was issued August 11, 1997.

On February 17, 1998, the utility filed a motion to file supplemental prefiled testimony on behalf of utility witness Seidman. Order No. PSC-98-0392-PCO-WS, issued March 16, 1998, denied Wedgefield's motion, stating that the information contained in the proposed supplemental testimony would be appropriately discussed in the utility's post-hearing brief.

On March 19, 1998, the Commission held the technical hearing in Wedgefield, Florida. The hearing was continued and concluded on March 26, 1998, in Tallahassee, Florida. At the hearing, Wedgefield objected to the admission of Exhibit 4 into the record. (TR 106) The exhibit consisted of several letters written by local officials on behalf of their constituents. Wedgefield's objection was overruled and the letters were admitted. (TR 108-109) Official notice was taken of certain prior Commission Orders, on behalf of both Wedgefield and staff. (TR 109-111) Exhibit 8, consisting of letters related to a study performed by Orange County, were stipulated to by the parties and admitted into the record. (TR 116-117)

Wedgefield made an oral motion to strike certain portions from the prefiled testimony of OPC witness Larkin, arguing that the testimony called for the witness to reach conclusions beyond his expertise. (TR 119) Upon hearing the arguments of the parties and

comments from staff, the Commission denied Wedgefield's motion, stating that the utility's objection appeared to go more to the weight that the Commission would give to the testimony as opposed to its admissibility. (TR 121) Wedgefield also made an oral motion for reconsideration of Order No. PSC-98-0392-PCO-WS, which denied the utility's request to file supplemental prefiled testimony. (TR 121) After hearing the arguments of parties and staff's comments, the Commission found that the utility had not demonstrated any mistake of fact or law, and denied Wedgefield's motion for reconsideration. (TR 129-130)

Customer testimony was taken at the beginning of the technical hearing on March 19. Ms. Carolyn Crosby testified that customers generally support transferring the utility to Wedgefield Utilities subject to these conditions: rate base is equal to the purchase price and a new development, referred to as either the Commons or the Reserve, does not increase rates. (TR 14) Ms. Delma Deacon testified that the utility's rates exceed comparative rates for several local utilities. (TR 19-22) Ms. Deacon's rate study (EXH 2) confirms this rate disparity. Ms. Jacki Finley also testified that her bills were exceedingly large. (TR 23-31) Mr. Dennis Derotiak testified that any increase in rates should be shifted to the developer of the Reserve. (TR 38) Mr. Dan Dela Fuente presented several letters from public officials who opposed increased rates on behalf of their constituents and spoke in favor of the purchase price relative to retention of the seller's rate base value. (TR 40-44)

Ms. Vicki Bruno testified that water service to her home was interrupted from December 20 through December 22, 1997. (TR 87) She testified that she was told by utility personnel that the utility's pipes were brittle and shattering and should be fully replaced. (TR 87) In response, Utility Witness Seidman testified that the reported break occurred at a location where 10" and 6" mains intersect and several valves are found close to or under the pavement. (TR 364) He testified that shifting and settling may occur over time because of traffic patterns. He reported that the pipes didn't break but, instead, separated from the valves. A repair crew began work when the problem was discovered and, over a 48-hour period, completed the reconnection work. According to the utility, about 17 customers experienced a water outage and customers whose water pressure fell below 20 pounds per square inch were issued a boil water notice. (TR 364-365)

Mr. Lou Nathan, who recounted his previous experiences with this utility, testified that customers asked Orange County to examine this system for possible acquisition. (TR 53) According to

Mr. Nathan, the County found that acquiring this system was not economically feasible for various reasons. (TR 54) Mr. Nathan reported that the Department of Environmental Protection (DEP) informed the customers that the utility was meeting minimum standards with "very, very hard water." (TR 55) Mr. Nathan also testified that although he recognized that this proceeding was not a rate case, his principle concern was:

> [I]f, in fact, the Commission allows the Company to depreciate at a rate of 2.8 million and then use that as a basis of cost, there's no question in our minds that the Utility Company will the come forward and say that they are not making any money, and, therefore, they will initiate a rate case. That is our major, major concern.

(TR 61) Mr. Nathan asked the Commission to deny Wedgefield's requested rate base amount since the "the low purchase price . . . truly established the worth of the facility." (TR 76) He explained that he did not oppose the proposed transfer to Wedgefield (TR 77), but opposed the proposition that the acquiring company should stand in the seller's shoes with respect to rate base. (TR 79)

Pursuant to Rule 25-22.056(3)(a), Florida Administrative Code, each party shall file a post-hearing statement which shall include a summary of each position. On April 28, 1998, Wedgefield and OPC each filed their Statement of Issues and Positions and Post-Hearing Briefs.

This recommendation presents the staff analysis of the issues as testified to at the hearing on March 19 and 26, 1998.

## DISCUSSION OF ISSUES

**ISSUE A**: Should the proposed stipulations be approved?

**RECOMMENDATION**: Yes. (REYES)

**STAFF ANALYSIS**: In Prehearing Order No. PSC-97-0952-PHO-WS, issued August 11, 1997, all parties and staff agreed the following stipulations were reasonable. However, these proposed stipulations were not ruled on at hearing. Staff recommends that these now be approved by the Commission.

1. Wedgefield Utilities, Inc., paid cash of $545,000 for the utility's assets. In addition, it agreed to make contingent payments equal to every other service availability charge in the area known as The Commons if and when it is developed.

2. The applicant utility has not requested rate base inclusion of any acquisition adjustment.

Additionally, all parties and staff agreed to the exhibit entitled "Acquisition Feasibility Analysis of Econ Utilities Corporation," dated June 1995 and prepared under the control and supervision of Alan B. Ispass, Director, Orange County Utilities, being entered into the record without objection. Staff recommends that the Commission need not rule on this stipulation as the exhibit was offered as a stipulated exhibit and moved into the record without objection at the hearing. (TR 49)

**ISSUE B**: Should the Commission approve staff's specific recommendations on Wedgefield Utilities, Inc.'s proposed findings of fact and conclusions of law?

**RECOMMENDATION**: Yes. The Commission should approve staff's specific recommendations on Wedgefield Utilities, Inc.'s proposed findings of fact and conclusions of law as contained in Attachment A. (BRUBAKER, REYES)

**STAFF ANALYSIS**: The recommendations on the proposed findings of fact and conclusions of law are contained in Attachment A.

**ISSUE C**: Should the Citizens' objection to Late-Filed Exhibit No. 18 be sustained?

**RECOMMENDATION**: Because staff has decided to withdraw its request for Late-Filed Exhibit No. 18, the Commission need not rule on the Citizen's objection. (BRUBAKER, REYES)

**STAFF ANALYSIS**: During the hearing on this matter, staff requested that the utility provide as a late-filed exhibit "a per customer operating and maintenance expense analysis for Econ Utilities Corporation for the years 1992 through 1997." This exhibit was identified as Late-Filed Exhibit No. 18. By motion filed on April 14, 1998, OPC objected to this exhibit. In its objection, OPC argues that had the exhibit been offered at the hearing, OPC would have conducted extensive cross-examination concerning the contents of the exhibit.

In its response, filed April 17, 1998, Wedgefield argues that if OPC's objection to Late-Filed Exhibit 18 is sustained, that ruling would be inconsistent with the ruling by which Exhibit 4 was admitted into evidence over objection. Exhibit 4 consists of four letters written by public office holders on behalf of customers served by Econ. At the hearing, Wedgefield objected to the admission of the letters on the basis that they are hearsay. (TR 106-107) Wedgefield argues that if OPC's objection to Late-Filed Exhibit 18 is sustained, then Exhibit 4 should also be stricken from the record. As an alternative to either dismissing OPC's objection to Late-Filed Exhibit 18 or striking Exhibit 4 from evidence, Wedgefield suggests in its response that the Commission could reopen the record to allow OPC to conduct cross-examination with respect to Late-Filed Exhibit 18.

On April 23, 1998, OPC filed a response to Wedgefield's response to OPC's objection. OPC's response states that Exhibit 4 was admitted for non-hearsay purposes, while Late-Filed Exhibit 18 was offered for hearsay purposes (i.e. for the truth of the matters contained in the exhibit). OPC further contends that Wedgefield could have offered the information contained in Late-Filed Exhibit 18 through testimony at hearing, either through a witness of its own or as a cross-examination exhibit.

Upon review of the exhibit, staff has determined that the exhibit is unnecessary and, therefore, has decided to withdraw its request for the exhibit. Based on this withdrawal, staff does not believe it is necessary to address the merits of either OPC's or Wedgefield's arguments contained in their respective pleadings.

Accordingly, staff recommends that a ruling by the Commission on OPC's objection is unnecessary.

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

**RECOMMENDATION**: The utility's facilities were in fair condition and were not operating in violation of any Department of Environmental Protection standards. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: The assets were all functioning and not in violation of any state regulations. They were not in the best of condition, but were not in extremely poor condition, either.

