BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 001502-WS

In the Matter of

PROPOSED RULE 25-30.0371,
ACQUISITION ADJUSTMENTS.
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PROCEEDINGS: WORKSHOP

BEFORE: CHAIRMAN E. LEON JACOBS, JR.
COMMISSIONER J. TERRY DEASON
COMMISSIONER LILA A. JABER
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER MICHAEL A. PALECKI

DATE: Wednesday, February 7, 2001

TIME: Commenced at 9:40 a.m.
Concluded at 3:50 p.m.

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

REPORTED BY: TRICIA DeMARTE
Official FPSC Reporter

DOCUMENT NUMBER-DATE
02742 MAR-1 ō
FPSC-RECORDS/REPORTING

IN ATTENDANCE:

CHRISTIANA T. MOORE, FPSC Division of Appeals.

MARSHALL WILLIS, TROY RENDELL, GREG SHAFER, FPSC Division of Regulatory Oversight.

KENNETH A. HOFFMAN and MARTIN McDONNELL, Rutledge, Ecenia, Purnell & Hoffman, and FREDERICK LEONHARDT, JOHN CIRELLO and JIM PERRY, representing Florida Water Services Corporation.

WILLIAM GRANTMYRE and JERRY TWEED, representing Heater Utilities.

DAVID deNAGY, representing United Water and United Water and United Water Florida.

MARTIN FRIEDMAN, Rose, Sundstrom & Bentley, representing AquaSource Utility.

STEPHEN BURGESS and CHARLES BECK, Associate Public Counsel, Office of the Public Counsel, MARK CICCHETTI and HUGH LARKIN, representing the Citizens of the State of Florida.

BEN GIRTMAN, CARL WENZ and FRANK SEIDMAN, representing Utilities, Inc.

PROCEEDINGS

COMMISSIONER DEASON: Call the workshop to order. Could we have the notice read, please.

MS. MOORE: Yes. This workshop is being held pursuant to a notice of workshop issued on December 21st, 2000, and published in the Florida Administrative Weekly on December 29th.

COMMISSIONER DEASON: Thank you. I know this is a -- we're a little informal, this is a workshop, but we will go ahead and take appearances. It probably will help the court reporter. For everyone that's going to participate today, if you will at least go ahead and introduce yourself and your affiliation.

MR. BECK: My name is Charlie Beck. I'm with the Office of Public Counsel. And we have three persons with me here today: Mark Cicchetti, Steve Burgess, and Hugh Larkin.

MR. SEIDMAN: That moved on quickly. My name is Frank Seidman with Management & Regulatory Consultants, Inc. I'm here representing Utilities, Inc. And also here today is Mr. Ben Girtman, attorney for Utilities, Inc., and Mr. Carl Wenz of Utilities, Inc.

MR. FRIEDMAN: Marty Friedman of the law firm of Rose, Sundstrom & Bentley. We're here representing AquaSource Utility.

MR. HOFFMAN: Good morning, Commissioners. My name is Kenneth Hoffman; directly behind me is Martin McDonnell. We are with the firm of Rutledge, Ecenia, Purnell & Hoffman. With us is Frederick Leonhardt, who is a senior vice president and general counsel of Florida Water Services Corporation. And we're all here on behalf of Florida Water Services Corporation this morning with Florida Water's president to my right, Dr. John Cirello. Behind me also is Jim Perry, and Jim is a senior VP and the CFO of the company.

And, Commissioners, we also have with us, behind me to my right, Bill Grantmyre who is the president and house counsel for an affiliate, Heater Utilities, as well as Jerry Tweed, who is the vice president for Heater.

COMMISSIONER DEASON: Thank you.

MR. deNAGY: Good morning, Commissioners. My name is Dave deNagy. I represent United Water and United Water Florida.

COMMISSIONER DEASON: Okay. Anyone else? Okay. Thank you. Staff, what's the order of business today?

MR. WILLIS: I'd like to make some introductory comments here, and at first, point everybody to the handout that was available. It's the blue booklet. If you turn to the first tab that has the agenda, that's basically the agenda for today that Staff would like to follow.

First of all, as everybody is turning to it, I would like to thank everybody for coming today and the excellent participation that we're going to have.

To Staff and the Commission, this has been an extremely controversial and important issue. It's an issue that's been with us 20-plus years, and I've been working on it, as well as a large quantity of Staff over the years, dealing with trying to get an acquisition adjustment codified in a rule. And as many of you have known who have been with us in that process, it's been a long, tedious task, and a rule has not been put on the books yet.

Just going through the handout to let you know what's in it, just for ease of the workshop, we have put together the agenda itself. There are -- on the next page and the next tab you will see additional comments or additional discussion questions. I had my secretary fax those to all of the people who filed comments, so you should have had those probably a week ago, just to help facilitate some discussion over the issue itself.

The following tab is the actual notice which includes the white paper. In case anybody wants to reference that in their comments, that's there also. There are two loose pages, which you will see, Pages 3 and

4. I noticed this morning that they somehow got left out when this was put together. I have handed out -- included those with the handouts that were out here, and I have given the Commissioners copies, and I may have stuck them in your blue binders if you don't see them laying separately.

The next tabs are nothing more than the comments that were actually filed, prefiled. Everybody's comments are here for ease of looking at. The next tab includes a time line, which Mr. Shafer is going to go over shortly, to describe the tasks that we have gone through over the last 20 years. And we have also included a history of the acquisition adjustments. I think Mr. Seidman, in one of our workshops in the past, did one of these, and we have basically updated some of his work to bring it up to the current year 2000. But that, in essence, is what's included in the handout.

The last part of it is nothing more than other state activity which came out of a Staff workshop which was held in December of last year, just for reference there also about what other states are doing. There is also, I understand, another handout which was presented this morning, and Mr. Shafer is going to summarize that when he makes his presentation in a minute.

Getting back to the agenda. I really wanted to make some comments to try and focus everyone on exactly why we're here today. We're dealing with the acquisition issue, naturally. We've been at this for 20-plus years, as I said before. We have an acquisition policy which has been basically put out in orders of the Commission, in many orders, and that policy was put out in the notice itself. And it basically is that absent any extraordinary circumstances, there is not going to be an acquisition adjustment, that the rate base of the seller will be that of the purchaser.

And also, in many orders the reason for that's been published too, and the reason there, which we also put out in our notices that -- the reason for this over the years is to basically facilitate the acquisition, to give an incentive for acquiring some of these small companies, to try and make the industry itself more efficient, to take care of some of these nonviable systems. And that was the real reason for the acquisition policy as put out through the orders of the Commission.

Now, today, we find ourselves looking back at that policy itself, how it's worked over the 20 years, and I think the idea or the reason that Staff was looking at this workshop is to try and focus on two main issues. One, we've been through it for 20 years. Is there a need to continue that same policy? Is there a need for incentives out there? Are the incentives correct? And if so, maybe we can get to the point of putting this down in a rule this year and moving forward.

The second issue I think we all have to deal with today and discuss is something that's come about over the last seven years, I think, and that's what you might term the real -- the large deals or the large negative acquisition adjustments that have occurred in a couple of circumstances. It's created some real controversy with customers. It's created controversy with the Office of Public Counsel, and I think it's something that we have to address. It can't be ignored. And that's something that I think we definitely need to be putting in our comments today to the Commission and discuss in here.

With that, I think I'll turn it over to Greg now, and Mr. Shafer is going over the history that we've been through here and also talk about the handout that he's presented here today.

MR. SHAFER: Thank you, Marshall. I'm not going to belabor the history too terribly much. A lot of us have lived through a good portion of it already, and some of it hasn't been the most pleasant. But the time line that's included in the book at the tab "History of PSC Orders" begins in 1989, and actually the Commission's policy predates 1989. But in 1989, it was a significant case in which the Office of Public Counsel raised the acquisition adjustment issue in a docketed case. And there was a considerable amount of discussion and testimony in that particular case which then led later in the year to the Office of Public Counsel asking for a -- to initiate rulemaking or initiate an investigation on acquisition adjustments, which the Commission chose to open an investigation.

That investigation led ultimately to a PAA order in 1990, August of 1990, which was protested and subsequently a hearing was held. Again, there were -- many of the parties present today participated in that hearing, and ultimately, as a result of that hearing, the Commission issued an order in February of 1992 that has been the guiding light in terms of Commission policy and practice for acquisition adjustments. That order was Order Number 25729.

After that, in 1991, a docket was opened to look at a broad range of water and wastewater rules. And one of the items that was part of that docket, and this doesn't really show up on the time line, was again to look at the acquisition adjustment issue. There were a lot of topics covered in that docket, and the Commission decided at that time to spin out the acquisition adjustment issue and workshop it separately and go on a separate track.

That initiative basically died on the vine, and it didn't really become a hot topic again until March of 1999, a particular case involving Utilities, Inc.'s acquisition of Wedgefield Utilities. Commissioner Clark, then Chairman, Commissioner Clark at the time asked Staff to bring a rule proposal to the Commission. And we took an analysis to Internal Affairs, actually, that was the March '99 date, and seeking some direction from the Commission on which way they would like to go.

And their direction at that time was to proceed on a parallel track to get a rule in place for the acquisition adjustment issue and to also look and see whether or not we needed to provide additional incentives, whether incentives were necessary, whether the policy that was codified in the previous order addressing the policy was still valid, and effectively that's how we got here today.

A rule was proposed back in December and -- or October, I'm sorry, of 2000, and the Commission asked us to workshop it one more time to consider a broader aspect of what acquisitions are all about. So that's kind of how we got to where we are today.

Moving to the paper that was distributed this morning. It's really just an update and perhaps a recasting of the white paper that was attached to the

March Internal Affairs -- March '99 Internal Affairs item and also was attached to the notice to this workshop. When I say "recasting," I think there's been perhaps a highlighting of the notion of the deals that Marshall talked about and also kind of a summary of the state of the water and wastewater industry in Florida in terms of the smaller companies and what their earnings picture looks like and what are some of the problems and issues.

In addition, there's a summary of what some of the other states have done with highlighting at the end of the paper, the approaches that Staff thinks, you know, are potentially good options for the Commission to consider in the future.

MR. WILLIS: Commissioners, next on the agenda, we're scheduled to start with discussions of the parties, and first up on the agenda we have Florida Water. And we did this on the way that most of the comments were filed as they came in, from my knowledge as how they came in anyway. If there is any other order the parties might want, that's fine with us, but we had Florida Water on the agenda first.

MR. BECK: Marshall, I was wondering if we might ask Greg a couple of questions about his comments. Or is that --

MR. WILLIS: It's permissible with me if it's permissible with the Commission.

COMMISSIONER DEASON: Questions -- you probably want to wait until after the comments are completed, and then if you have questions, we'll entertain those.

MR. BECK: Okay.

COMMISSIONER DEASON: Mr. Hoffman, are you comfortable going first?

MR. HOFFMAN: Yes, sir.

COMMISSIONER DEASON: Very well.

MR. HOFFMAN: Commissioners, we filed comments on January 30th, and I won't reiterate everything that's in there. I'll begin by saying that the nuts and bolts of our positions on these issues are essentially reflected in those comments. Very quickly, you know, what we're looking for through this process is certainty, finality, and standards. And by "certainty" and "finality," we would hope that any rule that may arise as a result of this proceeding would give a utility the option to establish rate base at the time of transfer, and that any decision made by the Commission would have finality so that we would no longer have issues litigated two, three, four times in rate cases.

We would also hope that that type of provision, and we think this is essential, would allow the utility to basically opt out of the transaction in the event that the utility requests the establishment of a specific rate base and that request is not granted so that the utility would know up front where it stands on a prospective basis in terms of the Commission's establishment of rate base. And that at the utility's option could be processed and completed during the time of the transfer.

Secondly, Commissioners --

COMMISSIONER DEASON: Mr. Hoffman, you are indicating that you wish to have the ability to have a transfer not take place if a certain treatment is not afforded?

MR. HOFFMAN: Commissioner, the utility would have to file an application for transfer. And in any rule that may come out of this, we would like to see a provision that would grant the utility the option to establish rate base, including a positive acquisition adjustment at -- you know, during that proceeding rather than waiting until the next rate case. And if the utility's request is denied, the rule would allow the utility to basically void the transaction and not move forward with it. So everybody would sort of know where they sit on a prospective basis.

Secondly, Commissioners, we would look to build on the existing policy in terms of establishing a symmetrical system for negatives and positives. So that specifically what I mean by that is, if the issue involves a negative acquisition adjustment, we believe it would be appropriate to place the burden on the customers of the Office of Public Counsel to establish the appropriateness of inclusion of a negative acquisition adjustment.

And likewise, flip side. If the case involves a positive acquisition adjustment, we believe that it's appropriate to place the burden on the utility to demonstrate to the Commission that the benefits arising out of the purchase would justify the inclusion of the positive acquisition adjustment.

And the third thing, Commissioners, I mentioned standards. And what I'm talking about there are the types of standards that we believe are necessary to promote consolidation in the private water and wastewater industry that would bring benefits to the customers of the utilities that we may seek to purchase but as well as to our existing customers, which we think is an important consideration as well.

Right now, Commissioners, under your policy, which is basically book value absent extraordinary circumstances, it's somewhat unclear as to what it would take to demonstrate to you whether a positive acquisition -- a positive acquisition adjustment should be included or whether a negative would be included. We think it would be good for the industry to lay out standards or criteria through a rule so that we would have notice up front when we're at the negotiating table whether we believe that this is the type of transaction where we would have good prospects for prevailing on a positive acquisition adjustment.

And what I'm talking about there are the types of things that are laid out on Pages 5 and 6 of our comments. And, of course, you know, it gets to whether we would be providing an approved quality of service and bringing rate stability, lower financing costs, improved environmental compliance, the types of things that you've heard discussed before that we believe are appropriate for consideration in the inclusion of a positive acquisition adjustment. So I just wanted to lay out those introductory comments. Again, the things that we have to say are laid out in more detail in our written filing.

We have Dr. Cirello, Mr. Perry, Mr. Grantmyre, and Mr. Tweed from Heater Utilities, and we'd like to begin with Dr. Cirello.

COMMISSIONER DEASON: Very well.

MR. CIRELLO: Good morning. My name is John Cirello. I'm the president of Florida Water Services. I want to talk to you this morning about this subject that is near and dear to our hearts. We're fortunate in that our product is an irreplaceable product and a product not subject to change. However, our industry is going through a significant change. It continues to consolidate and grow faster than any other utility industry in the United States and, most especially, in the state of Florida with its record number of housing starts that exceeds any other state; in fact, any other group of states in the United States, whether its the entire northeast that Florida exceeds in terms of the housing starts that occur here that experience the growth or the fact that we're growing at an average in Florida of 4 percent. Most of us see it every day as we proceed to work and as we see the landscape changing around us.

But the industry is consolidating for a lot of reasons. The easiest one is to say it's economies of scale and efficient and effective management that's driving it. Some of it is related to environmental regulation that puts higher and higher standards on the quality of what we produce.

The application of technology and the ability to operate that technology with the expertise that keeps many of the small systems at bay, because they have neither the opportunity to put in that technology nor the expertise to operate it. The investment that takes place, the major infrastructure that has to be put in to support the system, let alone to create expansion of a system -- in comparison to other utilities, it takes $4 of capital to generate a dollar of revenue in the water industry. That compares to $3 in the electric industry and $2 to $3 in the telecommunications industry. So we're a heavy capital investment, capital intensive business.

What kind of consolidation has been going on? Mergers, obviously, operating contracts to operate systems, and the purchase of assets, which we are talking about today. The estimate is that a trillion dollars in investment will be made in the water industry over the next 20 years. And we continue to generate small inefficient, ineffective systems usually associated with construction and construction of housing, construction of development in the state of Florida.

Our system at Florida Water over the last five years has grown significantly by some 65,000 or 70,000 customers. About 50 percent of that growth was internal growth where customers tied onto our systems, but 50 percent of that growth was by acquisition of systems that we acquired within the state of Florida. We find over the last five years that the prices continue to rise for the acquisitions. Driven by foreign investment that look at the opportunity when you have a trillion dollars estimated to be spent within an industry, trust me, it gets worldwide attention. So we have foreign investment coming into the United States and foreign investment coming into Florida. That has driven prices up.

