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January 30, 2001

Ms. Blanca S. Bayo, Director
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Tallahassee, Florida 32399-0850

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Re: Docket No. 001502-WS
In re: Proposed Rule 25-30.0371, Acquisition Adjustments

Dear Ms. Bayo:

Enclosed for filing on behalf of Florida Water Services Corporation ("Florida Water") are an original and fifteen copies of this letter which sets forth Florida Water's responses to the questions listed on pages 3 and 4 of the Notice of Workshop issued December 21, 2000 in the above-referenced docket.

1. What goals do you believe the Commission should be trying to achieve through a water and wastewater industry acquisition policy?

Florida Water's Response: The Commission's acquisition adjustment policy should focus on the following goals:

- (a) leveling of the playing field of private water and wastewater utilities that compete with governmental utilities in the acquisition of utilities.
- (b) maintenance of environmentally sound, reasonably priced water and wastewater services to customers served by utilities subject to Commission jurisdiction.
- (c) avoiding abandonment or deterioration of troubled or distressed utility systems regulated by the Commission.

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(d) insuring that customers are not harmed by acquisitions.

(e) promotion of capacity development, financial viability and economies of scale for utilities subject to Commission jurisdiction and regulation.

(f) promotion of consolidation of utility systems to achieve environmental compliance, economies of scale, rate stability and safe and adequate, safe and sufficient water and wastewater services for customers of utilities regulated by the Commission.

(g) adding certainty for acquiring utilities by allowing acquiring utilities the option of establishing rate base at the time the utility files an application for a transfer of a certificate.

2. Should the Commission still be promoting acquisitions?

Florida Water's Response: Yes. The water and wastewater industry is a rising cost industry with the continuing need for increased investments and increasing costs of environmental compliance. These factors make it difficult for smaller utilities to remain financially viable and to provide environmentally compliant water and wastewater services. The acquisition and consolidation of utility systems benefit the customers of the acquired system who may be saddled with a utility that lacks the resources, professional staff and/or desire to provide high quality, environmentally compliant service. Such utilities often fail to make or simply lack the resources to make the necessary investments to upgrade facilities or install new facilities necessary to provide safe, sufficient and reliable service. The promotion of acquisitions and consolidation in the water and wastewater industry benefits the customers of utilities who lack the resources to provide high quality service on a long-term basis. Consolidation also can bring rate stability, lower financing costs, improve service, improved environmental compliance, improved operations, professional and sophisticated management and operations, and removal of the risk of abandonment to the customers of the acquired utility. At the same time, consolidation can bring economies of scale and lower cost per customer and enhance revenue stability to the acquiring utility.

If the Commission fails to implement a policy or rule that promotes acquisitions, the results will be detrimental for the private water and wastewater industry. Utilities and their customers who suffer from disinterested management, high cost financing, and/or inadequate financial resources will remain subject to a lower quality of service and the risk of abandonment. Larger, professionally run utilities who seek to expand their customer base and revenue stability through growth will decline acquisition opportunities and the above-mentioned benefits that come therewith if regulatory policy promotes negative acquisition adjustments or fails to promote positive acquisition adjustments.

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3. Is there a need for different policies for (1) large utilities acquiring large utilities, (2) large utilities acquiring small utilities or (3) small utilities acquiring small utilities?

Florida Water's Response: There does not appear to be a strong justification for implementing different acquisition policies triggered by the size of the acquiring utility or the acquired utility. Different rules for different sized utilities may become unnecessarily complicated and could inappropriately categorize acquisitions based on the size of the utilities involved. The facts and circumstances of each acquisition will be somewhat different and should be analyzed under a general set of comprehensive criteria. The Commission's goal in this docket should be to develop comprehensive policies that promote consolidation of utilities and improve overall service and rate stability for all customers, notwithstanding the size of the acquiring utility or the acquired utility.

4. Should the Commission be looking at different incentives to encourage acquisitions, such as rate of return (i.e.: modification of the equity leverage graph), in place of or in conjunction with the current acquisition policy?

Florida Water's Response: The Commission should indeed take this opportunity to consider different incentives to encourage acquisitions. These proposals should be developed through the workshop process. Examples of states that have implemented policies to foster acquisitions include the states of New York, Pennsylvania and California as outlined in the December 21, 2000 Notice of Workshop. Such incentives may include any combination of rate of return premiums, a phase-in of and rate recovery for plant improvement costs, a plant improvement surcharge to the customers of the acquired system, and an analysis of whether the purchase price was at or below the replacement cost of the land and facilities of the acquired utility.

5. Should the Commission be addressing the accounting treatment for acquisition adjustments? Should the amortization period for acquisition adjustments relate to the composite remaining life of the assets purchased?

Florida Water's Response: The Commission should only address the accounting treatment for an acquisition adjustment if the acquisition adjustment is allowed for ratemaking purposes in establishing rates. Florida Water also notes that the length of the amortization period may soften the impact of a positive acquisition adjustment on rates.