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

**STAFF ANALYSIS**: In this case, the condition of the acquired assets is of special concern because it was presented as a rationale for rate base inclusion of an acquisition adjustment. OPC and some customers contend that the assets were so poorly maintained that the purchase price, not the seller's net book value, is the proper rate base amount. Mr. Jack Shreve, as Public Counsel, opened the meeting with these remarks: "If justification for the lower purchase price was it was run down and needs improvement, so be it." (TR 10)

In Order No. PSC-96-1241-FOF-WS, issued on October 7, 1996, the Commission approved the transfer of plant facilities to Wedgefield as a final agency action. That same order established a rate base balance as a proposed agency action. At the hearing in Orlando, Commission Deason explained that the sole issue during the hearing would be "an acquisition adjustment which is critical in the determination of the rate base of the entity to which the assets have been transferred." (TR 7)

Arguments in Briefs

In its brief, Wedgefield argues that erroneous allegations were made with respect to the condition of Econ's facilities. (BR 16) Wedgefield contends that statements from the Orange County Public Utilities Division (OCPUD) report were taken out of context and misapplied to a "stand-alone, privately owned system which operates under different regulatory requirements and a substantially different operating situation." (BR 17) Wedgefield alleges that Mr. Larkin, who is not a professional engineer and never visited the utility, is unable to evaluate this system.

Wedgefield further contends that Mr. Larkin's characterization of the condition of the utility is "second-hand, hearsay, and not convincing," and that such expressions of opinion are neither authoritative nor reliable. (BR 18)

In its brief, OPC argues that the utility's assets were in poor condition because Econ did not have a preventative maintenance program. (BR 6) OPC contends that this observation is meaningful since that refrain is repeated throughout the OCPUD report. (BR 7) According to OPC, the utility's repair expenses will increase as its facilities age, particularly those associated with maintaining asbestos cement lines. Thus, OPC contends that historical costs are not indicative of future costs. (BR 8)

Condition of Assets

As noted above, Wedgefield contends that the facilities were not in violation of any state regulations and, while not in the best of condition, neither were they in extremely poor condition. (BR 16) Conversely, OPC argues that the assets were in poor condition because of the lack of any preventative maintenance program by Econ Utilities. (BR 6) These were the positions adopted by Wedgefield and OPC in the pre-hearing order and their post-hearing briefs.

Utility Witness Wenz testified that this utility was in compliance with regulatory requirements and not in any immediate danger of falling out of compliance. (TR 173) Mr. Wenz testified that, based on his personal observations and discussions with other local company personnel:

> this appeared to be just a typical developer-owned system, whose attention was diverted to developing, and he didn't maintain this like a professional utility company would. There was some maintenance things that had to be taken care of.... Just your typical troubled developer-owned utility company. (TR 234)

During cross-examination, Mr. Wenz testified that Econ's facilities were not up to his company's standards in some respects. He explained that painting was needed as an aesthetic measure and to prevent corrosion, some lift stations needed to be reworked, and some pumps needed to be replaced. (TR 192) He agreed that the condition of the assets played some role in Wedgefield's purchase negotiations. (TR 192) He acknowledged that infiltration, the entry of groundwater into a wastewater system, was probably a problem, but he was uncertain whether the problem was excessive or

cost efficient to replace. (TR 192) However, he explained that looking for infiltration was a routine part of maintaining a sewer system. (TR 199-200)

During the initial two years that Wedgefield has operated this system, approximately $125,000 has been spent for plant facilities. (TR 202) This includes $29,000 to refit a master-lift station, replace blowers at the utility tanks and equipment, $25,000 to $8,000-$9,000 to repaint utility wastewater plant, $8,000 to replace a driveway at the wastewater plant, and $15,000 for engineering work for expansion of the wastewater plant. Also, about $38,000 was spent to replace lines improperly installed by the developer, which was offset by a $30,000 developer payment. (TR 397-398) By comparison, the gross plant value of the acquired plant facilities was $6,712,055 at December 31, 1995. (EXH 10) Thus, Staff believes that Wedgefield's recent additions to plant are not abnormal nor indicative of major problems.

According to OPC Witness Hugh Larkin, Econ was a functioning utility that was not in "dire need" of being taken over, although he testified that it was not properly maintained. (TR 272) Mr. Larkin never visited the utility to personally evaluate the plant facilities. Instead, he used documents produced by others to support his position. (TR 254) One such document, titled "Acquisition Feasibility Analysis of Econ Utilities Corporation," was prepared by the OCPUD in January of 1995. As noted above, the customers asked Orange County to evaluate this system for possible acquisition. Mr. Larkin testified that a "prevalent comment" in that report was that maintenance and repairs were only performed on an emergency basis since Econ did not have a preventative maintenance program. (TR 255)

In its report, the OCPUD stated that rehabilitation and improvement costs of $4,642,367 were anticipated for the water and wastewater systems. Estimated improvements to the water treatment facility totaled $489,555, while rehabilitation of the distribution system totaled $577,612 (EXH 5, Tables 3-2 and 3-3). Improvements to the water plant included installing a new well and pumping equipment, as well as softening and scrubbing equipment. The softener was replaced sometime in 1996. (TR 377) The major rehabilitation cost for the distribution system involved replacing asbestos-cement pipes that were installed between 1962 and 1970. (EXH 5, page 2-2) Projected improvements to the wastewater collection plant totaled $839,960, while rehabilitation of the collection system totaled $2,734,755 (EXH 5, Tables 3-7 and 3-8). Improvements for the wastewater treatment plant mostly involved projected expansion costs. But for the collection system, Orange

County concluded that all of the asbestos-cement pipes would need to be replaced, that lines should be moved from the rear to the front of houses, and that substantial and corresponding repaving costs would be incurred. (EXH 5, page 3-4)

Interconnection of this utility with Orlando's utility system was deemed impractical for various reasons. A significant concern was the cost of installing water and wastewater transmission lines to interconnect Econ's facilities with Orange County, which was estimated to be $6,096,035 (EXH 5, Table 3-5) for the water system and $5,084,288 (EXH 5, Table 3-10) for the wastewater system. Orange County's water and wastewater facilities are about 10 miles from Wedgefield. (TR 355)

Mr. Larkin noted that Econ's own engineer commented that asbestos-cement pipe would eventually need to be replaced. (TR 258) Staff notes, however, that the quoted portion of that draft report does not identify when replacement would be needed. Mr. Larkin also testified that Econ failed to adequately maintain its facilities: "(t)he obvious reason for the low purchase price in relationship to the net book value is that many of the assets will have to be replaced or repaired." (TR 266)

In rebuttal testimony, Utility Witness Seidman stated that Mr. Larkin's characterization of this utility was "second-hand opinion" presented to justify a negative acquisition adjustment. (TR 327) He testified that he inspected the utility's facilities prior to writing his testimony and just prior to the hearing in Orlando. He testified that Mr. Larkin's prefiled testimony led him to believe the system was in "shambles." Instead, he testified that the system was in relatively average condition for a small system. He testified that everything was "functioning", there were no violations, but there is maintenance which should be done. (TR 355) He testified that the OCPUD report indicated that severe corrosion was present at Econ's water and wastewater plants, but he further explained that visible corrosion has been corrected and other corrosion problems can and will be corrected through normal maintenance. (TR 357)

Mr. Seidman testified that this system operates under the environmental jurisdiction DEP and the Orange County Environmental Protection Department. He testified that those environmental agencies regularly inspect the utility and establish compliance standards, but OCPUD does not. He further testified that OCPUD has imposed standards on its own systems that may not be required or economically feasible for an independent utility in order for it to provide safe, efficient and sufficient service. (TR 328-329)

Mr. Seidman testified that the OCPUD report concluded that Econ's water supply, treatment, and distribution systems were basically in good condition, but that there were problems with the wastewater system. He said while OCPUD's report did not find that the plant was malfunctioning, the report indicated that there was an indication of significant inflow and infiltration problems. (TR 355-356) However, he explained:

> That in itself is not some type of -- something that puts a system in poor condition. We know that the pipes in this system are old. There's indication that a portion of them are asbestos cement pipe, which represents about 20% of the pipe that's in the ground now. That was the standard at the time they were put in. There's not much you can do with them except take them out. That is not feasible for a system this size. (TR 356)

Mr. Seidman testified that OCPUD's report suggests that $3.3 million of its estimated $4.6 million capital improvement cost is needed to relocate mains from rear lot to front lot lines, to replace asbestos lines, or to replace "old" cast iron pipes. He testified that: "(t)here is no requirement on a privately owned utility to engage in such a massive replacement program, nor is Orange County or the DEP requiring the utility to do so." (TR 329-330) Instead, he said that OCPUD evaluated this system under the assumption that it would be integrated into the county's water and wastewater system. He explained:

> The analysis then details some $4.6 million in "costs" allegedly needed to bring the system up to County "standards." There is an inference that this amount of money must be spent because the utility system is "substandard." That is an incorrect inference and it is misleading. (TR 328)

Mr. Seidman testified that statements from the OCPUD report that maintenance was only performed on an "emergency basis" were conjectures that were not otherwise explained or substantiated in that report. Instead, he testified that he believed that maintenance may be performed on an "as-needed" basis without every instance being an emergency. As Econ incurred cumulative net operating losses of $2 million and net income losses of $4 million from 1988 to 1995, Mr. Seidman said he would not be surprised that a preventative maintenance program was not in place. However, he testified that Wedgefield can actively pursue a capital improvement program and finance capital additions, which is the intended

benefit of the Commission's acquisition adjustment policy. (TR 331-332, 387-388)

Summary

Based upon the evidence in the record, staff recommends that the Commission should find that the acquired assets were in fair condition, not in the best condition nor extremely poor condition. As stated earlier, Mr. Wenz testified that the facilities are in compliance with regulatory requirements and were not operating in violation of any DEP standards. (TR 173) Any significant problems which may exist relate to the use of asbestos-cement pipes for distribution and collection lines, a not uncommon practice when those lines were installed. (TR 379) While replacement of these lines will eventually be necessary (TR 333), immediate replacement is not economically feasible. We believe the record shows that the acquired assets were relatively "typical" for a developer-owned system. For this reason, we recommend that the Commission should find that the utility's facilities were in fair condition, were typical of other utilities, and were not extraordinary in nature.