Our principal competitor many times is a public utility, not the other utilities you see sitting at the table here. And our principal competitor for a system to purchase is a public utility that does not follow any of the rules that you have set down in terms of economic control. Prices are many times two and three times book at or above replacement cost, not depreciated cost. The uneven playing field provides a distinct advantage to public utilities to come in and many times exceed prices that we would suggest that we can tolerate without acquisition adjustment by factors of two.

I can tell you that our growth over the last number of years keeps our costs down. It allows us to spread those costs over more customers. It allows us to stabilize our rate structure. It pays for the application of new technologies, and it pays for the application of new treatment methods and new management methods. It makes us more efficient. Many of our acquisitions are tuck-in, as we call them, acquisitions. These are acquisitions within proximity to where we serve where we can take advantage of the proximity to our current customers and allow us on opportunities that we have to tie systems together to make us more efficient and effective.

You are a body that operates by rules, that operates by guidelines and standards. What we need in our industry in Florida today are those rules and guidelines, especially as they relate to acquisition adjustment. The factors that will govern are taking the risk of purchasing a new system.

Businesses take risk every day, but one thing business doesn't take, if it's going to stay in business, is unreasonable risk. So we avoid unreasonable risk as any good business would. The unknown is always, always treated as unreasonable risk. Without guidelines, without standards, without criteria to know when and if we should be before you for an acquisition adjustment to allow us the opportunity to grow our systems on an even playing field, we are at a business loss, if you will, to seek that.

For the troubled systems, it allows us to avoid those systems rather than incorporate those systems when indeed we should be encouraged to incorporate those systems to take away the troubled systems. We need to address the many thousands of systems in Florida that currently exist and the new ones that are put in every day. Developer systems, as for example, put in by developers as a requirement for the development but many times the product is treated as an amenity, not as an essential service, an amenity to sell their homes.

The consolidation of those systems improves quality, improves service, and benefits the customers, because currently when we run into those systems and we take the opportunity to purchase those systems, what we are finally solving for the customers is the poor quality they have been getting from inefficient, ineffective treatment and distribution and the nonexistent service that customers constantly complain about that many times are your customers as well. And we're the customer who doesn't feel there's been a benefit from the service provider.

You need to encourage professionals, like the people sitting at this table, represented at this table, in the field, not developers, not part-time owners, professionals to participate in this business and supply this essential product. Acquisition adjustment is an opportunity for you to level the playing field and to also allow professionals to enter this field in Florida.

You have the opportunity with this workshop to listen to many reasons more than I can bring up here today, but others will bring up on my behalf, and of course, others will bring up on the industry's behalf, but I ask you to look at the reasonableness and to take into account the customer here, the customer, because he's the beneficiary, not the companies, the customer. And I thank you for the time. Any questions?

COMMISSIONER DEASON: Mr. Hoffman, do you have further presenters?

MR. HOFFMAN: Yes, sir, we do.

COMMISSIONER DEASON: Probably it would be best to go through your entire presentation, and then we'll open it up to questions to any of the presenters.

MR. HOFFMAN: Okay. Commissioner Deason, I would just let the parties know, the participants know that Dr. Cirello needs to leave by 10:30. So I suspect that we'll be done by then, but I just wanted to let everybody know that.

COMMISSIONER DEASON: Well, perhaps in an abundance of caution, if there are questions for Dr. Cirello, we'll go ahead and open that up to questions at this time. Mr. Beck.

MR. BECK: Thank you, Commissioner Deason. Dr. Cirello, one of my questions concerns the public utilities purchasing the small companies versus the private ones such as your own. I'm wondering if what you're asking the Public Service Commission to do is to determine whether customers are better off being served by a private utility with a positive acquisition adjustment that would be paid by the customers versus being served by a public utility, and how would you recommend to the Commission that they make that decision?

MR. CIRELLO: I believe what I asked for is that the Commission take a look at the playing field and level the playing field because currently the playing field is not level, and we do not have an opportunity to compete in that arena for those customers, nor to provide them the service that we can in that setting.

MR. BECK: But rather than what you see as leveling the playing field, shouldn't the Commission be more concerned with the customers whether they're better off being served by a private utility with the customers paying a positive acquisition adjustment versus being served by the municipal utility?

MR. CIRELLO: There are many examples out there where public utilities have purchased systems and then applied a surcharge to what were previously your customers. And those public utilities apply that surcharge rather openly to those customers, and the rate that the customers pay within a very short time is increased dramatically. So this is not an assumption that a public utility brings lower rates to the customer.

In fact, we have an example such as that one that we were subjected to where we have a public utility trying to take one of our utilities by condemnation and a quick take. We've been able to fend that off. And one of the things that happened was that precipitous thing where the community came in and took -- by order that was eventually rescinded, took the utility over, and then issued to the customers the projected surcharge, which was going to be significant, some $30 per month per customer for the next five years to pay for the acquisition. And I don't think the customers were benefited there at all by the public utility taking it over. It was part of -- the injunction that we filed stopped that; that was part of the evidence that was used.

MR. BECK: So, Doctor, do you think the Commission should make the determination whether customers would be better off under a private utility versus a municipal?

MR. CIRELLO: No. I think the Commission should take the opportunity to protect the customers that they have from that type of operation. And the only way they can is to consider positive acquisition adjustments in cases like that.

MR. BECK: That's all I have. Thank you.

COMMISSIONER DEASON: Staff.

CHAIRMAN JACOBS: First of all, let me just apologize. I was down at the Legislature this morning. Nothing of interest down there. But -- and we were talking about water, in fact. There was a water presentation at the House, so we were consistent. Staff.

MR. WILLIS: Commissioners, I have one question of Dr. Cirello, and it really goes to the nonjurisdiction of counties. I'm really curious as to -- about what's going on in those counties that you have systems in that are not jurisdiction under the Commission and what's going on with the counties and your company as far as acquisitions, if any. If you could, tell us about it.

MR. CIRELLO: We have a unique situation in Florida in that counties can take back regulation. They can also be our regulator as well as our competitor. It makes it a very, very unique situation. It's like putting us into a competition but making sure that we wear a weight belt every time the race is run.

It's a difficult situation because we need to share with the regulator as well the activity in our seeking systems to purchase, and at the same time, the county, if you will, is looking at similar systems to purchase. So we're competitors at the same time we're before these people. It is not an equal or equitable business situation at all.

And in terms of acquisitions, we tend to keep away from those because of that situation where we may be able to bring some benefit, and in many cases, our rates are lower, which is sometimes embarrassing, to the host county. We don't participate because of the competition and the consequence.

MR. WILLIS: That's all the questions we have.

CHAIRMAN JACOBS: Very well. Are we in an order of procession? Before you leave, Dr. Cirello, there is one question. I noticed in some of the other states Staff has outlined some where there is sort of a portfolio approach to looking at how to encourage more so than focussing primarily on acquisition adjustment. That is an essential factor. They look at the holistic approach of attracting companies to acquire these. Are there other factors or issues that we could look at that would cause you to look at acquisition more attractively?

MR. CIRELLO: We have with us today another utility system that our parent corporation, Elite Water Services, which I also am the president and CEO of, owns, and that is, Heater Utilities. And the president of Heater Utilities, Bill Grantmyre, will speak to you about this in particular, but it is located in North Carolina. It is the largest private water and wastewater utility in the state of North Carolina.

I could tell you that in North Carolina, and I believe they will go through it in their testimony, we work hand and glove with the Commission to solve some of the more difficult problems in the State, some of which are related to the quality of service and the quality of product being generated, troubled systems, and in that situation, I believe they will give you a detailed example of a more recent one.

It has been to the benefit, we believe, to the customers in the system, as well as the State, as well as the Commission, as well as the environmental agency within the State and the federal agency as well, to solve some of those problems, and that we've been able to apply our resources as opposed to public resources to solve some of those problems. And I think there is a role and a benefit that we can provide, as well as, I think, our counterparts within the State can provide, to help solve the many, many problems that Florida has in this particular area. And they will present to you, Commissioner Jacobs, a detail of that today.

CHAIRMAN JACOBS: Okay. Thank you.

COMMISSIONER PALECKI: I have a question.

MR. SEIDMAN: Excuse me, Commissioner. Could I ask Mr. Cirello a question?

CHAIRMAN JACOBS: Go ahead.

MR. SEIDMAN: As a chief executive officer for Florida Water, do you have any problem with the basic Commission policy that's in effect now, that absent extraordinary circumstances, the purchase at this kind of premium shall not affect rate base as the building block for a rule?

MR. CIRELLO: I think what we said here earlier, which my counsel said, we would like to take the current policy and build upon that policy so that there are defined rules and guidelines. And I think when business has defined rules and guidelines that they know they can operate within, not necessarily decisions, but defined rules and guidelines, businesses can make appropriate decisions as to whether they should or should not go forward on behalf of their investors with regard to the risks they're about to take.

And it's that factor that we're asking you to look at and apply rules, if you will, guidelines, if you will, standards, if you will, to assist so that this doesn't become an unknown element. And I think in other states that we operate in, North Carolina, in particular, they are set rules and guidelines that are very specific that one has to make, and one has to be able to prove; that we have to be able to prove as a utility and demonstrate as a utility in terms of benefit, in terms of risk, in terms of reward that are established by the Commission that make it a much more definable process as opposed to an unknown. And I think that's what we're looking for.

COMMISSIONER PALECKI: You were previously asked a question by Marshall Willis about your experiences in counties that are not regulated by the Public Service Commission. What are your experiences with regard to investing in systems that are not regulated by the Commission? Are you more likely to invest in those counties, less likely? And what are the criteria you use in making these investment decisions?

MR. CIRELLO: Our investment decisions in those counties is based on meeting the needs and ensuring the quality and the service to our customers. I've indicated to you that when we get into competition with a county that we're regulated by to purchase a system, we tend not to get into that conflict because they are also our regulators. And it is a conflict.

And I put it -- it's not to say it's hard and fast that we never, but we're not likely to put ourselves at odds with our regulators over a property. And I think you can understand why.

COMMISSIONER PALECKI: So are you saying you're more likely to invest in systems that are under the jurisdiction of the Public Service Commission as opposed to being regulated by the individual counties?

MR. CIRELLO: Our record is pretty clear on that over the last five years, yes.

COMMISSIONER PALECKI: As far as purchasing of systems that are inadequate, that need substantial investment to bring them up to standard, wouldn't a more fair manner of bringing things to a point where the utility can earn a fair return but yet the ratepayers still are not being penalized to project the investment that it would be necessary for the utility to make to bring that utility up to standard, and then set a rate in that manner rather than through some artificial acquisition adjustment?

MR. CIRELLO: Well, that's basically what we're doing when we're evaluating a system for acquisition. We're taking a look at current costs, the purchase price of the system, as well as the future investment necessary to bring it up to standard. That may be true for a system that you may call "troubled" or you may call "perfectly fine." The standards fortunately or unfortunately are fairly broad in some area with regard to the type of treatment that's being provided and the degree of treatment that's being provided. So we look at all the factors, and we put that into our purchase price.

Yes, you're correct that when you look at that there's got to be at least the opportunity, and I think as we'll demonstrate here with our latest experience in North Carolina where we did get an acquisition adjustment. We also committed to make the improvements necessary to bring that system up to the standard that it should be at, and that was all incorporated within the rate structure. But there was some assurance to us through acquisition and adjustment that we would get the acquisition adjustment to complete that purchase, and now we're completing, if you will, the improvement of that system to the benefit of the customers.

COMMISSIONER PALECKI: Thank you.

MR. WILLIS: Commissioners, could I ask just one more question, please.

CHAIRMAN JACOBS: Go right ahead.

MR. WILLIS: Dr. Cirello, I don't mean to put you on the spot here, but you are a person who has a lot of knowledge in the industry with acquiring companies, and I was just wanting to know if you could give us some insight on your thoughts concerning the controversy over the large negative acquisition adjustments that sometimes happen out there in the industry and how this Commission should go about treating those or looking at those.

MR. CIRELLO: Quite honestly, we have not come across large negative acquisition adjustments. And the industry itself, except for rare instances that may occur on an individual unique situation, negative acquisition adjustments in a rising cost industry, in a consolidating rising price industry with regard to -- are probably hard to come by if people are competing.

And indeed, my latest knowledge is that the Dutch are now actively seeking to participate in this opportunity to buy systems in the United States. So now we have the English, the French, the German, the Dutch, and some utilities, some other electric utilities that are coming into the system, so there's a lot of competitors coming into the water business. And that price seems to be rising as opposed to falling well above the depreciated cost.

CHAIRMAN JACOBS: And that brings me to my question. If we were to pursue a policy to encourage consolidation, should we be driven by a price that's bid by a foreign company? Not that we want to discourage them, but their views of the marketplace may be different than ours. They have pure investment in mind, and it is to their advantage to see these prices escalate, whereas we have to address the obvious public interest in making sure that these systems in some way track their cost. How do we balance that?

MR. CIRELLO: You're absolutely correct, Commissioner Jacobs. The only balance you have is to ensure that in the investigation process, if you will, or in the review process that there is a demonstrated benefit to the customer in the acquisition process, a demonstrated benefit to the customer. And I think that's got to be your guideline. Without a demonstrated benefit to the customer, one can then question why the acquisition is even necessary.

CHAIRMAN JACOBS: Very well. Do you have questions, Commissioners?

COMMISSIONER PALECKI: I have one further question.

CHAIRMAN JACOBS: One More.

COMMISSIONER PALECKI: My background is in the electric and gas industry, and I'm very new to the water and wastewater industry. But in reading through the materials that have been put together for this workshop, I noticed that in California there have been very strong pronouncements made by the California Legislature that would encourage their Commission to move forward with consolidation of these small mom-and-pop systems. Is there any kind of language that has come out of the Florida Legislature at all on this issue that would give us some guidance here at the Florida Commission?

MR. CIRELLO: There's none that I'm aware of, but then again I'm not an expert in this particular area. I claim expertise in a very small area, but I'm not aware of any language at this particular point from the Florida Legislature. But indeed, what California is trying to do is solve a problem of many, many developer systems that are out there. And I use the term "developer;" many, many small systems that are out there that are bringing anywhere from average to poor to absolutely terrible quality service and water product, if you will, to the customers. And it continues to exist in a widespread fashion. Florida has similar problems as well.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JACOBS: Very well.

MR. WILLIS: Commissioner Palecki, Mr. Hoffman might be able to address that question. I'm not sure, but he might.

MR. HOFFMAN: There's nothing out there, Commissioner, that's been proposed or that's on the books that directly addresses and responds to the specific subject that you raised. There is a provision on the books that is indirectly related to the issue of acquisitions. And if you go back a few minutes, you'll recall Dr. Cirello was talking about the issue of the conflicts inherent in county regulation and how that tends to be an impediment to the purchase of systems in jurisdictional counties.

One of the things that we think could enhance the interest of the customers who are regulated by the Commission now, and perhaps in the future, would be to fix, I'll use the word "fix," a provision in Chapter 367, and that's a provision under 367.171. And that's a provision which was passed by the Legislature back in the '89-'90 time frame.

And when the Commission first reviewed that provision -- it's the cross county boundary provision, and when the Commission first reviewed that in its first case, it quite logically concluded that it appeared that the intent behind the provision was to provide efficiency, so that if a utility such as Florida Water operated in multiple counties, it would view -- it would be viewed to be functionally related so that the Commission would have jurisdiction over Florida Water systems, not only in the Commission jurisdictional counties, but in the county jurisdictional counties.

But through litigation, which Commissioner Deason has been involved in and is quite familiar with, the courts have interpreted that provision to require a pipe to cross county lines, which basically has nothing to do with efficiencies and which has nothing to do with avoiding duplication of efforts or two or three different standards of regulations throughout counties versus what might be regulations at the Commission.

So to wrap up, I think that perhaps an amendment to that statute which would give the Commission jurisdiction over utilities that operate, very simply put, operate in multiple counties would be a benefit for customers in the State, the customers of privately owned utilities.

COMMISSIONER PALECKI: Has the industry been working towards trying to fix that situation?

MR. HOFFMAN: I am not directly involved in those types of efforts, Commissioner, so I can't say with certainty whether they have or whether they haven't, but I would certainly encourage the Commission to get behind that effort at some point in the future.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JACOBS: Thank you. Next speaker.