6. With respect to negative acquisition adjustments, would it be appropriate to recognize the unamortized acquisition adjustment balance in rate base with the amortization expense recognized below the line at the time the utility files a request for a rate increase, as an alternative to the present policy?

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Florida Water's Response: Although Florida Water is unclear as to which "present policy" Staff refers to in this question (the acquisition adjustment policy or a policy for accounting for acquisition adjustments), Florida Water would state that the accounting treatment for acquisition adjustments should be symmetrical, *i.e.*, an appropriate commensurate adjustment to amortization expense should be made whether the acquisition adjustment is positive or negative.

7. With respect to the positive acquisition adjustments, should the acquiring utility have to prove that the synergies caused by the acquisition more than offset the acquisition adjustment?

Florida Water's Response: Subject to and depending on the criteria that may be established by the Commission in this docket for inclusion of a positive acquisition adjustment, Florida Water generally believes that it is appropriate to place the burden on the acquiring utility to justify the inclusion of the positive acquisition adjustment in rate base by demonstrating that the benefits brought by the acquisition to the acquiring and acquired utility justify the increase in rate base, based on criteria such as that set forth in Florida Water's response to Staff Question 8 addressing positive acquisition adjustments.

8. What should the future acquisition policy of this Commission be?

Florida Water's Response: It is Florida Water's experience that the "market" for water and wastewater utilities today is consistently set at or near the replacement costs of the facilities. In other words, notwithstanding the book value of the facilities of the selling utility, which in many cases are substantially depreciated, purchase price demands are consistently placed at or near the replacement cost of the facilities. This reality should be recognized by the Commission in establishing a pro-consolidation acquisition adjustment policy.

Florida Water believes that any rule developed by the Commission addressing acquisition adjustment policies should include the following:

a. A process by which the utility may, at its option, seek to establish rate base, including consideration of the acquisition adjustment, at the time of the transfer or expansion of the certificate, with such determination being final and not subject to reconsideration and relitigation in future rate cases.

b. The burden to establish a negative acquisition adjustment should be placed with customers of the acquiring utility. The Commission's current acquisition policy recognizes that an acquisition by a utility at a price below book value is transparent to the customers, *i.e.*, the rate base of the acquired utility does not change absent extraordinary circumstances. The imposition of a negative acquisition adjustment imposes a potential double reduction on the acquiring utility by

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lowering rate base to the purchase price and, subsequently, by lowering that rate base based on potential non-used and useful adjustments. The prospects of such an outcome will only insure that professionally run, economically efficient water and wastewater utilities such as Florida Water will decline to pursue purchases of water and wastewater utilities at a price below book value particularly where it is apparent that prudent investments will be required to provide environmentally compliant water and wastewater services. The results of a pro-negative acquisition adjustment policy will only hurt the customers of distressed utilities and increase the number of abandonments.

c. Positive acquisition adjustments should be promoted. A pro-positive acquisition adjustment policy is required to allow Commission regulated utilities to compete on a level playing field with governmental utilities that are not saddled with the burdens of the Commission's regulatory framework, including non-used and useful adjustments. The burden of establishing a positive acquisition adjustment should rest with the acquiring utility. Incentives should be considered and developed through the workshop process to promote positive acquisition adjustments including the consideration of:

- (1) Inclusion of the positive acquisition adjustment in rate base at the time of transfer or expansion of the certificate of the acquiring utility.
- (2) The length of an appropriate amortization period.
- (3) A rate of return premium for the acquiring utility.

Factors relevant to the inclusion of a positive acquisition adjustment which should be discussed and developed through the rulemaking process include:

- (1) Whether the purchase price is at or below the replacement costs of the acquired land and facilities.
- (2) The rates, quality of service and alternatives available for continued operations for the acquired utility (this could also apply to a negative acquisition adjustment).
- (3) Whether the acquisition would provide rate stability to the acquired utility.
- (4) Whether the acquisition would provide lower financing costs to the acquired utility.
- (5) Whether the acquisition would provide improved service to the acquired utility's customers.
- (6) Whether the acquisition would provide improved environmental compliance to the

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acquired utility's customers.

(7) Whether the acquisition would provide improved operations to the acquired utility's customers.

(8) Whether the acquisition would provide improved management and overall operations (billing, customer service, etc.) to the acquired utility's customers.

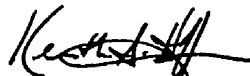
(9) Whether the acquisition would provide improved management of water supply to the acquired utility's customers.

(10) Whether the acquisition would produce economies of scale for the acquiring utility.

(11) Whether the acquisition would produce enhanced revenue stability and customer growth for the acquiring utility.

Florida Water thanks the Commission for the opportunity to provide this preliminary input for the upcoming Commission workshop. Florida Water intends to participate at the workshop and hopes to assist the Commission in developing a prospective acquisition adjustment rule which promotes needed consolidation in the private water and wastewater utility industry.

Respectfully submitted,



Kenneth A. Hoffman

KAH/rl