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

**RECOMMENDATION**: The record indicates that Econ was a functioning utility but was economically troubled. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: Yes. It was financially troubled, having sustained cumulative net losses in excess of $4 million over the most recent eight year period and lacked either the means or commitment to invest in future capital needs or future maintenance.

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

**STAFF ANALYSIS**:

Arguments in Briefs

In its brief, Wedgefield argues that Econ was a troubled utility, but different from Econ, Wedgefield has the financial ability and capacity to commit funds to operation of this utility. (BR 36) Wedgefield contends that if OPC's witness admitted that this system was troubled, that would support the applicability of the Commission's policy of excluding the acquisition adjustment. (BR 37)

In its brief, OPC contends that while Econ was able to meet environmental standards, it did not have a formal preventative maintenance program, only doing what was necessary to facilitate housing development. Nonetheless, OPC contends that Econ was not a troubled utility. (BR 11)

Background

The term "troubled" is discussed in the Commission's statement about the incentive that acquiring companies may realize when small systems are purchased. As a general policy, absent extraordinary circumstances, it has been Commission policy that a subsequent purchase of a utility system at a premium or a discount shall not affect the rate base balance. As stated in Order No. 23376, issued August 21, 1990, the purpose of this policy is to create an incentive for larger utilities to acquire small, "troubled" systems.

In its brief, OPC contends that Econ was not a "troubled" utility since it was able to meet standards by providing maintenance on an emergency basis. In contrast, Wedgefield argues that Econ was financially troubled, having sustained cumulative net losses in excess of $4 million over the most recent eight-year period and that it lacked either the means or commitment to invest in future capital needs or future maintenance. These were the positions adopted by Wedgefield and OPC in the pre-hearing order and their post-hearing briefs.

Utility Witness Seidman testified that he was amused by Mr. Larkin's apparent inability to conclude that Econ was a "troubled utility." He testified:

> I find that conclusion amusing. He used a substantial part of his testimony to imply that this utility was like a car about to lose its wheels, that the expense to just keep it running would be enormous, and that the previous owner did practically nothing to maintain it. Then, when it comes to determining whether the utility is troubled, he turns to the PSC staff Engineers' report which says, well it's not so bad, it needs some improvements, but there is no problem with the water, and the wastewater plant is fine. (TR 341)

Mr. Seidman stated that Mr. Larkin balked at concluding that the utility was "troubled" because he "knows the purpose of the Commission's acquisition policy is to give large utilities an incentive to purchase small, 'troubled' utilities." (TR 342)

Mr. Wenz testified that the previous owner confided that: "although he wanted to continue to develop property, he was no longer interested in operating a utility or committing funds to it." In contrast, Mr. Wenz testified that Wedgefield's parent company only operates utility systems. With this affiliation, Wedgefield will be able to attract capital at a reasonable cost and benefit from economies of scale through sharing common vendor and management resources. (TR 170-172) He testified that his company is probably the largest active company acquiring troubled water and wastewater systems in Florida and that it relied upon this Commission's acquisition adjustment policy to bargain for and purchase these systems. (TR 176)

Recommendation

In Issue 1, concerning the condition of the utility's assets, OPC argued in its brief that Econ's assets were poorly maintained.

(BR 6) In its feasibility study, Orange County reported that repairs were performed on an emergency basis and that there was no regular preventative maintenance program. (EXH 5) Mr. Wenz testified that the prior owner was not interested in operating a utility or committing funds to it. (TR 170) Utility Witness Seidman testified that Econ incurred operating losses of over $2 million in operating income and $4 million in net income from 1988 through 1995. (TR 332) Staff believes these conditions are characteristic of a "troubled" utility. The record indicates that Econ was not in a position to increase its maintenance costs, to actively pursue a capital improvement program, or to finance capital additions. (TR 332) Conversely, Wedgefield appears able to assume these obligations. (TR 170-171) Based on the foregoing, the evidence in the record indicates that although Econ was a functioning utility, it was economically "troubled." Accordingly, staff recommends that the Commission find that Econ was a "troubled" system.

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

**RECOMMENDATION**: There are no extraordinary circumstances in this case that warrant rate base inclusion of an acquisition adjustment. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: No. There are no extraordinary circumstances, and there should be no acquisition adjustment.

**PUBLIC COUNSEL**: 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.

**STAFF ANALYSIS**: The Commission has considered the issue about extraordinary circumstances in its policy decisions in numerous cases. Basically, the Commission has found that, in the absence of extraordinary circumstances, a subsequent purchase of a utility system at a premium or discount shall not affect the rate base calculation. An acquisition adjustment results when the purchase price differs from the seller's net book value.

Arguments in Briefs

Wedgefield contends that rate base inclusion of an acquisition adjustment is not appropriate since there are no extraordinary circumstances in this case. (BR 17) It argues that OPC misunderstands Order No. PSC-96-1241-FOF-WS if it believes this issue only depends upon used and useful measures. Instead, Wedgefield argues that a used and useful adjustment "temporarily" removes the disputed balance in a rate proceeding, whereas inclusion of the acquisition adjustment "permanently" reduces the original cost balance. (BR 40) Wedgefield submits that it presented a late-filed exhibit (EXH 18) which shows that the utility's operating expenses were reduced after its acquisition by Wedgefield. (BR 42) However, that document was not admitted into evidence.

In its brief, OPC argues that, first, the disparity between the purchase price and the seller's net book value and, second, the absence of preventative maintenance are just reasons for rate base inclusion of the negative acquisition adjustment. (BR 13)

Disputed Issues

OPC Witness Larkin testified that extraordinary circumstances are present in this case. First, he testified that Wedgefield's cash payment for Econ's assets was $545,000, whereas Econ's rate base at December 31, 1995, was $2,845,391. Additional payments to Econ are expected if development of the Reserve or Commons proceeds. (TR 250) Mr. Larkin testified that Econ's assets were only worth $545,000 because of "the condition of the assets and the amount of improvements necessary to bring the assets to an acceptable condition." (TR 254) Mr. Larkin testified that the extraordinary circumstances for this case were:

> Wedgefield was able to purchase this utility for approximately 20 cents on the dollar. And if an acquisition adjustment is not recognized, that these ratepayers will be asked to pay a rate of return on whatever portion of that 2.8 million is eventually used and useful. And our feeling is it's probably pretty high now. Plus, whatever repairs and maintenance expenses are necessary to bring this up -- this utility up to a standard that would be acceptable for the consumption of the customers. (TR 272-273, 285)

However, Mr. Larkin acknowledged under cross-examination that, absent this sale, Econ would have been allowed to earn a return on its net original cost, plus depreciation, subject to used and useful adjustments. (TR 277) Also, Mr. Larkin stated that he would not be troubled by the sale if Wedgefield had paid $2.8 million to acquire Econ's assets if that was an arm's length transaction. (TR 285-286)

Mr. Larkin prepared two schedules that illustrate relative income requirements under two investment alternatives: the purchase price before future payments, or $545,000, and the seller's net investment at December 31, 1995, or $2,845,391. He first calculated that allowing a 12.95% pre-tax return on the seller's investment would yield a 67.61% return on the purchase price. (EXH 16, Schedule 1). Second, he calculated that allowing a 6% return on a $2,800,000 investment would yield a 30.83% return on $545,000. (EXH 16, Schedule 2)

Staff believes that these calculations only show that the acquiring company may realize an enhanced return on its investment that exactly corresponds to the price differential: the larger the price difference, the larger the expected return. However, when used-and-useful measures are considered, the income differential is

accordingly reduced. (TR 283) Further, Mr. Larkin's equations do not show that Wedgefield's revenues would exceed Econ's comparative revenues. If operating expenses are reduced, the assumed expansion of earnings may be offset by a reduction in expenses. If cost of capital charges are reduced, other savings may result. (TR 171)

Utility Witness Seidman testified that he believed the price difference was the only condition that Mr. Larkin characterized as extraordinary. He argued that using this argument to justify inclusion of the acquisition adjustment was an exercise in circular reasoning. Instead, according to Mr. Seidman, the price difference is the incentive that the acquiring company obtains for buying the utility. (TR 361-362) On an overall basis, Mr. Seidman said the Commission should examine its policy from two perspectives: first, that Mr. Larkin's arguments have all been made before and rejected in a generic proceeding, and second, that the acquiring company relied upon the Commission's policy to bargain for and purchase this system. (TR 353)

Review of Other Cases with Negative Acquisition Adjustments

In its brief, Wedgefield asked the Commission to consider the results of a study conducted by Wedgefield's consultants of 99 different cases that addressed acquisition adjustments from 1988 through 1997. (BR 49) According to Wedgefield, that period was selected to coincide with expression of the Commission's policy in the generic docket. According to Wedgefield, these orders address 31 cases that involve negative adjustments, 33 cases that involve positive adjustments, and 35 cases that seem to implicitly describe positive acquisition adjustments. Wedgefield reported that of the 31 cases that involved negative adjustments, only three orders approved rate base inclusion of the negative balance. In 12 other cases, according to Wedgefield, the order merely reiterated the policy statement that acquisition adjustments will only be included under extraordinary circumstances. Wedgefield then summarized the 16 cases where this topic was more fully addressed and the 3 cases that approved inclusion of the negative adjustment. Wedgefield's analysis of those issues is discussed in Attachment "A" to its brief. (BR, "A")

Staff also reviewed previous Commission decisions regarding rate base inclusion of negative acquisition adjustments. We have selected some of these cases because they address material differences under percentage or dollar-wise considerations. Other cases are selected because relevant issues are discussed. We believe these cases provide a general framework for consideration of this issue.