MR. PERRY: I appreciate the opportunity for the Commission letting us speak today. My name is James Perry. I'm the chief financial officer of Florida Water Services. You do have our prefiled comments, and I won't go through all those, but I do want to keep it kind of brief. In going through all the other comments that were filed today in the industry, I think you will find a theme today that's reflective of our position and I think everybody else's. And it's already been hit upon by Dr. Cirello and Mr. Hoffman.

The guidelines under an acquisition adjustment continue to be establishment of guidelines and standards and some type of certainty in the process. We also look for some type of regulatory finality once the acquisition adjustment is established, and really, by establishing these things, we really end up with the basis for the economics of the transaction. We know what we are going into, we have an idea of what we're going into, and what the outcome will be. And any type of transaction that we enter into or contemplate, we need these basic guidelines and standards.

The factors that you have already heard and discussed and will be continued to be discussed today why this is important, the acquisition adjustment in a lot of times in a consolidation of this industry brings several positives to both the customers of the utility today and the customers of the utility that's being acquired that will be rolled into that customer base.

The first of these is really the professional management of the system. You've heard the discussions about small developer systems and/or systems that are not developer systems lacking in professional management.

Consolidation economies of scale. That factor will be talked about significantly. And it is said before, the economies of scale both help the customers being acquired in the system that we have today. Quality of service and improved service, the issues in regards to environmental regulation.

Customer communications. This one seems kind of nebulous, but it's really interesting in the systems that we have been acquiring lately. The lack of communication with customers. It's occurred because of a -- small developers were almost an absentee owner basis.

The environmental stewardship compliance, I already talked about. Rate stability and lower financing cost.

The consolidation. As most of you know, the entities that are consolidating have a very favorable capital structure. They are typically well-financed, well-backed, and that results in the lower financing costs. A lot these small mom-and-pop's, the financing cost sometimes exceeds the leverage graph formulas on your return on equities. So there's a lot of difficulty there.

And one thing that is really happening that we are seeing and it was prevalent in some of the California Legislation and discussion was the establishment or increased conservation efforts. I think all the utilities at the table here today have plans in place and have conservation efforts that they participate in that they bring in when they consolidate these smaller systems.

And finally, the rate stability for all the customers, not only the system that we're acquiring, but our current customers as well.

Those are just some of the general comments I wanted to make. And I'd really like to flow in -- if anybody has any questions, I'll answer them, but kind of transitioning to Bill Grantmyre, who is the president of Heater Utilities. And as said earlier, Bill has a unique situation in North Carolina where they acquired a troubled utility at a very significant premium and a significant acquisition adjustment, and then subsequent to that, there was significant capital investment that needed to be brought into that system in order for that system to get up to standards. And I think that example really plays into a lot of these elements that I've discussed earlier.

CHAIRMAN JACOBS: You mentioned rate stability. It would occur to me that there is going to be tremendous pressure on rates. I was having a conversation with Dr. Cirello earlier. First of all, in the instance where you have a system that has not been properly maintained, you are going to have to do the upgrades. So those are going to go, and then the acquisition adjustment, if you assume that it's a positive, would go on, seems that you're going to have the potential for rate shock rather than stability. How do you address that?

MR. PERRY: Well, I think it's almost on a case-by-case basis, but if you have a utility that has environmental concerns and you have to put in an additional plant to meet the corrections for the environmental stewardship and the DEP requirements, you're going to have to do that regardless if you're the individual owner or the acquiring owner.

So there is a fixed cost there, but what typically transpires is, when we look at a system, we understand we have to put in "X" amount of dollars of capital to bring it up to standards. But what we also factor in is, we know we can consolidate that system. We have a lower cost of operations. We have a lower cost of customers service. We have lower cost of overall management because we bring that system in. So they are mitigating factors that will reduce the rate shock, if you will.

There's still going to be rate impacts, but it will be far less by consolidating that system than by letting it stand alone.

CHAIRMAN JACOBS: Okay. Thank you. I'm sorry, could you give us your name again, please.

MR. McDONNELL: My name is Marty McDonnell. I'm here with Mr. Hoffman, who had to leave the room.

CHAIRMAN JACOBS: Okay. Then you're going to give way to --

MR. PERRY: Mr. Grantmyre.

CHAIRMAN JACOBS: -- Mr. Grantmyre.

MR. GRANTMYRE: Good morning. My name is Bill Grantmyre, and I'm the president and house counsel for Heater Utilities, North Carolina. With me today is Jerry Tweed, who's our vice president and director of regulatory affairs. Jerry will also be -- I'll make the main presentation, but Jerry will also be available to answer questions.

Jerry -- just a little background on him -- he, for ten years, was the director of the water and wastewater department of the public staff of the North Carolina Utilities Commission, and for seven years, he was on the staff subcommittee of NARUC on the Water Committee. So he has extensive experience, 24 years' experience, in water and wastewater regulation, as do I.

But with regard to -- I need to explain a little bit about the public staff in North Carolina because it enters in very much in my presentation. We do not have a consumer advocate outside the Commission. The Commission has a public staff which is the consumer advocate group and represents the using and consuming public in all utility cases: Electric, telephone, gas, and water and wastewater. And they do all the investigations and all the testimony, and really, the Commission has a very small staff that really assists them in deciding the cases. The Commission is the judge, and they have a small staff that supports them in deciding it. But the public staff is the consumer advocate group that advocates for the public. And as you see in my presentation, it comes into play very heavily.

First of all, in North Carolina, there's really no history of any litigated cases regarding negative acquisition adjustments. It's very, very rare that anything is bought below book in North Carolina, and there really have never been any litigated cases, so I couldn't even tell you what the treatment would be in North Carolina.

With regard to positive acquisition adjustments, Mid South Water Systems was an acquisition adjustment in North Carolina whereby the Commission in May of 1999 approved a transfer to Heater Utilities of Mid South Water Systems and approved a very large acquisition adjustment. They basically approved the full purchase price we paid for this system of $9 million in rate base. That was our purchase price. They approved the full purchase price and rate base.

And also, when they approved the transfer and the acquisition adjustment, that was at the time of transfer, and it was a final decision on the acquisition adjustment. It's -- basically, what Florida Water had asked for is that the Commission determine the rate base at the time of transfer. And actually, that is a procedure commonly followed in North Carolina, where if the company or the public staff requests a final decision or a decision at the time of transfer, the Commission basically always makes that decision at the time of transfer. So that's a normal procedure.

In the Mid South case, it was a negotiated stipulation settlement between Heater and the public staff. We had extensive negotiations with the public staff. When we presented them with our contract for the acquisition, we had data requests. We then sat down with them as to exactly what our findings was as to the conditions of the systems, what we would have to do to upgrade these systems from capital upgrades, what we would have to do for operational upgrades.

The public staff was very concerned that they wanted these systems operated in the same manner that Heater operated its other systems; that is, they wanted to know our staffing levels, the management supervision.

They got into very great detail as to the -- you know, would we have the same salary levels, would we have the same work order processes, the same billing processes. And it was very crucial that we did give them assurance that we were going to incorporate all the Heater operational procedures into this new system, and they would be operated just like the systems that Heater owned in the Raleigh-Durham area. So that was very crucial.

Mid South was a large water company. It was the third largest in North Carolina when we bought them. It had 10,000 water customers and over 200 separate water systems. So it was a large company made up of very small water systems. It had over 400 water wells, supply wells. From the wastewater side, they had 2,000 customers and 31 separate wastewater systems. They operated in 19 counties in the Piedmont and western North Carolina, really ranging from Charlotte and Winston-Salem, all the way up to the Tennessee line and the mountains. So it was a system -- large company made up of very small systems spread out over a large geographical area.

Mid South was a very troubled water company. They had some serious operational problems. They had some serious compliance issues with the North Carolina Utilities Commission, show cause type hearings. They also had show cause and compliance issues with the state regulatory agency that regulated water, which we call DEH, and wastewater, DWQ. So it was a company that seemed to be in constant litigation with the regulators of all types.

When the Commission approved the full purchase price and rate base, they did a unique thing in that they stepped in the purchase price. We were granted $7 million at closing, and the remaining $2 million was stepped in over time. And the way they stepped it in was somewhat unique, and they said that it would be based on customer growth in the 19 Mid South counties. The Mid South systems were almost all built out. There was some growth left, but they said any new developer systems which Heater acquired; that is, when I say "new developer," that is a brand new system that has never been put in. And we negotiated with the developer that we would participate in installing the original system that that would count towards the customer growth to bring in over time the acquisition adjustment, but they excluded existing systems. They said if you acquire an existing system in those counties, that would not count towards customer growth to bring in the rest of the acquisition adjustment.

So they came up with a very unique formula on that, and what they said was, for every customer you add in these 19 counties either on a Mid South system or a new developer system, we would bring in $450 of the acquisition adjustment, this remaining $2 million. So that was a very unique and creative way to encourage the step in of this acquisition adjustment and also encourage us to acquire new systems in that area.

CHAIRMAN JACOBS: And of course, on these later acquired systems, you would not be able to get any kind of adjustment on those either, would you? Because those --

MR. GRANTMYRE: On the later acquireds, if we bought an existing developer system -- I'm sorry, existing water or wastewater system, you know, that would be treated on a case-by-case basis. There was nothing in the stipulation that dealt with what we would do on those. When we got a new developer system, we would be granted whatever investment we had in that system, but there would be no acquisition adjustment on that new developer system other than this $450 per customer that's left over from this $2 million piece that they set aside. That would be brought into rate base gradually, and it would only be brought in in the next general rate case. It would not be flowed in immediately or with the new developer system.

As I said earlier, we had a substantial number of upgrades to these systems. And in the two years that we've had these systems, we've spent between 2.5 to $3 million each year on the Mid South system's upgrade. This was a very undercapitalized company that operated on an operating ratio. We have that in North Carolina and had a very small rate base. And we had presented all these to the public staff that these were our upgrades that we were planning on doing, and we have to continue to do more.

This acquisition adjustment is the largest acquisition adjustment ever approved in North Carolina, and the final order from the Commission from the time it was filed, the application was filed, until the time of the final order was a period of six weeks. And we closed four weeks thereafter, we closed the transaction. But that's a summary of the Mid South.

I'll be glad to provide -- answer questions on any details. And Mr. Tweed, with me, is our director of regulatory affairs. If there are any questions as to North Carolina, our regulation in general, Mr. Tweed would be glad to answer those.

CHAIRMAN JACOBS: Any questions, Commissioners? Staff? Any other parties?

MR. SHAFER: I have one question. If we could possibly get a copy of that settlement agreement at some point.

MR. GRANTMYRE: Yes, we could provide you the settlement and the stipulation.

MR. SHAFER: That would be great. Thanks.

MR. BURGESS: Commissioner, may I ask a couple of questions?

CHAIRMAN JACOBS: Go ahead.

MR. BURGESS: I understood you to say that the regulation of it is on operating ratio, the rate regulation of the companies in North Carolina is on operating ratio?

MR. GRANTMYRE: Okay. North Carolina has a statue that says if a water or wastewater system requests, the Commission shall regulate it by operating ratio. So if there's no request, then the Commission would have the option. In general, the Commission regulates companies with very small rate bases based on operating ratio and those companies with significant rate bases on return of rate base. For example, Heater Utilities is operating on return on rate base; Utilities, Inc., is regulated based on return of rate base; and really, all the professionally run utilities return on rate base.

MR. BURGESS: Okay. I was trying to understand how if it was based on operating ratio, how an acquisition adjustment to rate base would have any effect.

MR. GRANTMYRE: Yeah. The Commission has the option of going either way, but the larger companies are return on rate base.

MR. BURGESS: Thank you.

MR. SHAFER: If I could just follow-up on the operating ratio methodology in North Carolina. Could you tell me, you know, how they determine whatever markup there would be over breakeven?

MR. TWEED: They basically give you a return on your operating revenue deductions or your operating expenses. They calculate that overall return on your expenses similar to the method they would use to calculate your overall return on rate base.

MR. SHAFER: And what was the level of return on that particular transaction?

MR. TWEED: There was no rates increase involved in the transfer of Mid South to Heater, so there was no return determination at the transfer proceeding.

MR. SHAFER: Okay.

MR. WILLIS: Could I follow-up also, just talking about North Carolina itself, if it's appropriate?

CHAIRMAN JACOBS: Go ahead.

MR. WILLIS: Does North Carolina provide any policy or incentives to try and acquire -- have larger companies acquire small companies?

MR. TWEED: You mean above and beyond the positive acquisition adjustments that they give? They have done that for us on six cases in the last two and a half years or so. They have given positive acquisition adjustments to Heater. Above and beyond that, are you talking about return bonuses and things like that?

MR. WILLIS: Correct. Any kind of incentives, higher rate of return, any kind of incentives.

MR. TWEED: I haven't seen a higher rate of return granted as an incentive; that doesn't mean that they wouldn't do it. They do have a standing policy to encourage consolidation of utilities under professionally owned utilities. I think the EPA encouraged that in their viability capacity development task force. All that stuff that the EPA was going through encouraged that. And the North Carolina Utilities Commission joined in with the health regulators and basically agreed that they would take steps to try to encourage consolidation, including looking at the positive treatment for utilities such as acquisition adjustments and other incentives, but I haven't seen any other yet that have been necessary. The positive acquisition adjustment is a pretty good incentive by itself.

MR. WILLIS: Does the Commission have any kind of written policy on that encouraging --

MR. TWEED: The Commission doesn't have a written policy on it. They generally regulate by precedent. You bring the case before them; they will decide that case as a precedent, and other companies use that precedent. But no written rule.

MR. WILLIS: On the purchase of Mid South, did the Commission elaborate anywhere, in an order or something, as to the reasons that they were granting the acquisition adjustment?

MR. TWEED: Not in the Mid South case, but they have in the some other cases. The basic test -- or a lot of the things that are mentioned here in Florida Water's comments, for example, but the transaction, first, has to be at arm's length. You can't do it trading within your companies. The purchase price must be prudent. That's a determination the Commission just looks at. Those two are fairly simple.

The third one is, there must be benefits shown to the customers. Now, the benefits shown to the customers involve all of these things that have been discussed here today, including the ones that are in the Florida Water comments and the Staff comments. The benefits of consolidation generally such as economies of scale, professional management, all of that is laid by the Commission in determining whether to grant the positive acquisition adjustment based on the benefit to the customers.

I guess one of the major differences is that -- the way I'm reading the Florida policy or rule is, there is an extraordinary circumstance hurdle to go over, and I don't think -- that's much more difficult to accommodate consolidation than a positive signal, which is not an extraordinary circumstance. I don't know that these circumstances are extraordinary where professionally run utilities are taking over nonprofessionally operated utilities. That's not really that extraordinary, but everyone wants to see it happen. The positive acquisition adjustment is a signal that the Commission can send to the regulated industry that will make it happen.

MR. WILLIS: On the Mid South acquisition, you said the Commission allowed 7 million purchase price in rate base. Was that the acquisition adjustment or was a portion of -- what portion of that was the positive acquisition adjustment?

MR. GRANTMYRE: The order approving the transfer did not specify what the acquisition was. And the acquisition adjustment still is not totally known exactly what dollar it was. I could give you some background facts. In the last rate case of this company, the rate base was, give or take, 1.4 million. And that was a test year, '93-'94. And the company was an operating ratio company, so it paid little attention to its rate base. And that was the consumer advocate public staff number, and the company simply accepted it and didn't waste any time litigating it because it really didn't make any difference to them.

The company was not very strong on its accounting and accounting for plant additions. And over time, before we bought it, they did make a number of plant additions and improvements, not all of which were recorded as capital assets on the books to increase the rate base. So we don't know exactly what their rate base really was, and the Commission didn't know it at the time they approved the acquisition adjustment.

It would have been significant -- the rate base would have been quite a bit above the 1.4 million because six years had elapsed, but it would have been well, well, well below the $9.0 million purchase price. When we closed the transmission, we finally got their books, which were incomplete. They showed a rate base of approximately $2 million, but that rate base was understated. But since the Commission had approved the entire $9 million, we didn't waste a lot of time doing accounting for no reason. So it would have been in excess of $2 million, but we're not sure exactly where, but nowhere near the $9 million.