By Order No. 14364, issued May 14, 1985, in Docket No 840157-WS, the Commission reviewed the purchase of Park Manor, a water and wastewater system, by Southern States Utilities, Inc. (SSUI). Original cost rate base values of $7,363 for water and $13,553 for wastewater were established at the transfer date, while SSUI's purchase price was $100 for each system. The Commission stated that its policy was to retain the seller's net plant investment unless circumstances indicated that the purchase was imprudent. The Commission held that SSUI demonstrated that the water system was a prudent purchase and approved retention of that system's net plant balance. However, the Commission found that SSUI failed to demonstrate that the wastewater system was a prudent purchase, and the $100 purchase price was used instead. The Commission found that the wastewater system only served 22 customers, could not be interconnected to a neighboring wastewater system, had limited growth potential, and that its operating costs were greater than other systems owned by SSUI. To compare cases, Wedgefield's purchase in this case involves about 700 customers (TR 398); modest growth is projected (TR 398); but there are no comparable interconnection issues or cost comparisons.

By Order No 20707, issued February 6, 1989, in Docket No. 880907-WU, the Commission reviewed the purchase of Utility Systems, Inc., by Sunshine Utilities. The purchase price was $5,000 for a system with a net book value of $13,236. The Commission stated that its policy, absent extraordinary circumstances, was to exclude the acquisition adjustment. That order stated that in some cases the Commission has examined whether the acquired assets were in such poor condition that replacement was needed, what comparative customer growth and operating costs revealed, and whether the purchase was prudent. In that case, the Commission stated that Sunshine Utilities did not request inclusion of an acquisition adjustment and no extraordinary conditions were found. Comparing cases, Wedgefield is also not requesting an acquisition adjustment. Although growth is slow, Wedgefield is expanding. (TR 398) An added concern in this case is when the utility's distribution and collection lines and mains will be replaced. Mr. Seidman testified that while Orange County's feasibility study indicated that substantial sums would be needed to replace lines, there is no requirement for a privately owned utility to engage in such a massive replacement program. (TR 329) He testified that the utility's collection and distribution lines and mains will probably be replaced when their useful lives are concluded. (TR 333) With respect to its operating expenses, Wedgefield should benefit from economies of scale through sharing common vendor and management resources with other systems owned by Utilities, Inc. (TR 170-172)

By Order No. 23970, issued January 1, 1991, in Docket No. 900408-WS, the Commission considered the transfer of facilities from Springside, Inc., to Springside at Manatee, Ltd. The estimated purchase price was $26,355 for water and wastewater facilities with a net book value of $228,805. The Commission concluded that a large negative acquisition adjustment resulted from that transfer but allowed retention of the seller's net plant balance. In Docket No. 900408-WS, the acquisition cost was about 11.5% of the net book value, but that condition alone was not considered an extraordinary circumstance. In Wedgefield's case, the purchase price (excluding future payments) is about 20% of net book value. (TR 272) If future payments are considered, when they mature, Wedgefield's purchase price will approach $1,000,000, or about 35% of Econ's net book value. (See Issue 4)

By Order No. 25584, issued January 8, 1992, in Docket No. 910672-WS, the Commission reviewed the transfer of facilities from Hideaway Service, Inc., to FIMC Hideaway, Inc. This system was obtained in a foreclosure case. The assigned purchase price was $60,794 for plant facilities with a net book value of $150,457. The consequent negative acquisition adjustment was not included in rate base as no extraordinary conditions were found. Instead, the Commission found that the previous owner did not properly maintain the utility and that the acquiring company had spent and would spend considerable sums of money to bring the systems into compliance with regulatory requirements. Despite that finding, the Commission did not find evidence of extraordinary circumstances.

By Order No. PSC-93-0011-FOF-WS, issued on January 5, 1993, in Docket No. 920397-WS, the Commission reviewed a system with a net book value of $490,498 that was purchased by CGD Corporation for about $175,361. This matter was reviewed in a staff assisted rate case. This case was unusually complicated and involved numerous intercompany and family transactions and resulted in certain nontaxable exchange conditions. In that case, the Commission found that the transfer involved both related-party transactions and nontaxable exchanges, which justified rate base inclusion of the resulting acquisition adjustment. Comparing cases, Wedgefield's acquisition of this utility was reportedly an arm's-length transaction and a taxable exchange. (TR 403)

By Order No. PSC-93-1675-FOF-WS, issued November 18, 1993, in Docket No. 920148-WS, the Commission reviewed a rate application filed by Jasmine Lakes Utilities Corporation (Jasmine). In that proceeding, the Commission considered opposing arguments concerning inclusion of a $17,753 negative acquisition argument. Jasmine argued that the Commission had previously approved its acquisition

of that system by Order No. 23728, issued November 7, 1990, in Docket No. 900291-WS, without the acquisition adjustment. OPC intervened in Docket No. 920148-WS, and presented evidence that the utility was in poor condition before its purchase, was not properly maintained, and had been neglected by the previous owner. Upon review, the Commission concluded that it would be unfair and unjust for Jasmine to receive a return on the acquisition adjustment. The Commission based its decision on customer testimony, repairs and improvements needed at the transfer date, and lack of responsibility by previous managers. The Commission, however, noted that when the system was transferred, more than 80% of its water was being purchased from Pasco County. Comparing cases, there are similar allegations of improper maintenance in both cases, but the option of purchasing water from another utility is not available to Wedgefield.

By Order No. PSC-94-1602-FOF-WS, issued December 27, 1994, in Docket No. 930570-WS, the Commission considered the transfer of facilities from Lake Placid Utilities to Lake Placid Utilities, Inc (LPUI). This system was purchased out of bankruptcy in an arm's-length transaction that was approved by the Court. The purchase price was $55,000 and the net book value was $83,424. LPUI, which is another subsidiary of Utilities, Inc., argued that rate base inclusion of the negative acquisition adjustment would be inconsistent with a policy that encourages acquisition of small, poorly-run systems by larger, more professional utilities. Further, LPUI noted that its parent company has purchased systems at a premium without a concomitant positive acquisition adjustment. Upon review, the Commission concluded that the negative acquisition adjustment should not be included in rate base.

By Order No. PSC-95-0189-FOF-WU, issued February 9, 1995, in Docket No. 931122-WU, the Commission reviewed the transfer of Lakeside Golf, Inc., to Southern States Utilities, Inc. (SSUI). The purchase price was $119,625 and the net book value was $304,521. SSUI stated that its purchased price was derived based upon the used-and-useful condition of the acquired utility. SSUI further argued that reducing rate base first through an acquisition adjustment and later through used-and-useful factors would be double counting. Upon review, the Commission concluded that rate base should not be reduced by the acquisition adjustment since the acquired company did not have any major service problems and customers would enjoy reduced rates with SSUI. In this docket, Mr. Wenz also testified that reducing the purchase price by used-and-useful adjustments would be punitive. (TR 222)

By Order No. PSC-95-0268-FOF-WS, issued February 28, 1995, in Docket No. 940091-WS, the Commission reviewed the transfer of Lake Utilities, Ltd., to SSUI. The purchase price was $372,828 and the net book value was $436,708. SSUI again stated that its purchase price depended on used-and-useful principles. Upon review, the Commission concluded that there were no extraordinary circumstances to warrant rate base inclusion of the negative acquisition adjustment in that case.

By Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, the Commission considered contrasting positions regarding rate base inclusion of negative acquisition adjustments for two systems purchased by companies associated with SSUI - the Lehigh (LUI) purchase and the Deltona purchase. At the hearing in this case, Wedgefield's counsel asked Mr. Larkin to refer to his testimony in Docket No. 950495-WS wherein he argued that Lehigh's assets were purchased at a 60% discount and that there should be a consequent $3,873,373 negative acquisition adjustment applied to SSUI's investment. Reviewing that issue, the Commission stated that: "(e)ven a possible showing that LUI's assets were purchased at 45% of book value does not demonstrate that extraordinary conditions exist, or that we erred in not recognizing extraordinary circumstances in our prior decisions." However, the Commission further stated that since the Lehigh and Deltona transactions were sales of stock, rather than assets, acquisition adjustments would not apply anyway.

Staff Recommendation

Staff recommends that there are no extraordinary circumstances that warrant rate base inclusion of an acquisition adjustment in this case. As discussed in Issue 1, we believe the acquired assets were in fair condition, neither extremely good nor extremely bad. Some water and wastewater lines were installed using asbestos-cement pipes, but there are no immediate plans to replace those facilities. (TR 378-379) Instead, the record shows that the estimated cost just to replace those lines would exceed the net book value of all of the utility's existing facilities. (TR 392)

We do not believe that the acquisition adjustment issue should depend upon the magnitude of the price differential. In other cases, the Commission has encountered larger price and percentage differences while approving retention of the seller's net book value. (TR 362) Based upon certain underlying assumptions, including a 100% used-and-useful finding, Mr. Larkin calculated that Wedgefield would realize a 67.71% pretax return on its initial $545,000 investment. However, used-and-useful adjustments, if any,

will reduce Wedgefield's income requirement. (TR 283) Further, any savings due to reduced expenses and cost of capital features are ignored in Mr. Larkin's model.

Interconnection with Orlando's utility system was deemed impractical for various reasons, including significant costs to replace Econ's asbestos-cement lines and even larger expenditures to install transmission lines between Econ and Orlando's service areas. (EXH 5) In other respects, Mr. Seidman testified that the OCPUD report indicated that severe corrosion was present at Econ's water and wastewater plants, but he explained that visible corrosion has already been corrected and other corrosion problems would be corrected through normal maintenance. (TR 357)

The Commission reviewed its policy concerning acquisition adjustments in Docket No. 891309-WS. In Order No. 25729, issued February 17, 1992, the Commission acknowledged that the buyer not only earns a return on the acquired utility's rate base but also depreciation on that balance. The Commission concluded that without these benefits, "large utilities would have no incentive to look for and acquire small, troubled systems." In the generic case, the Commission concluded that, absent extraordinary circumstances, the seller's net book value should be retained. We do not believe that extraordinary conditions have been shown in this case.

Accordingly, for these reasons we recommend that there are no extraordinary circumstances in this proceeding that warrant rate base inclusion of an acquisition adjustment.

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

**RECOMMENDATION**: From an accounting perspective, the contingent payments should be recognized when the contingent payments are made. For ratemaking purposes, the contingent payment issue is meaningful only if the purchase price is approved as the rate base balance. If the seller's net plant balance is approved as the rate base balance, that calculation is not affected by the contingent payment issue. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: It has no effect on rate base.

**PUBLIC COUNSEL**: 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 know as the Commons. If provision of service to this area increases the cost to provide water or wastewater service to existing customers, the contingent payments should not be recognized.

**STAFF ANALYSIS**: OPC argues that the purchase price for Econ's facilities is the proper rate base amount and that future payments should only be recognized when paid. On the other hand, Wedgefield argues that Econ's net book value is the proper rate base amount, which is not affected by future payments. (BR 44)

Arguments in Briefs

In its brief, Wedgefield argues that there is no relationship between its payment of the contingent liability and Econ's rate base value and, thus, this topic is irrelevant. (BR 44) In its brief, OPC argues that the contingent payments should only be recognized when actually paid, and only if those payments do not collaterally increase the cost of service for existing customers. (BR 13)

Basis for Contingent Payments

By the terms of the purchase agreement, dated January 17, 1996, Econ agreed to sell its water and wastewater facilities to Wedgefield's parent company for an immediate $545,000 cash payment plus future payments based on expected development of the Commons.

The agreement reflects that the added consideration will be 50% of the expected connection fees for the Commons. (EXH 11, Purchase Agreement, p. 6) 400 housing units were originally planned for the Commons. At the hearing, Mr. Wenz testified that he believed the expected hookups had been reduced to 328. (TR 229) Under either condition, using the present $3,000 per unit connection fee, these future payments will increase Wedgefield's overall purchase price. In Order No. PSC-96-1241-FOF-WS, issued October 7, 1996, Econ's per book investment of $2,845,391 was compared with Wedgefield's projected total investment ($545,000 plus $600,000) to disclose an excluded acquisition adjustment of $1,700,391. Using updated information, Wedgefield's projected investment will be about $1,037,000 ($545,000 plus $492,000) and the acquisition adjustment will be $1,808,391. However, from a policy perspective, derivation of the acquisition adjustment balance is largely a balancing measure since the real issue is its inclusion or exclusion.

In its brief, Wedgefield comments that this issue is not relevant since it does not affect Econ's historical investment in plant facilities. OPC and its witness, Mr. Larkin, advocate recognition of the additional payments only after those payments are made. Then, their proposed accounting treatment for the additional payments would be a credit entry to Contributions-in-Aid-of-Construction (CIAC) offset by an equivalent debit entry to the acquisition adjustment account. (TR 251) Staff agrees that this method properly reflects the gradual nature of the contingent payments. At hearing, Mr. Wenz testified that Wedgefield will fully account for any CIAC due from development of the Commons and recognize a contingent liability to Econ to reflect any subsequent payments, which is consistent with the accounting treatment proffered by OPC. (TR 224)

Over time, Wedgefield's purchase price will likely increase, thereby changing and reducing the negative acquisition adjustment. However, Order No. PSC-96-1241-FOF-WS did not explain that this change would be gradual. Instead, that order focused on a full accounting for future CIAC balances to preclude any understatement of CIAC due to retention of connection fees by the seller. That comparison in that order produced a price differential based upon Wedgefield's prospective investment, not the current amount. If Wedgefield's purchase price is approved as the rate base amount, then Mr. Larkin's proposal to initially eliminate future payments is proper and should be approved.

As an alternative, Mr. Larkin proposed waiting until the cost of serving the Commons is known to evaluate whether the additional payments should be charged to the acquisition adjustment. (TR 251)

Since that option involves uncertainty regarding future cost efficiencies, staff recommends that Mr. Larkin's alternative proposal should not be adopted at this time.

According to the purchase agreement, all distribution and collection facilities within the Commons will be contributed to Wedgefield. (TR 223) Further, a $3,000 cash connection fee is currently required for new customers. Those factors are further addressed in a Memorandum to the Closing Agreement (paragraph 6):

> Seller . . . agrees to design and install the water and sewer facilities (lines, mains, pumps and related facilities) in The Commons and agrees to contribute those facilities to the Purchaser's utility as a contribution-in-aid-of-construction (CIAC); provided, however, Seller shall not be required to make such contribution and Purchaser shall pay for the design and installation of the water and sewer facilities if Seller's contribution would cause a reduction in the hook-up fee below $3,000 per lot. (EXH 11, Memorandum of Closing Agreements, p.3)

Staff Summary

As noted above, Wedgefield contends that Econ's net book value should be the rate base amount, which does not depend upon subsequent payments to Econ. Conversely, OPC advocates use of the purchase price for future ratemaking purposes. It appears that both parties agree as to the proper accounting treatment for the contingent payments; the disagreement arises from different perspectives relative to retention of the seller's net book value versus the purchase price. While staff supports retention of the original cost balance as the rate base amount, we agree with OPC's position that the contingent portion of the purchase price should only be recognized when the actual payments are made. However, for ratemaking purposes, the contingent payment element is an issue only if the purchase price is approved as the rate base balance. If the seller's net plant balance is approved as the rate base balance, that calculation is not affected by any contingent payment issues.

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

**RECOMMENDATION**: The respective net book values for the water and wastewater systems were $1,462,487 and $1,382,904 at December 31, 1995. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: As of the date of the transfer, the net book values for the water and wastewater systems are $1,462,487 and $1,382,904, respectively.

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

**STAFF ANALYSIS**:

Arguments in Briefs

In its brief, Wedgefield explains that there is no dispute regarding the net book value of the acquire assets, which was $1,462,487 for the water system and $1,392,904 for the wastewater system. (BR 45) In its brief, OPC concurs that the original cost balance was about $2,845,394 for the combined water and wastewater systems. (BR 14)

Audit Examination

The accounting records for Econ Utilities were reviewed by Ms. Kathy Welch, for the calendar year ended December 31, 1995. Ms. Welch is the Regulatory Analyst Supervisor for the Commission's Miami District Office. Based upon her inspection and her reliance on previous audits, Ms. Welch concluded that the original cost value for the acquired facilities was $1,462,487 for the water system and $1,382,904 for the wastewater system. (TR 133-135) Ms. Welch testified that she examined Econ's books but did not inspect its facilities, and was uncertain whether an engineer from Tallahassee may have visited the utility. (TR 138) However, she stated that she was not expressing an opinion on whether rate base inclusion of an acquisition adjustment was proper. (TR 140)

Utility Witness Wenz testified that the rate base balances calculated in staff's audit correctly reflect the original cost of plant in service, net of accumulated depreciation and unamortized CIAC, at the time of transfer. (TR 167) OPC Witness Larkin

testified that he was not taking exception to the audit report, which showed a net book value of $2,845,391 for the combined systems. (TR 250, 275)

Therefore, since the audit conclusions are not disputed, staff recommends that the net book values for the acquired water and wastewater systems, at December 31, 1995, were $1,462,487 and $1,382,904, respectively.

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

**RECOMMENDATION**: Rate base inclusion of the negative acquisition adjustment is not appropriate. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: No. A negative acquisition adjustment is neither appropriate nor authorized in this case.

**PUBLIC COUNSEL**: 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.

**STAFF ANALYSIS**:

Arguments in Briefs

In its brief, Wedgefield argues that rate base inclusion of a negative acquisition adjustment rests with the party requesting such treatment, which in this case is OPC. (BR 45) In its brief, OPC argues that a $2,300,394 negative acquisition adjustment, or Econ's net book balance of $2,845,394 less the $545,000 cash purchase price, should be included in rate base. (BR 14)

Acquisition Adjustment Policy

On November 17, 1989, OPC asked the Commission to initiate rulemaking or, alternatively, to investigate its policy regarding acquisition adjustments. Since at least 1983, the Commission has consistently held that the rate base calculation should not include an acquisition adjustment absent evidence of extraordinary circumstances. The Commission reviewed this issue in Docket No. 891309-WS. By Order No. 22361, issued January 2, 1990, the Commission rejected OPC's petition to initiate rulemaking but granted its request to investigate this topic. Thereafter, the Commission invited interested parties to submit written comments and conducted workshops to discuss this subject. By Order No. 23376, issued August 21, 1990, as a proposed agency action, the Commission concluded that it would not be appropriate to amend its policy respecting acquisition adjustments. In that order, the Commission stated that: "[n]ot only might OPC's proposed change not

benefit the customers of troubled utilities, it might actually be detrimental, by removing any incentive for larger utility companies to acquire distressed systems." On September 11, 1990, OPC filed a protest to Order No. 23376.