COMMISSIONER PALECKI: How did the Commission in North Carolina determine that 9 million was a prudent purchase price?

MR. GRANTMYRE: I think they had looked at what the rate base per customer would be, what was being paid for other systems, a comparable bid by one of our competitors on the system. Actually, our bid was less than theirs.

COMMISSIONER PALECKI: Did they look at replacement cost?

MR. GRANTMYRE: No, they did not do that calculation. They may have done that, the public staff may have done that, but they didn't share it with us if they did.

COMMISSIONER PALECKI: Did you do any sort of engineering evaluation study of the system that you shared with the Commission?

MR. GRANTMYRE: We did an inspection of all the systems, and we had provided that to the public staff. Again, the public staff is the one who does -- whereas you-all's Staff does the investigations, the public staff assumes their role as far as the audit in investigations, and they are the consumer advocate. We provided them our investigations.

Again, the investigation was a little more difficult than some because of the nature of 230 separate systems spread out over 19 counties. It was not as easy than doing just a one major system that had, you know, 12,000 customers, but we did provide all our data to the public staff as part of their data request. They did file data requests, and we responded to them.

MR. TWEED: One of the things the North Carolina Commission does look at is the customer purchase price, and they compare it to the per customer rate base of the acquiring utility, which in this case would be Heater. So I'm sure they looked at that.

COMMISSIONER DEASON: Did they have any information on the level CIAC of the system they were acquiring?

MR. GRANTMYRE: The CIAC, it was almost all CIAC or a lot of CIAC on these systems. Mid South had uniformed rates on all its systems. You know, they were one rate structure, and the Commission did have a lot of information on the CIAC, yes, sir.

MR. WILLIS: On getting back to the Mid South transaction, if I may, how many rate cases have you had since you've acquired the company? Have you had one yet?

MR. GRANTMYRE: Yes. We had a rate case which was finished October 30th of 2000.

MR. WILLIS: Was the rate increase necessary because of the purchase price also as well as improvements?

MR. GRANTMYRE: The purchase price was a part of the rate increase, the improvements were part of the rate increase. We had a statewide rate increase where we brought Mid South into our uniform rates. Another part of the rate increase for Mid South was that in their last rate case, which was approximately '95-'96, they did a poor job of preparing it. And although they got a full rate increase on their sewer request, it was only half the allowed return they could have gotten. They got a 5 percent operating margin, and they could have gotten about a 10, which they got on their water operations. So they had not properly presented the case, and their rates were understated.

MR. WILLIS: You said you brought them into your uniform rate. Does Heater have uniform rates for all their systems in North Carolina?

MR. GRANTMYRE: Yes.

MR. WILLIS: How was the rate increase taken by the public?

MR. GRANTMYRE: We had customer hearings -- Jerry, do you want to answer this?

MR. TWEED: The Commission on the wastewater rates, the statewide wastewater rates, decided actually to put a larger percentage of the increase on the Mid South -- the former Mid South customers. Due to the large amount of expenditure we made on the wastewater systems, the public reception -- I think you are asking as far as bringing them into the uniform rates -- was surprisingly mild. There was not a great deal of objection given the fact that we were in for -- how many customers build --

MR. GRANTMYRE: It was about 34,000 customers we were in for a rate increase for.

MR. WILLIS: So when you brought them into the uniform rate, you raised the rates than to bring them in the uniform rate? Is that my understanding?

MR. GRANTMYRE: Yes. The Mid South customers had a greater rate increase because their rates were appreciably lower. With respect to the response of the customers, we had five hearings in the Mid South customer areas, and we had one hearing in the Raleigh-Durham area where the bulk of the Heater customers were.

In the Raleigh area, only 15 customers appeared and testified, and only one mentioned Mid South out of all the 15 customers in the Raleigh area. In the western part of the State, the Mid South area, we had anywhere from 1 to 40 customers appear at the various hearings and testify. They probably averaged about 20 customers at each hearing. And the customers, the Mid South customers, were very appreciative that the Commission had allowed Heater to take over the system and were very complimentary of the improvements, but as usual in rate cases, they wanted minimal rate increases or no rate increases.

COMMISSIONER PALECKI: How did the new rates compare to their previous rate for the Mid South?

MR. GRANTMYRE: The Mid South customers experienced approximately a 30 percent increase in water and wastewater. The Heater customers experienced about a 12 percent increase in water and wastewater. And it had been about three years since our last rate case, and I need to point out, North Carolina does not allow indexing like you-all do. You bring in gradually some expense increases. We allow no indexing, and therefore, rate cases are far more prevalent in North Carolina because it's the only way you can recover increased operating costs.

COMMISSIONER PALECKI: Did Mid South have uniform rates prior to the acquisition by --

MR. GRANTMYRE: Yes. They had their uniform rates. And in the rate case, we brought Mid South into our uniform rates, along with about four other companies we acquired over the last several years were also brought into the uniform rates.

COMMISSIONER PALECKI: And you did say that Mid South was made up of 119 separate systems?

MR. GRANTMYRE: Excuse me. They were made up of 200 water systems, 31 wastewater systems in 19 different counties.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JACOBS: Any other questions? Thank you, Mr. Grantmyre.

MR. HOFFMAN: Mr. Chairman, that concludes Florida Water's presentation.

CHAIRMAN JACOBS: Very well. Next on the agenda, I believe, is United Water.

MR. deNAGY: Yes, sir. Hi, Dave deNagy with United Water. I have no real agenda here other than glean an understanding, a better understanding what we're doing with acquisition adjustments. We had provided some written responses to the questions that were handed out. I would like to say, however, that United Water, formerly Jacksonville Suburban Utilities, did glean some benefit from acquisition adjustments since 1986. We look for continued relief that way.

We have situations in our area where we're faced with competition from quasi-governmental agencies and at least one county near us. We would like to have defined the extraordinary circumstances or benefits that need to be defined in order for the acquisition adjustment to be allowed. We have cases at hand, acquisition -- one acquisition I can think of that we have a possible investment savings for our customers; however, we're unsure the treatment of that when we make the purchase price for that utility. We also have a utility that -- or a part of our utility that we're looking at selling that is costing us money where we need to make a huge investment, and this would be the flip of a positive and negative acquisition adjustment. And we're not quite sure how we would justify -- we could justify that through savings and investment, but we're not clear as to the treatment under the Commission rules.

I agree with what Dr. Cirello had said earlier about leveling the playing field. It is very much a competitive industry, and we're very much interested in expanding and growing and also maintaining cost-effectiveness for our customers, as well as a return for our owners as well.

Other than that, Commissioners, I really don't have any other comments at this time. Again, I'm really here to just glean a better understanding of what we're doing with our acquisition adjustments. Thank you.

CHAIRMAN JACOBS: Thank you.

MR. WILLIS: Commissioner Jacobs, could we ask Mr. deNagy a couple of questions?

CHAIRMAN JACOBS: Go ahead.

MR. WILLIS: Mr. deNagy, United Water has had a history of only looking at acquisitions surrounding their Duval base, which would be Nassau County, Duval, and

St. Johns. Why has that been? Why hasn't United Water gone throughout the State looking at acquisitions?

MR. deNAGY: Well, we have taken a look at utilities in other counties. Our parent company, is my understanding, has certain minimum criteria that they want. So I think that has constrained us somewhat here in the recent past. We have gone through two owners now in the past five years, and that's also impeded somewhat what we want to do growth-wise.

MR. WILLIS: United Water also operates systems and owns systems throughout the United States, don't they?

MR. deNAGY: Yes.

MR. WILLIS: Do other Commissions that you deal with, other states have incentive programs or acquisition programs where you're acquiring companies?

MR. deNAGY: I believe that Pennsylvania and New York State have guidelines with that regard.

MR. WILLIS: Are you actively acquiring systems in those states?

MR. deNAGY: I believe in Pennsylvania we are at this time. I'm not sure about New York State.

MR. WILLIS: That's all the questions I have.

CHAIRMAN JACOBS: Any other questions? Thank you. I'm going to take a ten-minute break, give the court reporter a chance to breathe.

(Brief recess.)

CHAIRMAN JACOBS: We'll go back on the record, and Utilities, Inc., is up. You may proceed.

MR. SEIDMAN: Good morning, Commissioners. My name is Frank Seidman. I'm representing Utilities, Inc. Mr. Carl Wenz is here also. He may give some comments when I'm through, and Mr. Girtman. I'd like to start out first by welcoming back Mr. Palecki to Florida. Good to see you. Our paths crossed I think the last time when we were still trying to develop cogeneration pricing rules, so it goes back quite a ways.

COMMISSIONER PALECKI: Thank you.

MR. SEIDMAN: So far we've heard this morning --

COMMISSIONER DEASON: Now we know who to blame for that; right?

MR. SEIDMAN: What?

COMMISSIONER DEASON: I'm just kidding. I said, "Now we know who to blame for that."

MR. SEIDMAN: I lost. What we've heard so far this morning is, I think, some interesting ways of looking at incentives, but to get back to basics, I think we have to start somewhere and have some type of a benchmark, some type of a starting place. And that starting place, I think, really should be our existing policy for the Commission that absent extraordinary circumstances, a purchase at this kind of a premium shall not affect rate base.

Mr. Willis, when he introduced the program today, indicated that this policy had basically been developed over a series of orders over the years. That's partially correct, because back in 1989, this Commission had an investigation of the policy, a formal investigation, that was docketed with testimony. And the results of that investigation was to continue the policy, which we have today, which had been working for probably five or six years before that. And since that policy was confirmed in that order, we have had some 11, 12 years of experience with it. And it's been, I think, pretty good.

We've had something in the order of 100 or so acquisitions since that time that have been treated consistently under the existing Commission policy. So I think that speaks well, one, for consistency and, two, for the fact that the number of acquisitions indicates that something about the policy may be right. Now, it may be good to tweak it some and to spell out some additional procedures so people have a better feel for what it takes to meet certain requirements with regard to implementing an acquisition adjustment if one is warranted. But the basic policy itself, I think, is a good building block.

One of the good things about it is, it's simple.

It's easy to understand; it's easy to work with. And it pretty much is consistent or is fully consistent with the statutes under Chapter 367. Basically, what the policy effect is that it makes rate base transparent to ownership; that is, that rates are based on original cost regardless of who owns it, and unless something extraordinary is shown, that's the way things are going to be. So people can look forward to having rate base based on original costs of assets depreciated and net contributions regardless if it's owned by Ower A, Owner B, or Owner C down the road.

In the order that the Commission issued back in 1989, Order Number 25729, this is what the Commission had to say about that portion of the policy. The Commission has consistently interpreted the investment of the utility, investment of the utility is in quotes, as contained in Section 367.081(2)(a), Florida Statutes, to be the original cost of the property when first dedicated to public service, not only in the context of acquisition adjustments, but elsewhere as well. In our current policy, we do not deviate from this interpretation, nor do we exceed our statutory authority.

So what that really means is, if when a utility -- when a utility plant is put into service initially, if it costs $1,000 for pipe, rate base is going to be based on that $1,000 regardless of who owns it. And that's something that results in a stable rate base and stable rates for consumers. To me, that's the most important factor, I think, that we need to start with.

And what you have been hearing this morning is mostly with regard to how do we justify or what incentives can we give for positive acquisition adjustments? I think we have to be careful on the other side of what do we do about negative acquisition adjustments? What happens when a utility is purchased below that net book value of the rate base from the previous owner? And I think this consistency with the statue tells us what we do. You stay at rate base unless there's something special, something extraordinary that happens.

If you start to drop those rates, rate base, and the rates that go with it, you're sending out a false signal to people as to what the assets really cost to serve them. You may get a lower rate as a result of it, but you're going to get higher usage of water treatment facilities, and you're going to be facing now -- you're going to be fighting the conservation ethic that's in our statutes also. And that's the policy of the state of Florida. We want to conserve our precious resources. I think the last thing we want to do is to start making adjustments that result in those resources being priced at less than what they cost to have been put in the ground and provide the service.

And the other thing I want to make mention of is the fact that -- it's something, I think, that Mr. Hoffman said -- we need to see some finality when we deal with transfers in the acquisition adjustment rulings. It's very important that a utility be able to depend on what the Commission says in a transfer order with regard to its acquisition adjustment and know that that is going to stand the test of time.

So, therefore, what we've recommended is, if there is no showing of an extraordinary circumstance in a transfer, rate base continues as it was for the previous owner. If the Commission issues an order or not, that's final. It doesn't need to be addressed anymore because you've already considered, were there any extraordinary circumstances. They are not going to appear after the fact because you're dealing with circumstances that would have surrounded what was happening in the past up to the time of the purchase. So we need finality in that or else we're going to have -- I think we've had finality, for the most part, in this thing up until recently. And that has been one of the stabilizing forces that's helped as an incentive for large utilities to make prudent purchases.

And another thing, I guess, is the statute requires and common sense tells us that the Commission needs to make a finding that a transfer is in the public interest. If you can't make that finding that a transfer is in the public interest without the acquisition adjustment being negative, maybe you shouldn't be making that finding, but we should know about it at the beginning. That basically is the comments I want to make at this time. We have presented responses to the Commission's questions, and you-all have copies of that, and there's no sense going back over that.

MR. WENZ: I would just like to add just a couple of comments. Some of these we've heard earlier today that --

CHAIRMAN JACOBS: Could we get your name for the record?

MR. WENZ: My name is Carl Wenz. I'm vice president of Utilities, Incorporated. You know, the one thing that we look for in evaluating the regulatory environment at Utility, Inc., is certainty, finality, Commission standards that are measurable and quantifiable, and consistent application of those standards.

And I'd just like to say that the current policy as it exists, in my opinion, in our opinion at Utilities, Inc., the policy is working. We actively acquire other utility systems in the state of Florida. We pay more than book value, we pay less than book value, but the policy is working. So I would suggest not changing anything. But if you are inclined to change or to modify the current policy, I would certainly urge you to take into consideration the notion of certainty and finality. Those are very important to Utilities, Inc.

MR. GIRTMAN: Commissioner, I'm Ben Girtman representing Utilities, Inc. I'd like to specifically concur in some of Mr. Hoffman's comments made previously, and I'll just emphasize it rather than repeating, and that is the necessity of having rules that we can rely upon that are certain and final. We need to have orders of the Commission that are certain and final.

These companies make decisions involving many millions of dollars sometimes in a single case and certainly over time accumulatively. These are major investments. They have major impacts, not only on the companies themselves and the shareholders of those companies, the owners of the companies, but they have a major impact on the quality of service that will be available and whether service will be available in some cases to the residents of the state of Florida.

And so we need to look at the issue from all sides, not just a question of whether a company's decision is a prudent decision to invest in a company, but is the decision that the Commission makes going to be prudent in encouraging the availability of service and the quality of service that, I think, all of us want the citizens of Florida to have.

With the additional uncertainty that's being considered in this proceeding, it's very important that a purchasing utility have the ability to know what the final terms or the transaction will be before finally committing to purchase a utility. In prior cases when the application for a transfer has been filed with this Commission, the Commission had issued a final order approving the transfer but simultaneously issuing a preliminary order setting rate base for purposes of the transfer and delaying consideration of either positive or negative acquisition adjustments to a later time.

However, until the purchasing utility knows the final treatment of any possible acquisition adjustment, it would not be a prudent business decision to make a final commitment to the purchase; therefore, the utility should have the ability to opt out of the purchase if the Commission's treatment of acquisition adjustment is not as it had anticipated when making the initial negotiations to purchase that utility in the first place.

Right now, what we have under the current recent procedure is a "gotcha" procedure. You buy the system or sign a contract to purchase it, the Commission puts its final stamp of approval on the transfer, and then you come up with this question of an acquisition adjustment, which until just recently has been fairly reliable and certain. Over the past 100-plus cases that this Commission has decided since 1989, it's been fairly clear, fairly certain, and there hasn't been a whole lot of problem. But when we start tinkering around with the prior practice, that induces significant incertainty and causes problems, not just for the regulated utilities, but in the long term will cause problems for the customers in the state of Florida.