Thereafter, pursuant to Section 120.57(2), Florida Statutes, the Commission invited all interested parties to appear and be heard during an oral presentation on July 29, 1991. During this hearing, OPC argued that by failing to impose a negative acquisition adjustment on the buyer, the Commission was creating a "mythical" investment that exceeded the buyer's actual commitment of capital. OPC further argued that the Commission did not have the statutory authority to give the buyer the rate base of the seller. Conversely, utility companies argued that the Commission has broad authority to interpret its statutory authority in a manner which best serves the long-term interests of the ratepayers.

Reviewing its acquisition adjustment policy in Docket No. 891309-WS, the Commission heard contrasting positions regarding use of the purchase price or the seller's rate base for subsequent rate case proceedings. In Order No. 25729, issued on February 17, 1992, the Commission concluded its investigation and confirmed its acquisition adjustment policy. In that Order, the Commission stated:

> 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 general disinterest in utility operations in the case of developer owned systems.

Exchange Regarding Assumption of Benefits and Burdens

During the hearing, Commissioner Clark asked Mr. Wenz whether Wedgefield should assume some of the burdens as well as some of the benefits of "stepping in the shoes" of the former company. If the former company failed to properly maintain its system, did Wedgefield assume responsibility for that oversight? Mr. Wenz indicated that if Wedgefield incurred costs to correct infiltration problems, Wedgefield would expect to recover those costs even if those problems were due to the previous owner's neglect of maintenance. However, Mr. Wenz responded that Wedgefield would not expect full recovery of similar costs if it had always owned the system and failed to maintain its lines. Asked to explain the seeming incongruity of those positions, Mr. Wenz stated that Econ had $7 million in accumulated operating losses on its books and, therefore, insufficient funds to maintain its system better. Further, Wedgefield as the acquirer of a troubled utility system, would expect to recover its costs and not be held responsible for the previous owner's omissions. Asked whether the previous owner's failure to properly maintain the system would qualify as an extraordinary circumstance, Mr. Wenz stated that it "hasn't been historically." (TR 214-219)

Mr. Larkin addressed this subject during his opening remarks. He suggested that the Commission should use the actual purchase price and avoid subsequent sorting out of what was paid to correct this or that problem. If the Commission uses the purchase price, "we've got a number we can deal with. We won't have to deal with in the future about what may or may not be disallowed. Let them recover everything in the future that they pay to bring it up to snuff." (TR 274) Staff believes that Mr. Larkin's proposal goes to the heart of the many concerns that have been expressed over time about the Commission's policy. However, it effectively removes the incentive factor for Wedgefield.

Mr. Seidman also addressed the issue concerning the acquiring company's responsibility for problems caused by the seller. He stated that he believed Mr. Wenz was probably too careful in his remarks, and that some intermediate position was needed. He testified that when the Commission makes a negative acquisition adjustment, the buyer is held responsible since everything is written off, whether the impact is large or small: "(t)here's no

incentive to me under that type of arrangement for anybody to make a purchase." If the negative acquisition adjustment is not made, "the purchaser gets the incentive, but the door is still left open" in a rate case to evaluate whether improvements are needed to compensate for prior neglect. Since the Commission can review the problem in the future, the purchaser is protected because it has an opportunity to address those concerns at that time. He explained:

> You know there may be an adjustment appropriate in one particular account and not in another, instead of across the board and it's gone forever. To me that's fair. I've talked to Mr. Wenz, and he has no problem with that type of approach. (TR 369-370)

Recommendation

As noted in Issue 3, staff does not believe any extraordinary circumstances have been shown in this case. Further, staff does not believe that the price differential, alone, constitutes an extraordinary circumstance. Therefore, in accordance with Commission policy, a negative acquisition adjustment should not be imposed in this proceeding. Rather, staff believes the incentive provided through the Commission's policy should be made available to Wedgefield. For the reasons discussed above, staff recommends that a negative acquisition adjustment should not be included in Wedgefield's rate base balance.

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

**RECOMMENDATION**: The rate base amount should match the net book values of the acquired assets. (WALKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: The rate base amount should match the net book values of the acquired assets. Wedgefield accepts the results of the Staff Audit that the rate base for the purposes of this transfer is $1,462,487 and $1,382,904, for the water and wastewater systems, respectively.

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

**STAFF ANALYSIS**:

Arguments in Briefs

In its brief, Wedgefield argues that, pursuant to Section 367.081, Florida Statutes, the Commission must establish rates using the original cost of the company who dedicated that property to public service. (BR 45) In its brief, OPC argues that because of neglect by the previous owner, the $545,000 purchase price is the proper rate base amount. (BR 15)

Recommendation

As discussed in Issue 5, the recommended rate base values at December 31, 1995, were $1,462,487 and $1,382,904 for the respective water and wastewater systems, based upon Econ's net plant investment in the facilities. In Issue 6, Staff recommended that the rate base determination should not include the negative acquisition adjustment. Staff believes that Wedgefield's rate base balance should match Econ's net book balance at the transfer date, which is consistent with Commission policy. Therefore, staff recommends approval of rate base balances of $1,462,487 and $1,382,904 for the respective water and wastewater systems.

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

**RECOMMENDATION**: Rate base inclusion of an acquisition adjustment ultimately affects the utility's rates. The utility must support its rate base balance. A showing of extraordinary circumstances must be made to warrant a rate base inclusion of an acquisition adjustment. Once the utility makes an initial showing that there are no extraordinary circumstances, the burden of persuasion shifts to the opposing party to demonstrate that extraordinary circumstances are present. If the opposing party meets the burden of persuasion, the ultimate burden of rebutting the opposing party's allegations rests upon the utility. (BRUBAKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: Commission Order Nos. 23376 issued 8/21/90 and 25729 issued 2/17/92, require that the proponent of an acquisition adjustment, either negative or positive, bears the burden of proof. OPC, the only proponent of an acquisition adjustment in this case bears the burden of proof. The dissent in Order NO. PSC-96-1241-FOF-WS agrees.

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

**STAFF ANALYSIS**: In its brief, the utility argues that Rule 25-30.037(2), Florida Administrative Code, sets forth what a utility must file with the Commission when it seeks authority for a transfer of its facilities. The rule requires, in its pertinent part, that an application for transfer must include a statement setting out the reasons for the inclusion of an acquisition adjustment, if one is requested. (BR 47) Wedgefield argues that, therefore, if and only if a utility is seeking an acquisition adjustment, it (the utility) must justify the adjustment; the rule does not require the utility applicant to allege or prove why an acquisition adjustment requested by someone else should not be granted by the Commission. (BR 47-48) The utility asserts that there is no rule, statute or order which places the burden of proof on anyone other than the proponent of the acquisition adjustment. (BR 48) Wedgefield argues that OPC, as the only entity requesting an acquisition adjustment in this case, bears the exclusive burden to show why an negative acquisition adjustment should be granted. (BR 48, BR Attachment "A" 2-7, 32).

Although OPC raised the issue of burden of proof in this proceeding, it did not address the issue substantively in its brief or in the overview to its brief. OPC merely recited its position on the issue, as listed above. (BR 15)

After an extensive review of prior Commission Orders, it appears that the issue of burden of proof regarding the rate base inclusion of an acquisition adjustment, either positive or negative, is one of first impression before the Commission. Neither the utility nor OPC cited to any precedent directly on point.

Because the inclusion of an acquisition adjustment, either positive or negative, will ultimately have an impact on rates, staff believes that it would be useful to analogize this issue to the issue of who bears the burden of proof in a rate proceeding. In Florida Power Corporation v. Cresse, 413 So.2d 1187, 1191 (Fla. 1982), the Florida Supreme Court stated that the burden of proof in a commission proceeding is always on a utility seeking a rate change. See also Order No. PSC-96-0499-FOF-WS, issued April 9, 1996, in Docket No. 951258-WS. In previous cases, the Commission has held that in any rate case, the utility has the burden of proof. Order No. PSC-92-0266-FOF-SU, issued April 28, 1992, in Docket No. 910477-SU. See also Order No. PSC-95-1376-FOF-WS, issued November 6, 1995, in Docket No. 940847-WS; Order No. PSC-93-1288-FOF-SU, issued September 7, 1993, in Docket No. 920808-SU; Order No. PSC-93-1070-WS, issued July 23, 1993, in Docket No. 920655-WS; Order No. PSC-93-0423-FOF-WS, issued March 22, 1993, in Docket No. 920199-WS; Order No. PSC-92-0594-FOF-SU, issued July 1, 1992, in Docket No. 910756-SU.

In Docket No. 911188-WS, In Re: Application for a rate increase in Lee County by Lehigh Utilities, Inc., OPC filed a petition for reconsideration of Order No. PSC-93-0301-FOF-WS, issued February 25, 1993, in which the Commission authorized an increase in Lehigh Utilities' rates and charges. Lehigh Utilities filed a response to OPC's petition for reconsideration, in which it argued in part that Commission staff bore the burden of proving that certain tax loss carry-forwards existed because staff raised the tax issues. In the resultant Order on Reconsideration, Order No. PSC-93-1023-FOF-WS, issued July 12, 1993, the Commission disagreed, and found that the utility at all times bears the burden of proof in a rate proceeding.