Another point I, as a lawyer, would like to emphasize for your consideration is a point that was mentioned by Mr. Seidman about conservation. We have had a growing effort by the Legislature in Florida to promote conservation. This Commission has been actively involved individually and with the DEP in promoting conservation measures. You've just gone through, I know, some cases relating to golf course use of recycled water, if you will. There are a lot of things that are being done in the area of conservation, not just water, but in many other subject areas, recycling and others.

And if you follow a policy that requires utility -- water service particularly, water and sewer service, to be provided at lower than cost, lower than the rate base that was put in the ground, then you are considering a policy that is contrary to the stated legislative policy promoting conservation. Anytime I can go to a sale and by product below cost, boy, I'm there, and I'm going to buy all I can get. That's the same way it is with water.

If you require a negative acquisition adjustment, that produces an incentive for the customer to use more water because he doesn't have to pay what it costs to provide the water to him. And when you have a question of a transfer and the rate base from the seller is the same rate base that's acquired by the buyer, there's no harm to the customers. If the old owner had continued to provide service, they would have paid the same rates based on that same rate base. Too often you find that developer-related systems have come in and requested rates which are not fully compensable. The issue has been around for at least 20 years that I know of at my dealings with the Public Service Commission.

And so what you have sometimes is a case where a developer does not have fully compensable rates, he sells his system, and two or three or four or five or whatever number of years later, the buyer says, we need to raise these rates to receive fair rates. Well, that may produce a rate increase, which, of course, makes any customer unhappy that their cost of living is going up, but there's no difference. If the old owner had continued to own the system and come to this Commission to apply for fully compensable rates, then they would have been dealt with on the basis of their ownership of the system and would have been granted compensable rates if they asked for it.

Perhaps one of the areas that the Commission might want to consider is, in those systems which are developer-related or perhaps some that are not, if they come in and ask for less than fully compensable rates, perhaps there ought to be an examination of, should the Commission really do that. Now, the Commission is not in the business really of forcing utility companies to charge more utility rates than they ask for. That's been a policy of this Commission for a long time.

But I'd like to close in the Order Number 25729 which was considered and decided by this Commission in the early 1990s after its investigation workshops and investigation of acquisition adjustment policies. I'd like to read part of this paragraph; it's on Page 3.

"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."

Again, let me, please, emphasize the need for simplicity, for finality, for clarity. You have a very simple policy that works now. If you look at the policies of North Carolina, or excuse me, Pennsylvania, New York, California, the others that the Staff has presented to you, and I read the summary that the Staff had put forth about the number of acquisitions that have actually occurred in those states, there are very, very few, less than 10 percent of what's been done in Florida. Florida's policy works because it's simple, it's clear, it in fact is fair to all people concerned, including the utilities and their customers.

The bottom line is, your current policy works. Now, that doesn't mean it couldn't use some clarification, perhaps some definitions. But the current policy in fact has proven to be far more successful than in New York or California or Pennsylvania, and those are the states that Staff has cited to you. So we encourage you in your consideration of the issues before you to, let's don't throw out the existing policy without giving some very careful thought to why it's there in the first place, the reasons that are there in the development of that policy, the prior generic proceedings which were participated in by utilities, by the Office of Public Counsel before this Commission and the orders that the Commission issued based on those prior proceedings. The current policy works. Thank you very much.

CHAIRMAN JACOBS: Thank you. Any questions?

MR. WILLIS: Commissioners, I do, if you want me to start.

CHAIRMAN JACOBS: Go ahead.

MR. WILLIS: This kind of goes to Mr. Seidman or Mr. Wenz. I don't know who really wants to answer it. And I'd like to start off with the comments we just ended up with, and that's the incentives provided by other states. This morning we've heard some, I think, differing opinions, and I've seen differing opinions from the companies in the comments filed. I know I heard this morning, and I believe I heard that there was a desire to have some of those incentives brought to Florida from New York and Pennsylvania and some of the other states, maybe even California, I'm not sure, but Mr. Seidman's comments basically said that they don't work.

What do you believe about it, Mr. Seidman? If they don't work, do you think there's a need to even take those into consideration?

MR. SEIDMAN: I drew the conclusion they don't work based on the summary that Staff gave us of the number of acquisitions that were made under those policies. Now, I don't know if that was all the acquisitions, but if it there were, it was a pretty small number, just a handful, but maybe Mr. Wenz can express that better because he operates in other states.

MR. WENZ: Yeah, I would agree with that. And one of the problems is that, you know, the interpretation of the incentives that are talked about, the application of those are subjective. You know, what is a prudent purchase price? What is the definition of a troubled company? You've heard this Cinderella story of Heater taking over Mid South, and that's an example where acquisition adjustments work.

I've got a story that shows just the opposite. It was in the same state, North Carolina. It was shortly after Heater purchased Mid South. We purchased a wastewater company from a bankruptcy trustee. We went to an auction, and we were the high bidder. There was a very troubled company. It had been under the ownership of the bankruptcy trustee for a number of years. It was basically managed from the public staff, which you heard about from Mr. Grantmyre. Their net income every month was sent to the North Carolina Department of Justice to satisfy tax liens. Their access to capital consisted of a Visa card with a $2,000 credit limit. All of their tap fees were put into an escrow account and could not be removed without a Commission order. And we could not get an acquisition adjustment on that troubled company, what I would consider a very troubled company. And one of the things the Commission pointed to in their order was that none of the customers complained about the service. Well, it's a wastewater company, and the waste goes down the drain, and they are happy.

The point is, you know, the interpretation of a policy can be very subjective, and what is a troubled company, what is a prudent acquisition adjustment, what is a prudent purchase price. Each one of you Commissioners sitting up here today probably has a different definition of that. And the way the Florida policy is now is, rate base is rate base is rate base. There's no room for a subjective interpretation of that. And if you start getting into things like, you know, what are extraordinary circumstances -- we had a case last year where we had to prove that extraordinary circumstances didn't exist, and I didn't even know what we were trying to prove didn't exist.

But the policy here works. And, you know, Florida -- it's not just the policy acquisition adjustment policy. It's the whole regulatory scheme here. There's a lot of rules, there's a lot of policies, you know, that you know where you're going to come out when you file a rate case, you know how to apply the used and useful formula, you know how to apply the cost of capital formula. The less subjectivity there is to the regulatory scheme, the less risk there is and the more favorable -- the more friendly we find the environment. And that's why we're growing in Florida.

MR. GIRTMAN: In response to Mr. Willis' question, one thing that you have to do, too, is focus on the differences between positive acquisition adjustments and negative acquisition adjustments. There are many similar concepts related to those concepts, but there are some differences. And anytime you start deviating from rate base, you need to have a very good reason why. And when a utility comes in and asks for a positive acquisition adjustment, they need to have a really good reason to show why they should deviate from rate base, and if they can show the Commission that, then they should be awarded a positive acquisition adjustment.

Likewise -- and that's the utility's burden. If someone comes in and seeks to impose a negative acquisition adjustment, they ought to have to show why. It's their burden to deviate from rate base.

Now, if you have no deviation from rate base, that's the third possibility. Rate base is clear to most accountants. It's understandable, and it provides certainty rather than fair value regulation as we have had in this State in prior years. It gets very subjective when you start edging away from the certainty that's available in rate base regulation. And I know there are some concepts out there that are being used, some very successfully. But the greater number of variables that you inject into your determination of an acquisition adjustment, the less certain it is, the less reliable the purchasing utility finds that business circumstance for that particular purchase and the regulatory environment as a whole, and they will have a tendency to back off from purchases that they otherwise might make if there is -- if there are too many variables thrown into what is already a very clear policy.

MR. WILLIS: Mr. Wenz, you're one of our largest utility holders, private utility holders, in the state of Florida, and I know you are in North Carolina also, and I know you said our incentives are better in Florida. What other states do you currently operate under?

MR. WENZ: Well, we're in a total of 16 states. Most of the states along the eastern seaboard: Virginia, Georgia, Maryland, Pennsylvania, Ohio, Indiana, Illinois, Nevada, Arizona, Louisiana, Mississippi, and Tennessee.

MR. WILLIS: Are you considered a large investor-owned utility holder in any of those states besides North Carolina?

MR. WENZ: I would say no. Ohio, Indiana -- well, Indiana we're growing right now, but Ohio, Tennessee, Mississippi, those are single system states. We are probably one of the larger in Louisiana, let's say, and definitely the Carolinas.

MR. WILLIS: You don't own any utilities in Pennsylvania at all?

MR. WENZ: Yes, we own two utility companies in Pennsylvania.

MR. WILLIS: I was just curious because I understood they have incentive programs there too. Is there a reason why you haven't pushed to acquiring companies in Pennsylvania?

MR. WENZ: I just don't think the opportunity has presented itself in Pennsylvania. We purchased a company a couple of years ago from a developer, but I wouldn't call it a quote, unquote troubled company where we wanted to pursue the acquisition incentives offered by the Commission. I think we purchased at or near rate base, so we didn't pursue an acquisition adjustment.

MR. WILLIS: I asked this question to Florida Water's representatives this morning, and it goes to the nonjurisdictional counties in the state of Florida. What's been your experience as far as are you acquiring companies in the nonjurisdictional counties? If you could just kind of let us know that.

MR. WENZ: We have systems in Sarasota County and Hillsborough County which are nonjurisdictional.

MR. WILLIS: Are you actively acquiring in those counties or any other counties?

MR. WENZ: I think we're actively acquiring anywhere there is an opportunity. I wouldn't say that I would shy away from a county-regulated system. I prefer PSC regulation because I know PSC regulation. And, you know, our big thing at Utilities, Inc., is uncertainty. If we can remove an element of uncertainty, we're better for it, and there's less uncertainty dealing with the PSC than there is with a county regulator, so I definitely prefer it here.

MR. WILLIS: The next question I have deals with the comments filed by Mr. Seidman, and it deals strictly with one of the questions we asked. We asked basically if there's a need to have a difference in acquisition policy between large companies and small companies. And we've heard a lot of about viability of companies and the need to go out and have an incentive to purchase these troubled companies. But why do you-all believe we need to have the same incentives or the same policy for acquiring another large company versus small companies who might be troubled, especially when you look at a company who may be the same size or slightly smaller than you that isn't really financially troubled, they're just a good acquisition?

MR. WENZ: Are you looking at me? Well, I believe that, you know, right now prices are dictated by the market. You know, you negotiate the best price you can, and in light of that negotiation, you know, you have an idea what rate base is and you know how the Commission is going to treat it. If you start adding conditions to the policy, you know, based on large companies or small companies, again, it's a layer of uncertainty. And how are you going to define small companies versus large companies? And do you want encourage Utilities, Inc., to acquire just large companies or just small companies?

You know, we like to acquire systems in and around areas where we already operate, large and small.

CHAIRMAN JACOBS: If I recall, one of the states, I think it was California, has that kind of a connections limit on their acquisition policy, don't they, 3,300 connections or something of that sort? Are you familiar with that?

MR. WENZ: I don't recall that, Commissioner.

CHAIRMAN JACOBS: It's in the introduction here, I believe. No, I'm sorry, it's Pennsylvania. On Page 16 of the Staff introduction. They say that one of the considerations is that the acquired system has less than 3,300 connections, is not currently viable, is in violation of statutory and regulatory standards. Is that something that you would think would be unreasonable?

MR. WENZ: That I would think is unreasonable?

CHAIRMAN JACOBS: Uh-huh.

MR. WENZ: No, I wouldn't think that would be unreasonable. And the cutoff was 31? Did I hear you correctly?

CHAIRMAN JACOBS: 3,300.

MR. WENZ: 3,300.

MR. SEIDMAN: I was just going to add something. Are you through with that?

MR. WILLIS: I don't know. I have more questions, but --

CHAIRMAN JACOBS: Go ahead.

MR. SEIDMAN: I just want to add something, Marshall, with regard to what you were talking about whether the policy -- or why don't we need a policy that is different by size. If we assume we're going to use as a base the existing policy, I mean, it seems to take care of itself because the existing policy is basically rate base is continuous. So it wouldn't matter whether it was a large utility purchasing another large utility or small.

Any incentives that would be necessary on top of that would end up in the extraordinary circumstances portion. And there may not be any in the large one purchasing another large one. It may be good for the company, but they may not be -- you know, it may not be troubled, it may not have some financial difficulties, the ones that are being purchased, but the other company wants to purchase it just to increase their share or whatever, and it does no harm to the customers. If that's the conclusion, then there just wouldn't be any positive acquisition adjustment. I think it would take care of itself.

Whereas, in a larger one purchasing a smaller troubled one, then you're in a position where you could make some arguments that it's necessary for the public interest, and there are benefits to be had from it.

MR. GIRTMAN: Mr. Willis, following up on Mr. Seidman's comments, let's break down the question a little bit. Is it correct that if a large utility company in Florida wanted to acquire another large utility company in Florida, that by itself would not be a reason to reach -- for the Commission to reject that acquisition; that is, you would allow that acquisition?

MR. WILLIS: Currently, that's what the policy says.

MR. GIRTMAN: Okay. And if you had a small system that wanted to acquire a medium-sized or a large system, assuming that it's a prudent investment, but the size of the acquiring utility vis-a-vis the acquired utility really wouldn't have anything to do with whether or not you-all would consider it to be an appropriate acquisition, would you? That by itself.

MR. WILLIS: Not by itself, it wouldn't.

MR. GIRTMAN: Okay.

MR. WILLIS: It would be kind of strange to have a small one acquire a large one, though.

MR. GIRTMAN: I haven't heard of one, but I just want to break the question down so we can focus on the parts of it. Okay. So there's no problem in the size of an acquiring utility versus the size of an acquired utility, large versus small on either end; is that correct?

MR. WILLIS: Basically, yes.

MR. GIRTMAN: Okay. So what we're talking about is the question of whether you should have a different acquisition adjustment policy depending on the size of either the purchasing or the purchased utility; is that correct?

MR. WILLIS: Well, that's right. And it comes down to the fact that you have two different types of utilities operating out there that you might deem you might want to have a different policy for. And I think some of the states have moved towards that. Some states might look out there, like Pennsylvania, and say, there are troubled utilities that we actually have jurisdiction over, and we'd like to have incentives to get these troubled systems acquired by larger companies who can deal with their problems in a more efficient manner.

And then there are other companies who are acquiring larger companies that aren't what you would deem a troubled system. I think there's some differences there, and my question really went to trying to get your opinion on whether or not there really should be a difference in policy between those two circumstances.

MR. GIRTMAN: Okay. Breaking the question down even further. Isn't it possible that either a small, a medium-sized, or a large utility can be a troubled system, either financially or otherwise? Isn't that possible?

MR. WILLIS: It can happen.

MR. GIRTMAN: So if we layer on a restriction of size on top of being a troubled system, we in fact are interfering in market forces which otherwise might work to the benefit of the customers. That's just my perspective. That the more limitations, restrictions, requirements, and uncertainty that you impose on this, the more you inhibit the ability of these growing utility companies to acquire another system.

And I have yet to see a presentation of the rationale for having a different policy; maybe there is a reason for one, I just haven't seen one yet. Maybe you have read more than I have on the subject. I know there is a temptation to give an extra incentive perhaps for a larger system, utility system, to buy a small, troubled system, utility system, some kind of extra incentive, but I think if we get off the track and start looking at these myriad examples of what might be done and perhaps are done in the other states to fit their particular regulatory scheme, if we bring that to Florida, we basically mess up what's a fairly simple system that's working.

And, you know, if there is a need for an additional incentive to buy these systems, then we need to narrow the question way down and address that part of it, not necessarily big versus small.

MR. WILLIS: Let me ask a question dealing with acquisition adjustments themselves, and it goes to positive acquisition adjustments, and it goes to not recognizing negative acquisition adjustments. There's obviously benefits that have to be proven in what we term "extraordinary circumstances" when you approve a positive acquisition adjustment, when the Commission does that. Likewise, when the Commission grants a utility rate base instead of negative acquisition adjustment, there are reasons for that as in there are no extraordinary circumstances involved, and therefore, the Commission has granted negative.

What would your opinion be if in the future those synergies created by granting a positive acquisition adjustment don't come about. And likewise, if there were problems in the granting of a transfer where there was recognition of rate bases that are negative acquisition adjustment where the acquired company had problems and continued to have problems even more so, what would your opinion be as to whether or not the Commission should revisit those circumstances? And you might want to break down both positive and the recognition of a rate base separately in those because they are different.