Although the underlying case involved the granting of a certificate of public convenience and necessity, the Florida Supreme Court in Stewart Bonded Warehouse v. Bevis noted that while

the burden of going forward with the evidence as to an issue may shift in any particular case, the burden of proof remains with the applicant, and it is the applicant who must carry the burden of proof. 294 So. 2d 315, 317-18 (Fla. 1974).

Staff notes the issuance of a recent opinion from the Florida First District Court of Appeal, Southern States Utilities n/k/a Florida Water Services Corporation v. Florida Public Service Commission, et al., Case No. 96-4227, Commission Docket No. 950495-WS, issued July 10, 1998. In the facts underlying the case, Florida Water Services Corporation (FWSC) acquired the water and wastewater utility serving Lehigh Acres for less than what it cost the original owner to build the used and useful infrastructure. See the court's opinion at page 17. In the order on appeal, the Commission had declined a request from OPC to include a negative acquisition adjustment in the rate base to reflect the price FWSC paid. Id. In affirming this portion of the Commission's Order, the court concluded that OPC had made no showing of exceptional or extraordinary circumstances, and that the Commission therefore lawfully exercised its discretion in declining to make the requested adjustment. Id. The First District Court of Appeal opinion is silent as to the issue of burden of proof with respect to the acquisition adjustment; however, staff does not believe that the opinion is inconsistent with staff's position on this Issue. Similar to the opinion referenced above, staff believes that OPC was unsuccessful in demonstrating the existence of extraordinary circumstances in the instant case. There was therefore no requirement, either in the above-referenced case or in the instant case, that the utility rebut OPC's allegations and carry the ultimate burden of proof.

As stated previously, Wedgefield contends that Rule 25-30.037(2), Florida Administrative Code is controlling on this issue, and does not require the utility applicant to allege or prove why an acquisition adjustment requested by someone else should not be granted by the Commission. (BR 47-48) However, Rule 25-30.037(2), Florida Administrative Code, sets forth the items which must be filed in a transfer application, and does not address, either explicitly or implicitly, any legal standards on burden of proof. Although Wedgefield contends that there is a "long history of the burden of proof always being on the proponent of an acquisition adjustment," it fails to cite to any case law or previous Commission Orders which are on point as to the issue. (BR, Attachment "A," p. 2) As stated previously, OPC does not discuss or cite to any authority regarding the issue of burden of proof, in spite of the fact that it raised the issue.

Staff believes that in the instant case, as in rate proceedings, the ultimate burden of proof rests upon the utility. As stated previously, the utility always has the ultimate burden of proof with regard to its rates. Because the imposition of an acquisition adjustment will eventually affect the utility's rates, staff believes that the utility must carry the ultimate burden of proof as to why an acquisition adjustment should or should not be included in the rate base determination. As discussed in greater detail in Issue 9, staff believes that a showing of extraordinary circumstances must be made to warrant a rate base inclusion of an acquisition adjustment. Once the utility makes an initial showing that there are no extraordinary circumstances, the burden of persuasion shifts to the opposing party to demonstrate that extraordinary circumstances are present. If the opposing party meets the burden of persuasion, the ultimate burden of rebutting the opposing party's allegations rests upon the utility.

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

**RECOMMENDATION**: Consistent with previous Commission decisions, extraordinary circumstances should be shown to warrant rate base inclusion of an acquisition adjustment. (BRUBAKER)

**POSITION OF THE PARTIES**

**WEDGEFIELD**: Yes. The Commission must comply with its own Order Nos. 23376 (8/21/90) and 25729 (2/17/92), which confirmed the requirements for acquisition adjustments. Generic proceedings confirmed prior case-by-case development of the requirement that extraordinary circumstances must be shown before an acquisition adjustment is warranted. The dissent agrees in Order No. PSC-96-1241-FOF-WS.

**PUBLIC COUNSEL**: 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.

**STAFF ANALYSIS**: As discussed in greater detail in Issue 3, since at least 1983, the Commission has consistently held in previous orders that absent evidence of extraordinary circumstances, the rate base calculation should not include an acquisition adjustment. By Order No. 22361, issued January 2, 1990, in Docket No. 891309-WS, the Commission denied OPC's petition to initiate rulemaking, but granted its request to investigate the Commission's policy regarding acquisition adjustments. After holding workshops and inviting written comments, the Commission issued Proposed Agency Action Order No. 23376, issued August 21, 1990, which concluded that it would not be appropriate to amend the existing policy regarding acquisition adjustments. Pursuant to OPC's protest of that Order, a hearing was held pursuant to Section 120.57(2), Florida Statutes. By Order No. 25729, issued February 17, 1992, the Commission concluded its investigation and affirmed its acquisition adjustment policy.

In its brief, the utility argues that the current Commission policy regarding acquisition adjustments, which has been in effect at least since 1983, is that absent extraordinary circumstances, the purchase of a utility system at a premium or discount, shall not affect rate base. (BR 49) Wedgefield further contends that all of the arguments set forth by witness Larkin have been heard

and rejected by the Commission in the Docket No. 891309-WS proceedings. (BR 50)

In its brief, OPC argues that because the Commission does not have a rule regarding acquisition adjustments, it cannot have in place a policy which requires a showing of extraordinary circumstances in order to warrant the recognition of an acquisition adjustment. (BR 16) If the Commission had such a policy, Section 120.54(1)(a), Florida Statutes, would require the Commission to have a rule reflecting that policy. (BR 16) Section 120.54(1)(a), Florida Statutes, provides that rulemaking is not a matter of agency discretion, and that each agency statement defined as a rule by Section 120.52, Florida Statutes, shall be adopted by the rulemaking procedure as soon as feasible and practicable. Rulemaking shall be presumed feasible unless the agency proves that (1) the agency has not had sufficient time to acquire the knowledge and experience reasonably necessary to address a statement by rulemaking, or (2) related matters are not sufficiently resolved to enable the agency to address a statement by rulemaking. Section 120.54(1)(a)1.a.-b., Florida Statutes. In its brief, OPC contends that, unless the Commission is violating the Administrative Procedure Act, either the Commission has not acquired the knowledge and experience reasonably necessary to address a statement about acquisition adjustments by rulemaking, or the Commission has not sufficiently resolved related matters to enable the Commission to address a statement by rulemaking. (BR. 16-17)

OPC contends in its brief that, although there is no requirement for a showing of extraordinary circumstances, such circumstances have been shown by the combination of a lack of maintenance of Econ's facilities by the prior owner and the magnitude of difference between the net book value and the purchase price. In summary, OPC argues in the "overview" portion of its brief that

> 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 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. (BR 6)

Although the Commission has no rule regarding the rate base inclusion of an acquisition adjustment, previous Commission orders have consistently stated that, absent evidence of extraordinary circumstances, the rate base calculation should not include an acquisition adjustment. See Order No. 20707, issued February 6, 1989, in Docket No. 880907-WU; Order No. 23970, issued January 1, 1991, in Docket No. 900408-WS; Order No. 25584, issued January 8, 1992, in Docket No. 910672-WS; Order No. PSC-95-0268-FOF-WS, issued February 28, 1995, in Docket No. 940091-WS; Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS.

As discussed in Issue 8, a recent opinion from the Florida First District Court of Appeal, Southern States Utilities n/k/a Florida Water Services Corporation v. Florida Public Service Commission, et al., Case No. 96-4227, PSC Docket No. 950495-WS, issued July 10, 1998, is instructive in this case. In the Commission Order on appeal, the Commission had declined a request from the Office of Public Counsel to make a downward adjustment in rate base, ruling that:

> This Commission has acknowledged that absent extraordinary circumstances, the purchase of a utility system at a premium or discount should not affect rate base.

See the court's opinion at page 17, citing Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS. The First District Court of Appeal concluded that OPC had made no showing of exceptional or extraordinary circumstances, and that the PSC therefore lawfully exercised its discretion in declining to make the requested adjustment. Id.

Staff agrees with Wedgefield's contention that the current Commission policy regarding acquisition adjustments is that, absent extraordinary circumstances, the purchase of a utility system at a premium or discount, shall not affect rate base. (BR 49) Although what constitutes "extraordinary circumstances" must be determined on a case-by-case basis, extraordinary circumstances must be shown to warrant rate base inclusion of an acquisition adjustment. This is consistent with the investigation conducted as to the Commission's acquisition adjustment policy in Docket No. 891309-WS, and subsequent Commission Orders in which acquisition adjustments are at issue.

At the August 4, 1997 Prehearing Conference, an issue was raised by OPC regarding the effect of prior orders to the instant proceeding. After hearing from the utility, OPC and staff

regarding the relevance of the proposed issue, the Prehearing Officer struck the issue from the Prehearing Order, noting that the issue was essentially phrased as a rule challenge that would be more appropriately brought before the Division of Administrative Hearings in a proceeding pursuant to a Section 120.54, Florida Statutes. Subsequently, on August 11, 1997, Prehearing Order No. PSC-97-0952-PHO-WS was issued identifying the relevant issues, witnesses and exhibits. On August 20, 1997, OPC timely filed a motion for reconsideration of Order No. PSC-97-0952-PHO-WS. After hearing oral argument from both OPC and the utility, the Commission denied OPC's motion for reconsideration by Order No. PSC-97-1510-FOF-WS, issued November 26, 1997.