MR. SEIDMAN: Yes, they are. I guess positive first. I guess I don't have any real problem with revisiting when a positive acquisition is given, and the record is pretty clear on why that acquisition adjustment is given. I mean, if it's tied to something that's measurable, you can go in the future and see whatever was the reason occurred. I don't have any conceptual problem with that. But I think you just have to be wary of measurement techniques when you go ahead and do that, really. I think you almost have to set it out in the acquisition adjustment order what you're going to be looking for come the next rate case or whatever period of time you're going to be looking at it.

With regard to a case where a purchase is made at less than rate base and rate base is allowed to continue at the seller's rate base and the new owner, for some reason, doesn't deliver whatever, quality of service or whatever it is, I don't think you have the same problem. I think then you're still in the seller's shoes. If the seller was still there and had problems and came up to the Commission with a rate case, whatever actions the Commission would have taken for that seller with regard to the problems that that utility had, it would be the same ones for the purchaser.

I mean, if his plant doesn't operate, it shouldn't be in rate base, not necessarily forever through an acquisition adjustment, but through a rate base adjustment. If he has expenses that are improper, they should be disallowed. But I don't think some type of a -- going back and applying a negative acquisition adjustment to the purchase is the solution. I think you get all the solutions you need in your ability to put a limit on -- you know, the lower limit on rate of return, restrictions on expenses, removal of nonused or nonfunctioning plant from rate base, and the ability to require the utility to meet some type of standard in order to keep a rate increase, you know, a timetable for some improvements, required maintenance, something of that nature.

COMMISSIONER PALECKI: What about in the example where a utility is purchased for $5, it has a rate base in excess of $270,000? Now, apparently it must have been a troubled utility. The reason for the $5 sale price is probably because there's going to need to be a large investment made in order to operate that utility up to standard.

Wouldn't it be more fair for the Commission to recognize a negative acquisition adjustment, but then also recognize the additional investment that would be made to bring that utility up to the standard and use that calculation in setting the rate base rather than the $270,000 figure?

MR. SEIDMAN: Well, I think you run into the same problem. When you deviate from that original concept, you're treating the two owners differently. If the sale had not been made and that seller was still the operator and a lot of investment had to be made and he came to the Commission for rates to make that investment, you'd have to give it to him based on his original cost --

COMMISSIONER PALECKI: Under your example, we have $270,000 rate base, $5 purchase. A half a million dollars needs to be invested to bring the utility up to standard. It doesn't seem fair to me that rates should be based on 270,000 plus half a million. You're going to see a tremendous rate increase to the customer when it seems that the half a million dollars in improvements is what should be recognized.

MR. SEIDMAN: Well, that's going to be recognized regardless, I mean, because that is -- whether it's done by the previous owner or the new owner, that is investment that is going to be documented, and as long as it's used and useful, the Commission is going to be obligated to allow a return on it. It doesn't matter which owner made that investment.

COMMISSIONER PALECKI: But shouldn't the Commission recognize if a utility is being sold at a huge discount, like in that extreme example where the utility is purchased $5? I mean, should we wear blinders to that as a Commission?

MR. SEIDMAN: Well, to be blunt, yes, because the cost that was incurred, that 270,000 that's in rate base at the time of the purchase, that was investment that was actually made. That was money spent to put something in the ground, and it's still there, and it's still serving the customers. And if you don't recognize that, you're saying to the customers that these dollars that were expended by the utility -- and this Commission has already in its previous order in 1999 recognized that the plant in service at the time it was put initially into service is the basis for those rates. That's what the customer -- as far as the customer is concerned that investment has been made and is entitled to return.

COMMISSIONER PALECKI: Well, I appreciate the fact that you are being consistent. I mean, you are saying the same thing on the other side with regard to positive acquisition adjustments.

MR. SEIDMAN: Right. Positive acquisition adjustment -- with regard to positive acquisition adjustment, you're talking about moneys that are expended by the purchaser. Okay. And you're going to have to look at that and see if it's worth anything.

COMMISSIONER PALECKI: What about in the circumstance that we've discussed where a utility is not operating at -- achieving anywhere close to its allowed rate of return and it's clear that the rate base on the books may not be accurately calculated?

MR. SEIDMAN: The seller, you're taking about, or just a utility?

COMMISSIONER PALECKI: The current recognized book value of the utility appears to be quite undervalued.

MR. SEIDMAN: That the current book value is undervalued?

COMMISSIONER PALECKI: And the current rate base that's recognized by the Commission.

MR. SEIDMAN: I guess I'm not quite sure I understand. Is it what you're saying is that the numbers that are represented on the utility's books are not accurate?

COMMISSIONER PALECKI: Perhaps. Or, you know, I think we had an example where one of the speakers mentioned that the utility hadn't really bothered to have certain access recognized in a rate base.

MR. SEIDMAN: I think that was in the North Carolina case because they were on an operating ratio basis and didn't really care about it, but in this State we care. And, of course, when a transfer is made, the Commission Staff does an audit and establishes the book value of the assets being transferred at that time. And when they do that, they go back, and they do a complete paper trail of invoices and whatever other costs may or may not be part of the assets of that utility.

And by the time you get to the transfer docket and establish net book value, you're establishing what's really on the books after an audit. If, for some reason, that was not done and you come into a rate case and you find that the books are really inaccurate, then you make an adjustment. I mean, if there's stuff on the books that shouldn't be there, it's gone, you take it out of rate base. If it was equipment that was purchased and it is not functioning, you take it out of rate base.

Then, again, if there was something that they didn't have on the books but we have got a paper trail behind it, you know, then you'd put it on the books and continue with that as part of the rate base, but depreciate it back to the time when it was actually put on the books. You wouldn't start it fresh. So you would have a fairly well-depreciated asset coming onto books if it was something that was left off or, say, you know, put in ten years ago and nobody caught it.

COMMISSIONER PALECKI: I know in the gas industry there are a lot of circumstances where a regulated gas utility will purchase a propane utility that is not regulated, and there's really not a book value to be had at that point. Is that -- does that occur in the water and wastewater industry?

MR. SEIDMAN: No --

MR. WENZ: It occurs where you buy companies or buy systems that are owned by developers, or what have you, that don't have very good records. And it's the burden of proving that rate base exists, you know, is placed on the utility, the seller or the purchaser. So if you can't produce the books and records to support the rate base, you're not going to get the rate base.

COMMISSIONER PALECKI: So what do you look at then?

MR. WENZ: Well, you look at, you know, how it fits -- you know, in many cases, we evaluate an acquisition based on how it fits into the rest of our operations and what kind of efficiencies we can gain from operating it versus the way it was operated by the seller.

MR. GIRTMAN: Commissioner Palecki, if I could respond to some of your questions there.

COMMISSIONER PALECKI: Yes.

MR. GIRTMAN: You talked about the question of noncompensable rates and the rate base which is either understated or overstated. Those really are two separate issues. If you have a rate base which everyone agrees is an accurate rate base and the utility is asking for less than fully compensable rates, that's one separate issue.

If, on the other hand, you have a rate base that's approved by the Commission that appears to be either higher than it should be or lower than it should be, that's the separate issue which, in fact, can be addressed by the Commission under its current statutes and rules to make those kinds of adjustments to increase or decrease rate base to the appropriate amount.

Now, you also in your original question talked about the reasons why a seller would want to sell. There are many reasons why sellers want to sell utility systems, and some of them have absolutely nothing to do with the condition of the utility. Some people just -- they started that utility only so they could sell houses, and they have sold most of their houses, and they don't want to fool with it anymore. You know, the utility may be in real good shape, but they're not utility people. They have got one system, it's a pain in the neck to try to operate that small an operation, and so they sell it. And they may say, well, hey, I'll sell it for what I can get. You know, I need to sell it now because I've got other things I need to do. I'm going down South to build another development. I don't want this utility system. I need the money to buy more land.

COMMISSIONER PALECKI: But it results in a windfall to the purchaser.

MR. GIRTMAN: Well, depending on your assumptions again. There are so many different variations of facts in these cases that it's difficult to sit here and make a rock solid bottom line assumption that everything is going to be the same. I don't think we can do that.

But I want to give you an example. I own a desk. It's 36 by 72 inches. I've had it for years. It's a good desk. I like that desk, but I changed the way I have my home office set up in my home, and that desk was too big. There's nothing wrong with it, it's just too big. So I got a smaller desk, and I got that desk for sale, and I can never get what fair value is from it. I'm going to have to sell it at a garage sale or put an ad in the Penny Pincher, and I'm not going to get what it's worth, but I don't want the desk. It's sitting in my garage keeping me from parking my truck in my garage, and I've got to get rid of that thing, so I'm going to sell it at a loss. It has nothing to do with the quality of the desk or the condition of the desk.

COMMISSIONER JABER: Can I ask a question to Mr. Seidman to follow-up on a question you had from Commissioner Palecki? Using the same example where the acquiring company pays $5 but the rate base might be over $250,000, is it possible that if the Commission made no adjustment at all that that would actually prevent rate cases at least for a while and rate increases?

MR. SEIDMAN: You mean as a condition of the sale that the purchaser agree not to implement a rate increase for a certain period of time?

COMMISSIONER JABER: Yes. Anyone --

MR. SEIDMAN: Well, I'm thinking.

MR. GIRTMAN: Yeah, I'll start. Currently, the Commission --

MR. SEIDMAN: Don't answer for me, though.

COMMISSIONER JABER: I'm sorry?

MR. SEIDMAN: Don't answer for me.

MR. GIRTMAN: Currently, the Commission wants an acquiring utility to adopt the existing rates of the purchased utility, which they do. It's routinely done. They operate the system for at least a year, and then the Commission will entertain some kind of rate adjustment application based upon that year's experience, which makes perfectly good sense. You need to have some solid numbers to work with. You don't just go theoretically moving things around. And so you've got at least a year that any question of a rate case is postponed.

Another thing to consider is, if those are fully compensable rates and there's been no additions to plant, there's no justification for a rate increase. If the rates are not fully compensable and there's been no additions to plant, then maybe it's time the utility ask for some kind of an increase. There may be some improvements that they need to do to that system; they need some cash flow. There may be fully compensable rates and additions made, maybe environmentally required upgrades, improvements, new ponds put in, whatever. It may justify a rate increase.

So to say that a utility should not be able to come in for a rate increase for some specified period of time, longer than the existing one year that's already on the books, again, it creates an artificial and unnecessary restraint on the ability of utility companies to do what they have to do to serve their customers.

MR. WENZ: I don't think there's an answer to that without knowing all the other conditions, you know, how quickly all these capital improvements that are talked about will need to be made, how far out after the one-year normal waiting period you'd have to wait.

MR. WILLIS: Could I follow-up on that just a minute? I don't understand the one year. Where does the one year come from? I mean, I've been doing this for a while, and I don't understand where you are getting the one-year period you have to stay out when you're acquiring --

MR. GIRTMAN: That's the practice that I have understood is applicable in these cases, that you buy a system, you accept the existing rates, adopt those rates and rules and procedures that are applicable to the old utility, the selling utility, and then you wait a year before you file a rate case. Now, maybe that's not in the rule. I can't point you to a specific --

MR. WILLIS: I just want to point out, there's nothing in a rule that I'm aware of that says that. What really occurs here usually is a company's own desire to operate the company for a year under their own expenses, their own administrative costs, so they know what their true costs are before they come in. There's no written rule from the Commission that you have to wait a year to come in for any kind of rate relief.

MR. GIRTMAN: Has the Commission accepted a rate application from a purchasing utility after it's operated a utility system for less than a year?

MR. WILLIS: Yes, we have.

MR. GIRTMAN: Oh, you have. Okay. I was not familiar with that.

MR. WILLIS: We have especially looked at the small companies where they filed staff-assisted applications, because you've had somebody take over an abandoned company or a small system, and you have to deal with projected costs in those cases to keep that company viable.

MR. GIRTMAN: Okay. But what you're talking about, isn't it an individual or small operation acquiring a small, troubled system? It's not one of these bigger companies.

MR. WILLIS: That's where they have occurred.

MR. GIRTMAN: Yeah.

MR. WILLIS: They have occurred where you've had a large company take over a small company, and they need the funds to go in and make improvements. We've had to deal with that, and we've had to try and give increases based on projected costs.

MR. GIRTMAN: All right. Well, I was not familiar with that case, but I am familiar with the general practice of the Commission that you do wait for a year.

MR. WILLIS: That's where I kind of vary. There is no general practice in the Commission that I'm aware of, unwritten or written, that says you have to hold out a year --

COMMISSIONER JABER: Marshall, that's really beyond where I was going anyway. Let me ask Mr. Seidman a question to try to flush out this issue a little bit more. I'm looking for a way to balance what the customers have told us with respect to, don't allow the utility to receive the windfall of an acquisition adjustment, and then allow them to collect in rates the cost of making the necessary improvements, and kind of flushing out the idea that the utility buys these kinds of systems that are sometimes troubled system at their own risk and just, you know, achieving some sort of balance. And my question really is more guided to that end.

If the companies want an acquisition policy that encourages consolidation, then what's wrong with a policy that says, we won't make an adjustment, but in return, you won't have rate increases for, you know, whatever the appropriate time is? And I don't know that that's the right way to go, but it's just something I'd like to flush out a little bit more.

MR. SEIDMAN: I understand what you're talking about. You want to limit the impact, rate shock, as was mentioned earlier, or something like this. I guess the first consideration is, the first assumption is that in a case like this that rates are below cost already. A $270,000 purchase, a $270,000 rate base for $5, but they're not collecting rates based on 270. They're collecting rates based on 100,000 or 75 or whatever, and therefore, theoretically speaking, the utility would be entitled to increase the rates just to bring it up to par.

I guess, conceptually, I think there's room to work with something like that. I'm not going to speak for my client in this because, you know, he's a purchaser, and he knows what he has to face, and those things have to be considered. But certainly the necessity for the cash flow is a consideration. If there is no immediate necessity for the cash flow, probably willing to do something like that, but if there's a necessity for it and you need -- and you show it, then you should not be stopped from putting an increase in as soon as you are able to.

As a practical matter -- I don't know, maybe this is what Mr. Girtman got what's been going on as far as timing. But as a practical matter, the time involved in getting a transfer and an acquisition completed from the time you make the application or the time you get the order and put rates into effect, it may well take a year. It takes a long time sometimes to get an acquisition completed, and certainly, even if it's completed within, say, six months or so, if you were going to go ahead and put in an application for a rate case, you are not going to see anything happen for another six months. So it's a practical matter. There's usually pretty good leeway before rates would change under any circumstance.

But I think that's something that I think these, you know, owners should speak to as a practical matter of stepping up rates, you know, put them in as a tier or some type of agreement on a waiting period, whatever, if these circumstances warrant it and the cash is not needed.

COMMISSIONER JABER: Throughout this morning I heard some of the comments when I could, and some of the comments were, you want to be able to have all of the facts and all of the regulatory policies in mind when you go to the negotiating table. And it just seems to me if you know that that same $270,000 plant would require $200,000 in improvements, then not only would you think about the $5 you have to pay, but in fact the $250,000 that you have to -- so in other words, before you acquire that troubled utility, you have to keep in the back of your mind that up front you'll need $255,000, and that determines whether or not you acquire it.

MR. WENZ: Yeah, all of those things are taken into consideration. Just as a follow-up to your first question, you prefaced your first question to Frank with, if we want to develop a policy that promotes consolidation, you already have a policy that promotes or facilitates consolidation. I think consolidation is alive and well in Florida. So I'd just like to reiterate that as many times as I can today.

COMMISSIONER PALECKI: Well, I appreciate the consistency of your position in that you don't advocate either negative or positive acquisition adjustments, and you like to have the simplicity and the finality. But what about in practice when you've come before the Florida Commission? Have you asked for positive acquisition adjustments?

MR. WENZ: I don't think we have ever asked for a positive acquisition adjustment. I know Marshall has got a better memory than I do.

MR. WILLIS: You know, they have never asked for positive acquisition adjustment. The only positive acquisition adjustments that have been approved mainly have been with United Water. United Water Florida has come to the Commission asking for positives, and I don't think they have a negative at this point. But it was the circumstances behind their acquisitions. There were synergies there that were created with those acquisitions.

MR. HOFFMAN: Mr. Chairman, may I briefly chime in?

CHAIRMAN JACOBS: Go right ahead. It's a free-for-all.

MR. HOFFMAN: Okay. Very quickly. I happen to think that the issue that Commissioner Jaber is raising is, frankly, the type of thing that should be discussed in a workshop like this because it's just so easy for all of us to trot in the things we've said over the last ten years, and we are trying to see if we can think about other things and reach solutions.

Now, the concept of deferring a rate increase is worthy, I think, of further consideration, particularly if it contains provisions which would effectively or essentially allow a waiver depending on the circumstances with investments of certain magnitude. I can tell you that in the last of couple filings that Florida Water made, they did include potential positive acquisition adjustments, and the agreements do contain provisions that would essentially postpone -- a binding commitment to postpone any request for a rate increase.

And so on the negative acquisition adjustment side, while -- you know, I wouldn't agree about the characterization of a windfall, but I understand why customers might think that. On the negative acquisition adjustment side, staying out for a year or two or three or whatever it may be dampens things from the utility's perspective, and then when you move over to the positive side, it could be applied as well. Where there's a positive, staying out would dampen the impact, eliminate the impact from customer rates for a year or two or three.

So I guess all I'm trying to say is that I think it's a concept worthy of further consideration and a concept that, frankly, Florida Water has rolled into the last two filings that we've made involving Spruce Creek and the Steeple Chase system. And just very quickly. There's been a lot of discussion -- there was decision about this issue, Commissioner Palecki, of coming back down the road and reevaluating the components or the benefits that may have been considered by the Commission in justifying an acquisition adjustment. And speaking for Florida Water, I can tell you that we disagree with that because that defeats one of the sort of hallmark principles that we have here.

One of the most important components to us is, whatever the rules of the game are, let them be decided up front. And when they are subject to uncertainty and clouds and your financial statements have these implicit clouds over them because a piece of rate base is potentially at issue four, five, six, seven years down the road, that's not the type thing we would advocate or support. Thank you.

MR. GIRTMAN: In further response to Commissioner Jaber. You raised the question -- and it's very deceptively inviting to use the phrase "windfall" when you're talking about a utility buying another utility for less than rate base. If you go through -- when I first heard it, I thought, you know, that sounds pretty good. That's a reasonable argument, but when you start going through all the facts of these cases and these systems and the history of this and the ratemaking rules that are applied to this, it's not as simple as that.

And, in fact, in some of these systems that, for example, may have less than fully compensable rates, less than you, Commissioners, would have granted if the utility had asked for those rates, the windfall in fact has gone to the customers because they are paying lower rates than they otherwise might have had to pay. They may be suffering not as good a service, but they are not paying fully compensable rates either.

MR. WILLIS: If I could just follow-up to Commissioner Jaber's -- when she threw out the idea of trying to stay out for a while. There's another alternative out there that I don't think anybody has explored, and I'd just like to throw it on the table right now for anyone to comment on, and it kind of achieves the same thing.

As I understand it, Commissioner Jaber's idea was to maybe have the utility hold out for a while, but I understand the drawbacks of that, because we have DEP who comes along and mandates something two years later that you may not have even thought of, that anybody would have thought of would be a problem. And all of a sudden the utility is in bad posture where they have something coming along they have got to have rate relief for, and it could put them in a posture of abandoning or going bankrupt or ending up in a troubled utility status.

But how about the idea of what if someone comes in and purchases a utility for less than rate base, that the Commission at that point in time finds no extraordinary circumstances, then they would immediately accept a negative acquisition adjustment on that utility, and in return to kind of help blend this in over a period of time would accelerate the write-off of the acquisition adjustment?

For instance, you go out and purchase something for $100,000 that had a rate base of 30,000. The Commission would look at that; there's no extraordinary circumstances involved. Rather than say rate base, at that point the Commission would say, we're going to recognize the negative acquisition adjustment, and we're going to accelerate the amortization of that acquisition off over five years. What would happen then is, if you find yourself in the need to come in within three years, you would have to accept whatever unamortized balance there is at that point which would help stall out a heavier rate increase where you would have a rate increase on top of rate base because of needed improvements.

If you were able to hold out for five years, there would be nothing that would happen to you. In other words, that would be another method of looking at this saying, here's a way we can help you. We would like you to stay out as long as you can, but if you have to come in, we want you to recognize the unamortized balance. And what the Commission would give you at that point was an accelerated write-off of the negative acquisition adjustment far greater than the asset itself.

It's just an idea that might achieve the same thing. I don't know what your feelings are on that, if anybody wants to comment on it.

MR. WENZ: It's something we should talk some more about. And then at the end of the five years, what is your rate base?

MR. WILLIS: Rate base. It's rate base plus whatever you put into it. The acquisition adjustment would be gone in five years or seven years or whatever the Commission deem the accelerated write-off should be.

MR. WENZ: Well, that would certainly be a reasonable tradeoff to holding out.

MR. WILLIS: Does anybody else want to offer a comment on that?

MR. SEIDMAN: And if you came in, say, in the second year, would the amortization be above the line or below the line?

MR. WILLIS: The amortization, it would be above the line. In other words, you would have to accept the accelerated write-off. The accelerated write-off wouldn't change. It would continue to be accelerated at that point, but you would still get rate relief based on whatever the unamortized balance is plus whatever you had to put into the system. If you could hold out for that period of time, you would be back where you would be right now, which would be rate base.

At one end, it's an incentive to stay out, but it allows you to come in if you have a DEP mandate that says you have to get in here and do something and it's going to require millions of dollars --

MR. LARKIN: Who would pay the amortization?

MR. WILLIS: Pardon?

MR. LARKIN: The utility would eat the amortization.

MR. WILLIS: The utility would eat the amortization?

MR. LARKIN: Yes, the accelerated amortization.

MR. WILLIS: Well, the accelerated amortization would be recognized, but it would be on a declining basis at that point.

MR. LARKIN: Then you would have an immediate rate increase of one-fifth of the amortization.

MR. WILLIS: On a negative acquisition?

MR. WENZ: On a negative acquisition, it would be a benefit to the --

MR. WILLIS: It would be a benefit of the customers on a negative.

MR. LARKIN: Okay.

MR. WILLIS: It's just an idea I wanted to throw out for some thought.

COMMISSIONER DEASON: Well, let me ask you a question. The amortization, you said it would be above the line?

MR. WILLIS: Yes. You could consider it above or below the line. I think the Commission has the ability to do either one. If you think it would be more palatable to put the amortization below the line in that case and just recognize the unamortized balance, that would be my preference. I think that would be more palatable to the industry, to have the amortization below the line.

COMMISSIONER DEASON: What would be the rate base during the period of time that you're amortizing?

MR. WILLIS: During the period of time, it would be ever escalating back to rate base. In other words, if you accelerated write-off over five or seven years, you know, every year you would gain back one-seventh until you reached the end of the period where you would end up with the depreciated value of rate base in the seventh year.

MR. LARKIN: So in the case of a negative acquisition adjustment, there would be an immediate rate decrease?

MR. WILLIS: No, there would not. There wouldn't need to be at that point. The way I look at it, the benefit is that if a company goes in and makes and negotiates a good deal and they can stay out, then they could reap the benefits as long as they can stay out. But if they can't stay out, then they should be able to accept the unamortized balance being applied to rate base at that point.

It's just an alternative to the idea that Commissioner Jaber had that would give an incentive for a company to stay out, but if you had to come in, you would be able to get rate relief, but it would be with the knowledge that you're going to have to accept the unamortized balance of the acquisition adjustment being applied to rate base at that point. And I think the Commission would have the prerogative to say the amortization is below the line or above the line.

COMMISSIONER JABER: I understand my alternative, Marshall, I don't understand yours. I was thinking that an example or some sort of a hypothetical would be good. I just leaned over to Chairman Jacobs and asked if he would ask you for one.

CHAIRMAN JACOBS: Can you deliver one on-the-fly or would you --

MR. WILLIS: For a hypothetical, how that would work? Sure.

CHAIRMAN JACOBS: Well, let me poll the gathering here. It sounds like AquaSource we have three speakers, is that -- maybe take some time?

UNIDENTIFIED SPEAKER: My presentation is only probably going to take five to ten minutes.

MR. BECK: And we have three speakers, Chairman Jacobs.

CHAIRMAN JACOBS: It will take a while?

MR. BECK: I guess to file comments --

CHAIRMAN JACOBS: I don't want you to limit -- I just want to get a gage whether we should break now and come back or try and push through. But if you feel like -- I don't want you to limit your time at all.

MR. BECK: It's the Commission's pleasure. I mean, we'll keep going or break, either way.

MR. WILLIS: I could develop a better hypothetical over lunch, but I could do it on-the-fly too.

CHAIRMAN JACOBS: That also was a good --

MR. WILLIS: Before we break, though, I do have a couple of questions left that I'd like to --

CHAIRMAN JACOBS: Go ahead.

MR. WILLIS: One of these deals with -- and I hope I don't get something thrown at me from the bench, but it deals with incentives and uniform rates. We talked about incentives other than the acquisition adjustment policy, and I've heard Florida Water talk about -- I've talked to them in the hall, and I've talked to them -- you know, we've asked questions in here about it. And I've heard them talk about having the ability to have uniform rates. With Heater Utilities in North Carolina, it was a benefit to them when they went to acquire companies.

Do you-all consider that -- I know that Utilities, Inc., does not have uniform rates, and you are not really set up to do that because your systems aren't consolidated all into one company, but do you consider uniform rates as an incentive, or are there other incentives out there you would like to see also?

MR. WENZ: Well, I consider uniform rates an incentive. You know, the problem is when you acquire a smaller company and you want to bring them into your uniform rates, you're going to get opposition -- you may get opposition to a transfer because your rates are higher, so it really cuts both ways. And over the last several years, we have really avoided the whole issue of uniform rates here in Florida because it's been kind of a hot bed of -- it's been a bad issue down here in Florida. I prefer them. We've had them in North Carolina and South Carolina for a number of years, but not here, but I'm not opposed to them.

MR. WILLIS: My last question, and it is the last one I have -- it's kind of an easy one here compared to the others -- deals with the accounting treatment for acquisition adjustments.

When the Commission grants negative or positive acquisition adjustment, do you believe the Commission, at least I do, in my own opinion, believe the Commission should also in the order talk about the accounting treatment for the acquisition adjustment at least the period to be written off, the amortization period, the whole works, but do you believe that's something the Commission ought to be doing as part of the -- when one is granted a positive or negative?

MR. WENZ: I think that's all covered in the uniform system of accounts. So I would just leave it to the uniform system of accounts to dictate how it's accounted for.

MR. WILLIS: Except for the amortization period. There's nothing in the uniform system of accounts that talks about how the amortization should be done, and that's what I'm talking about. My opinion is, the

Commission should be dictating in an order the amortization period for acquisition adjustments when one is granted.

MR. WENZ: I'm not opposed to that.

MR. SEIDMAN: And if you take into consideration the proposal you have on the table here now, we're dealing with a negative acquisition adjustment as a -- over a five-year period, and then we have a different situation. No, we are not talking about amortization in the sense of whether it should be service life or whatever, but you are talking about a specific proposal, and I would guess that would have to be handled separately.

MR. WILLIS: Right, it would. That's all the questions I have.

COMMISSIONER JABER: Let me throw out a question for you, and to the degree you-all have covered this, I apologize. You just need to tell me. Have you thought about the idea of getting away from determining what extraordinary circumstances are, just getting away from that definition, and doing something more like what New York has done where they set the factors that the PSC should look at, and then review an acquisition case on a case-by-case basis and make a finding that those certain factors have been met? For example, factors like that the acquisition will result in improved quality of service, making it easier that the acquisition would result in the utilities complying better with federal and state regulations.

And Public Counsel, too, because I'd love to hear what your thoughts are from getting away from making a finding that the sale has extraordinary circumstances, but rather identifying factors and goals, and then looking at each case and saying, well, this acquisition meets the factors; therefore, it's in the public interest.

MR. GIRTMAN: Commissioner, several speakers have addressed the need for clarity, simplicity, finality of whatever procedure is going to be followed on acquisition adjustments. And there's been extensive discussion about the problems created for utility companies not being able to have knowledge up front of what the outcome is going to be. And anytime you string out a bunch of conditions or reevaluations and those kinds of things, it just introduces a great deal of uncertainty into the initial purchase decision.

There needs to be a decision up front that's done final, hey, we can live with this, or we can't live it and we won't buy it. But when you string those things out, it creates all kinds of problems.

COMMISSIONER JABER: Mr. Wenz.

MR. WENZ: Some of things are very subjective.

And, again, with each new Commission you may get a different interpretation of what those are. And I'll just reiterate again, I don't like uncertainty. And to the extent that we can eliminate uncertainty, you know, that's what I'd like to focus on.

COMMISSIONER JABER: Do you think that the Commission making a finding that something has or does not have an extraordinary circumstance gives you certainty?

MR. SEIDMAN: What gives you certainty is that the basic policy right now is that rate base will be continuous from one owner to another unless. And I don't think the other states do it that way. The other states start with nothing, and you go ahead and build up a case for something, whatever that something is. That's an uncertainty.

The certainty here is that you are going to get a continuity of rate base unless something else happens. Whether you call it extraordinary or, you know, other factors, I don't think that matters, but as long as you have a baseline, I think it's workable.

MR. HOFFMAN: Commissioner, I think that the facts show that in the Commission's adjudication of these cases, as Mr. Seidman says, the certainty is that it's book value. Eight out of some 110 cases resulted in decisions other than book value. The answer to your question is, yes, we have talked about it this morning, and Florida Water specifically is looking for and advocating that the Commission take an approach where there would be effectively more notice provided through the establishment of criteria that would be analyzed on a case-by-case basis.

MR. LARKIN: Are you looking for comments from us?

COMMISSIONER JABER: Yes.

MR. LARKIN: Well, we haven't had a chance yet, but I think we're looking for the same thing. But our position is that we want to find a middle ground, and the middle ground is not, let's make things sweeter for the utilities. Let's not only give them negative acquisition but positive acquisitions.

We want to see something where there's a sharing of the benefit of a negative acquisition, and I think that's the middle ground. And I think we can meet there, but we can't meet in the situation where all the benefits go one way. We don't go and solicit the customers to ask us to come down and fight about these things. We get calls; Jack Shreve gets calls; people ask him and they complain. If they didn't complain, we wouldn't be there; we wouldn't do those things. We would accept what the customers want.

But if you're buying a utility substantially below book value, there's something wrong. Even though the investment was put in the ground, it's not working right. It was designed for a bigger system, the developer has gotten his money out in the price of the lot. You can't ask the ratepayer to pay that and then pay for the improvements. It's unfair; it's unreasonable. And we oppose it, and that's why we raised these things all the time.

What we have offered now is, let's split the difference. Give us half of the acquisition adjustments, the negative acquisition adjustments, and we'll look at the benefits to the ratepayer. But it can't be a situation where things get better for the utility, and what we're here doing is a discussion discussing how we can improve the utility's financial condition without looking at the ratepayer's side.

COMMISSIONER JABER: Mr. Larkin, that is not what we're doing.

MR. LARKIN: Well, that's what we've heard so far.

COMMISSIONER JABER: Let me ask you a question. I'm looking for that middle ground. How do you determine -- what factors would you recommend we use to determine what the benefits to the ratepayer are? That's what I'm looking for. Instead of trying to define what an extraordinary circumstances is, I'm trying to determine what factors to apply.

MR. LARKIN: Here's a simple rule. You've got a negative acquisition, let's split it. Don't look at anything else.

COMMISSIONER PALECKI: Would you be consistent with a positive acquisition?

MR. LARKIN: No. Because a positive acquisition, you're paying more for that because there's an incentive there. There's something there that places the value of that system above its book value. There's a piece of land; there is access to more customers; the rates are higher than what they should be. So there are reasons not to give positive acquisition adjustments.

People don't pay more for a facility that is earning the market rate of return. If I go out and I buy a bond, a municipal bond, that has an 8 percent coupon rate and the market rate is 7, I pay a premium. I don't go back to the municipality and say, give me the premium that I had to pay by raising your coupon rate to 8 percent.