The matters raised in OPC's brief regarding whether the Commission's policy on acquisition adjustments constitutes an umpromulgated rule are substantially similar to those raised with regard to the proposed issue which was stricken during the Prehearing Conference, discussed above. Although the matter was not at issue in this case, staff notes that the acquisition adjustment issue is part of an on-going staff project on viability and capacity development in the water and wastewater industry. Technical staff is not prepared to go to rulemaking until the overall project reaches some conclusion. The issue has been considered in past rulemaking cases, in which the Commission was unable to reach a consensus on the issue of extraordinary circumstances.

**ISSUE 10 (NEW):** Should this docket be closed?

**RECOMMENDATION:** Yes, upon expiration of the time for filing an appeal, no further action will be necessary and this docket should be closed. If a party files a notice of appeal, this docket should be closed upon resolution thereof by the appellate court. (BRUBAKER, REYES)

**STAFF ANALYSIS:** Upon expiration of the time for filing an appeal, no further action will be necessary and this docket should be closed. If a party files a notice of appeal, this docket should be closed upon resolution thereof by the appellate court.

ATTACHMENT A

**PROPOSED FINDINGS OF FACT**

1. Utilities, Inc. is a privately owned public utility engaged solely in the business of owning and operating water and wastewater systems and has no developer relationships. It owns and operates 63 subsidiaries in fifteen states, including twelve in Florida where it maintains experienced management and professional operators. It is adequately financed, has access to capital at reasonable costs, and is capable of reducing costs of operation due to economies of scale. [Tr. 157, Wenz Direct Testimony page 1, lines 17-18 and 24-25; Tr. 173-174, Wenz Additional Direct Testimony page 10, line 23 to page 11, line 15; Ex. 11, Application for Transfer, and its Exhibit A].

**RECOMMENDATION**: Reject as argumentative or conclusory.

2. Through Wedgefield Utilities, Inc., its wholly owned subsidiary, Utilities, Inc. has the ability and commitment to make the necessary improvements in this utility. It has the potential to reduce costs through the allocation of administrative expenses and through access to an established purchasing system, and it is familiar with, and has the ability to comply with, state and federal regulations. [Ex. 11, Application for Transfer, Part I, Para. E. and Part II, Para. A.; Tr. 173-174, Wenz Additional Direct Testimony page 10, line 23 to page 11, line 15].

**RECOMMENDATION**: Accept.

3. Econ Utilities Corporation was a small, developer-owned utility with financial pressures due to sustained losses that made it difficult to attract capital at a reasonable cost and to operate and maintain the systems which put it in danger of not being able to expend the necessary capital to meet its obligations. The former owners either do not have, or are not willing to commit, the funds necessary to continue to operate and finance the utility. [Tr. 172, Wenz Additional Direct Testimony page 9, lines 12-19; Tr. 340-341, Seidman Rebuttal Testimony page 25, line 7 to page 26, line 2].

**RECOMMENDATION**: Reject as argumentative or conclusory.

4. In its negotiations to purchase Econ Utilities, Utilities, Inc. was fully aware of, and relied on, this Commission's acquisition adjustment policy stated in Commission Order Nos. 25729 and 23376. [Tr. 168-169, Wenz Additional Direct Testimony page 5, line 20 to page 6, line 20.]

**RECOMMENDATION**: Accept.

5. The Orange County Utilities Division has no authority over Wedgefield or any other utility, whether privately or publicly owned, and its "standards" are applicable only to its own operations. [Composite Ex. 8, ltr. dtd 4/13/1995, Mr. Ispass to Mr. Blake, page 1].

**RECOMMENDATION**: Reject as argumentative or conclusory.

6. Econ operated (and now Wedgefield operates) under the jurisdiction of the Florida Department of Environmental Protection (DEP), the Orange County Environmental Protection Department (OCEPD), and the Florida Public Service Commission. It is inspected regularly by DEP and by OCEPD. These three agencies provide standards for Wedgefield and determine what is necessary for compliance, based on Federal and Florida laws and regulations. [Tr. 328, Seidman Rebuttal Testimony page 13, lines 13-22; Ex. 11, Application].

**RECOMMENDATION**: Accept.

## PROPOSED CONCLUSIONS OF LAW

1. It is the policy of this Commission that, absent extraordinary circumstances, the purchase of a utility at a premium or discount shall not effect the rate base calculation and the proponent of an acquisition adjustment, either positive or negative, bears the burden of proof.

**RECOMMENDATION**: Reject as unsupported.

2. There is no extraordinary circumstances in this purchase, and no acquisition adjustment should be included in the rate base calculation.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

3. For purposes of this transfer, the rate base is equal to the net book value of the assets, excluding ratemaking adjustments such as working capital or used and useful adjustments, and is $1,462,487 for water and $1,382,904 for wastewater.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

4. Econ was (and now Wedgefield is) in compliance with the requirements of the Florida Department of Environmental Protection (DEP) and by the Orange County Environmental Protection Department (OCEPD).

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

5. Imposing a NAA would discourage the purchase of a system such as Econ, and that thwarts Commission policy and is a detrimental consequence to customers.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

6. At the time of sale, the Econ assets were all functioning and not in violation of any state regulations. They were typical of developer-owned utilities, not in the best condition and not up to the standard which Utilities, Inc. would want to maintain, but not in extremely poor condition, either.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

7. All the arguments set forth by Mr. Larkin have been made before and have been rejected by this Commission in generic proceedings and in prior, case-specific orders of the Commission.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

8. The utility will not be allowed to recover a return on assets which do not exist. Clearly, the assets do exist. They didn't disappear when ownership changed.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

9. A NAA is considered at the time of transfer and requires that extraordinary circumstances be found for taking the extreme step of permanently reducing the net original cost as rate base. A used and useful adjustment is used in a rate case for temporarily removing from rate base certain assets which are not currently used and useful in providing utility service to the customers. The two regulatory concepts perform different functions at different times. a) The contingent portion of the purchase price has no effect on rate base. In addition, the service area in the Reserve (formerly The Commons) is already under construction. The contract requires contingent payments to be made as soon as each new home is hooked up, so any "uncertainty" or "speculation" about whether payments will be made is unwarranted.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

10. A major purpose of Commission policy on acquisition adjustments is to create an incentive for larger utilities to acquire small, troubled utilities. If a benefit to the purchaser results from the purchase price being lower than book value, it is at the expense of the seller, not at the expense of the customer. In fact, rate base is unchanged, and, because of this, there is no harm to the customer.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

11. Commission Order No. 25729 listed several beneficial changes due to a change in ownership, which the current Commission policy is intended to encourage. It also found that the customers of utilities acquired under its policy are not harmed, and indeed benefit from a better quality of service at reasonable cost.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

12. To change the policy now not only would be a denial of due process but it also would defeat the purposes of the policy as originally developed and implemented by the Commission.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.

13. Rate base must recognize the original cost of assets at the time they were dedicated to public service.

**RECOMMENDATION**: Reject as unsupported.

14. Based on a review of prior Commission orders, including the dissenting opinions, the following factors either are not relevant to the Wedgefield transfer, are not "extraordinary circumstances", or do not otherwise authorize, require or warrant a negative acquisition adjustment.

The system does not require replacing, the jurisdictional status is known, there is growth potential, and the system will benefit from certain economies under new ownership. The improvements that have to be made are in the public interest. The revenue requirement associated with the net original cost of the system would be no more than under the previous ownership. There is no requirement to prove hardship on the part of the seller. The tax treatment of the seller is irrelevant. A large differential between purchase price and rate base is not, of itself, an "extraordinary circumstance". The determination of rate base in this case is not an initial determination; rate base was determined by the Commission in 1984, and there was no lack of original cost documentation. Even when a previous owner failed to maintain a system properly and the new owner had to make considerable expenditures to bring the system into compliance, these events are not "extraordinary circumstances". The customers do not have to "pay twice" because, regardless of ownership, the customers pay only for the legitimate cost of assets and expenses incurred and actually paid in their behalf. Customers will not pay for anything under the new ownership that they would not have been required to pay for under prior ownership. The transfer is customer-neutral, except for benefits the customers will receive due to new ownership. The sale did not result from a bankruptcy of foreclosure. The purchaser does not have uniform rates among its systems. To include both a negative acquisition adjustment and used and useful adjustments on the same plant would be double counting. Regardless of whether a purchasing utility includes a consideration of used and useful adjustments in its negotiations for acquisition or for setting the purchase price, a NAA is not warranted. In the public interest, the purchaser has already made improvements in the system and in its management. Only utility property, and no lots or other assets, were bought or sold in the transaction between seller and purchaser. Seller had not filed to abandon the utility

system. The seller has not been purchasing water or any other utility service from any other utility, and it has not been earning on unused plant components. Any ratemaking adjustments would have to considered in the context of a rate case. Not including a negative acquisition adjustment does no harm to customers. Rate base and monthly rates will not change as a result of the transfer. The sale of the utility does not involved a three-party or a nontaxable exchange, there are no family trusts or other trusts involved in the sale, and even without a negative acquisition adjustment, the seller will not recover, much less double recover, its investment. There has been no agreement or settlement of this transfer docket for any transfer rate base less than full net book value, and Wedgefield has not requested anything that would cause a change to rate base or rates as a result of the transfer.

**RECOMMENDATION**: Reject as not constituting a conclusion of law.