And on the other side of that, if market rates drop so low that the bond is selling at a discount, the municipality comes in and rolls over it. It buys it out.

And that's the same kind of treatment we're asking for here.

COMMISSIONER JABER: What if that utility would have been functioning more adequately and providing sufficient quality of service, had the rates gone up incrementally as they were supposed to -- I mean, how would you comment on the notion that perhaps really that when an acquisition occurs and it results in an automatic rate increase that that's really deferred maintenance that never occurred, but the rates were already too low?

MR. LARKIN: They were too low for a reason. They were too low for a reason, because if they were -- first of all, the system may just be starting -- the development may be starting to sell lots, and he's got 500 lots; he's sold 100. He can't expect to get compensatory rates because the system was designed for 500 customers.

If he's kept the rates down, he's kept them down because to provide the adequate -- the actual rate that he would have to charge, he would not sell his lots. So he's done that for a reason because customers coming in and saying, well, I have to pay an exorbitant amount for water and sewer, I will go somewhere else. But you can't pass that on to the ratepayer because they made that bargain with him when he offered them that lot. He didn't do that out of the graciousness of his heart. He did that because he wanted to market the lots and to charge a rate that reflected all of the system. It would have negated his ability to sell the lots. So it wasn't that he didn't come in and ask for it, he had a reason for not asking for it. And the reason was to ask for -- compensatory rates would have caused him not to be able to sell his lots.

COMMISSIONER JABER: But you would also acknowledge there are also owners, whether they were developer-related utilities or not, that just didn't do what they were supposed to do in taking care of that utility.

MR. LARKIN: Sure. The solution to that shouldn't be on your back. The solution to that is to go to the Legislature and get laws that prohibit developers from doing that. You can't solve the problem after the fact. You just can't let these people build mom-and-pop systems that aren't adequately financed, that aren't financially viable. It's not your job to correct that problem.

COMMISSIONER JABER: Wouldn't you acknowledge that the situations we see are the old problems, and in fact, no one is certificating the mom-and-pop utilities anymore?

MR. LARKIN: Well, I don't know that.

COMMISSIONER JABER: Okay. Mr. Seidman.

MR. SEIDMAN: I was just listening and talking about sharing. The previous owners were sharing the cost of the service between them and the customers. So the customers have been getting a benefit when the rates are below cost purposely. And that's something that you balance against purchase prices that may be less than rate base.

But I want to throw something here at the Commission with regard to what Mr. Larkin said. And I think he says it's not for you to fix these things about underfinanced companies, but it is. Nobody gets a certificate in this State without coming to this Commission and getting approval for it. And one of the things that you have to do is show that you are financially responsible.

And part of the solution to some of these problems of utilities that are operating below par may just be the Commission having a surveillance program to make sure the utilities are maintained.

COMMISSIONER DEASON: Any more questions? Okay. We're going to recess for lunch until two o'clock.

(Brief recess.)

COMMISSIONER DEASON: Call the workshop back to order. Mr. Friedman, I believe you're the next scheduled presentation.

MR. FRIEDMAN: Thank you, Commissioner Deason. My name is Martin Friedman of the law firm Rose, Sundstrom & Bentley. We're appearing on behalf AquaSource Utility, Inc. It seems to me that this procedure, it started a number of years ago, at least when the drafts of the proposed rules were coming out. It seemed to start out with an attempt to codify what was then existing PSC policy on acquisition adjustments.

There was another draft of the rule that came out, I guess, last -- well, it wouldn't be last December, it may even be the December before, that took into consideration some comments made at the last agenda conference. And it was also, more or less, codifying the policy, existing policy, with some more specificity on what constitutes extraordinary circumstances. It also included a burden of proof provision and also included a five-year looking forward type provision which would have given a five-year finality at the end of a five-year time frame.

And it seems to me that the drafts that we are getting are getting more restrictive and more restrictive and less encouraging of acquisitions than the earlier drafts have. And I know the Staff made a comment that apparently based upon their understanding of this Wedgefield case that they didn't think we ought to deal with the burden of proof issue. I don't think you can avoid the burden of proof issue. And I'll get to that in my general comments, but I am somewhat concerned that it seems like this rulemaking process has gone from codifying existing policy to, let's find a way to make negative acquisition adjustments easy and positive acquisition adjustments hard. And I don't think that philosophy is one that the Commission should adopt.

I would reiterate that a lot of what the other industry representatives have said is obviously what AquaSource Utility adopts. The one tweaking that AquaSource had presented earlier in the rulemaking proceeding and then articulated in its written comments was the Commission policy thus far to treat asset purchases different from a stock purchase, recognizing that a stock purchase doesn't affect rate base. And we had presented some financial information to the Staff early on that would suggest and AquaSource would suggest that when there's a 100 percent stock deal, that it should be looked at and treated similarly to an asset deal.

There are some advantages to some stock deals that would make the price less expensive. Generally, there are more favorable income tax consequence to a stock deal than an asset deal which would benefit not only the purchasing utility but also ultimately the customers.

The three things that I think that you have heard over and over again, and I'm going to do it one last time, is what the utilities that regulate industry needs to see is predictability, finality, and fairness.

The predictability is that you have a rule, if you're going to codify policy or make new policy in rule, a rule that is easily understandable and explained and interpreted throughout the industry. As they -- as you have heard, particularly the representatives who are actually in the trenches doing the buying and selling, they need to know when they go in and negotiate a deal how they can expect that deal to be interpreted by the Commission. And that is very, very important.

And they feel, based upon the policy that the Commission has thus far, that they have got that. You've heard Mr. Wenz say that he feels comfortable in Florida knowing when he does a deal what the Commission is going to evaluate in their acquisition adjustment -- applying the acquisition adjustment policy. That's very important for the industry to know that.

That goes back to an old -- the adage of stare decisis in the law, and that is -- and it's not just in the acquisition adjustment issues, with everything that the Commission regulates, that there needs to be predictability. The industry needs to know what they can expect when they come before the Commission, and that's of utmost importance, is that whatever comes out of this is something that's clearly articulated. It has adequate standards so that the policy or rule can be applied.

The number two issue is the one of finality. When these deals are done and the deals are brought to the Commission, I know some of the early deals that we did actually had the contract, had an adjustment after closing to adjust depending upon what the Commission determined the rate base to be. And we had done that in some early cases, which makes sense if you're tieing your purchase price to rate base.

Today, it's probably not done that exactly where they do an adjustment afterwards, but what you can see, though, is that if they came to the Commission and you approved the acquisition as being in the public interest and everybody went home happy, and then two years later a rate case is filed, and Public Counsel or the Citizens or the customers start raising, well, there should have been a negative acquisition adjustment, then that's not something that we can go back now years later and revisit.

And I know that this question of acquisition adjustment being revisited has come up many, many times, not just the most recent, the Wedgefield, but it came up years ago in one of my early cases I dealt with in the early eighties with Seacoast; that years after the sale, the Public Counsel still in their challenging acquisition adjustment, the Commission is still in there listening to evidence and testimony allowing that. And there's got to be some finality on that issue as to when the Commission rules on it. Good, bad, it's final.

And if somebody doesn't like it, take it on appeal and accept the consequences. But even if the consequences are bad, at least you know what the consequences are at the point in time when you are getting the transfer and not ten years down the road when you really can't do anything about it.

COMMISSIONER JABER: Mr. Friedman, let me ask you a question so that I make sure I understand what you just said. In your negotiations, you have left the sales price open or closing price open on the Commission making the rate base determination in a transfer case?

MR. FRIEDMAN: Yeah, in some early deals we did I'm thinking in the mid eighties probably, some deals I did that had a post-closing adjustment depending upon what the rate base was.

COMMISSIONER JABER: Okay. So then if the issue comes up again in a rate case, your point is --

MR. FRIEDMAN: You're lost. I mean, because no seller is going to say, okay, I'll let you come back five or six or eight years from now and take some money from me. I mean, it's just not done. And although a lot of the deals being filed now don't have those provisions in them, you may start seeing them again if the policy and rule that you-all adopt encourages negative acquisition adjustments. You may start seeing those types of either true-up provisions or just flat out back-out provisions. And that is not going to accomplish encouraging consolidation in the industry, which I think everybody, including Public Counsel, agrees it's better to have professionally run businesses rather than a proliferation of the mom-and-pop businesses.

The third issue that I wanted to address is one of fairness. What you do for negative acquisition adjustment, you ought to do for positive acquisition adjustment. What's good for the goose is good for the gander.

The second issue of fairness goes back to the burden of proof of issue. At least this last draft that I saw, the rule appears to make the utility even in a negative acquisition situation prove that there were not extraordinary circumstances. And I can tell you from a lawyer's standpoint, it is very difficult to prove the nonexistence of a fact. It's easy to prove a fact. It's hard to prove the nonexistence of a fact. And I would suggest to you as one of the prior drafts of the rule said was that the burden of proof is on the person seeking to assert a positive acquisition adjustment or upon the person seeking to assert the negative acquisition adjustment.

Whoever sought to seek a change from the rate base was the person that had the burden of proving the extraordinary circumstances justified. That's an inherently fair way to do it, not to say the utility has got the burden no matter what. That's not fair. And it does present technical problems in trying to prove the nonexistence of a fact.

And I would encourage the Commission to articulate a policy that does not discourage acquisitions and consolidations. And I'm afraid that this most recent draft of the rule that was attached as to the exhibit to the notice would do just that, and I would suggest that we go back to a more balanced draft, which I think the prior one accomplished, although I didn't like the five-year look-see. I think it needs to be more defined as far as positive and negative acquisition adjustment and taking your stand, making your best ruling, and then living with it rather than having that be able to be relooked at within a five-year window. Otherwise, I thought the prior draft of the rule was imminently more fair and a better rule the last one that has come out of the Staff. Thank you.

COMMISSIONER DEASON: Questions?

MR. WILLIS: Yes, Commissioner. First of all, I'd like to clarify, that rule draft I think you're referring to that's attached to the white paper was an old draft. It dealt specifically with contents in the white paper. In fact, the newer draft was the one that was filed by the Staff in December, I believe, or January.

MR. SHAFER: October.

MR. WILLIS: It was filed in October.

MR. FRIEDMAN: So it's still the draft that has the five-year look-see in it?

MR. WILLIS: Pardon?

MR. FRIEDMAN: It's still the one that has the five-year provision in it that you can go back and evaluate positive or negatives in five years?

MR. WILLIS: Yes, yes.

MR. FRIEDMAN: And doesn't that rule have the burden of proof provision in it too?

MS. MOORE: Yes, but the burden would be on the person seeking to deviate from rate base.

MR. FRIEDMAN: Okay. Because there was some discussion in here about, because of the Wedgefield case that you-all were going to say to drop that issue; is that not correct?

MS. MOORE: I don't recall anything like that. The Staff's most recent draft is the one that was with the recommendation last October.

MR. FRIEDMAN: Unamended by the discussion in this last draft, in the last discussion on the rulemaking?

MR. WILLIS: Yeah. It basically came out of the last Staff workshop. Is that what you're talking about?

MR. FRIEDMAN: Here's what I'm talking about. There's some language in this thing here that says -- it says, "Staff is recommending that the provision relating to burden of proof be removed if the Commission chooses to pursue rulemaking on this matter." Paragraph -- Page 20.

MR. WILLIS: What Mr. Seidman is showing me is what I was talking about. It was just -- it was a previous rule that was attached to the white paper that we -- that was sent out with a notice to try and get people a background. It may have created some confusion.

MR. FRIEDMAN: It confused little ole me.

MR. SEIDMAN: Yeah, I thought that was the most recent rule, and I responded in our comments to that rule.

MR. WILLIS: I figured that when I saw some of your comments. Getting to the questions, though, so we can move along here. And I don't know how well you will be able to address these, Mr. Friedman, but my reading of

AquaSource's comments -- and I'm looking at Page 4 of their comment sheet, and it's in answer -- it's labeled as Number 8: What should be the future acquisition policy of the Commission?

My understanding of that is a lot different from the other utilities, and my understanding is that AquaSource is seeking the Commission to not do anything with the acquisition adjustment at the time they purchase it with this what they call "don't file don't litigate" policy. They would just like us to allow the accounting treatment of whether it's negative or positive on their books so that the annual report would reflect that accounting treatment, and then the Commission did a future rate case, that rate case may be eight years down the road or ten years, maybe five or shorter, but at that point in time, that's when they desire the Commission to review whether or not that's applicable, whether or not they would grant an acquisition adjustment at that point.

MR. FRIEDMAN: What question are you looking at?

MR. WILLIS: It's the answer to question Number 8.

MR. FRIEDMAN: Oh, 8.

MR. WILLIS: It said -- the very last sentence. "Said another way, the acquisition adjustment should be allowed" -- and I think that means accounting treatment only, which means accounting treatment only would mean you would put it in the annual report, put it in your books. The Commission wouldn't exactly pass on it. And then it says, "a decision on ratemaking treatment deferred until the next formal rate proceeding."

MR. FRIEDMAN: Yeah, well, that says at a minimum that's what they're suggesting be done.

MR. WILLIS: That's just the minimum?

MR. FRIEDMAN: Uh-huh.

MR. WILLIS: Okay. But you-all wouldn't oppose having the Commission make that decision on the ratemaking treatment up front.

MR. FRIEDMAN: No, no. I mean, as long as it's a consistent policy that it do that and it means something. The way it is now, if you said, yeah, we get a positive acquisition adjustment on transfer and if you're not doing a rate case, it really doesn't mean anything, because we know that Public Counsel or the Citizens at some future date could say, well, that was a mistake, and convince the Commission that in fact the positive acquisition adjustment shouldn't be there. So that's the reason for their saying, no need to deal with it now.

The dealing with it now goes hand in hand with the finality. Let's make a decision, and the best time to make that decision is during the time of the transfer because that way the utilities if they need that or if they have a back-out provision, they can back out of the deal. But that goes hand in hand with the finality. Really, if you're going to set rate base at transfer and it's not final, what good does it do?

MR. WILLIS: I agree. The only reason for bringing this up is, AquaSource in many of their recent acquisitions have asked to defer that accounting treatment.

MR. FRIEDMAN: Exactly.

MR. WILLIS: They have had no desire to have the Commission rule upon an acquisition adjustment at this point --

MR. FRIEDMAN: That's correct.

MR. WILLIS: -- and defer that. And the problem I see inherent with that is, you get down the road seven years and the Commission looks at it and says, there's no reason to grant this, and they don't grant it. And then you have purchased the utility company, and you may have thought you deserved an acquisition adjustment, but you didn't get it. And wouldn't it have been better to know that back at the very beginning?

MR. FRIEDMAN: Well, believe me, if we thought that we could have gotten an acquisition adjustment under the then current policy, we would have asked for it.

MR. WILLIS: Okay.

MR. FRIEDMAN: We wanted to leave the door open just like the Public Counsel leaves the door open. That's all.

MR. WILLIS: Okay. The only other question I have is, in -- and I believe it's back on the answer to Number 5. You state that Kentucky and Indiana allow acquisition adjustments on stock purchases. Do you know why? What criteria or why they are doing that?

MR. FRIEDMAN: I guess it was at the last workshop, I gave you-all a copy of the orders from those states that articulated those policies or accomplished that result. If you want another one, I'll be glad to send them to you.

MR. WILLIS: I'd sure like to have them. Maybe Mr. Shafer has them in group. It would be helpful if you could give me some more copies.

MR. FRIEDMAN: I will be glad to do that.

MR. WILLIS: Thanks. That's all I have.

CHAIRMAN JACOBS: I'm back again. Are there other questions? No more. You did a great job.

MR. FRIEDMAN: Short and to the point.

CHAIRMAN JACOBS: Thank you. So that takes care of AquaSource. Public Counsel.

MR. BECK: Thank you, Chairman. We have

comments by three people we'd like to present, and start with Mark Cicchetti, who has prefiled comments, and then follow that with Hugh Larkin, who has as well, and then we would like to conclude with Steve Burgess, who will have some concluding remarks.

MR. CICCHETTI: Mr. Chairman, Commissioners, I'm Mark Cicchetti. I'm a senior financial consultant with C.H. Guernsey & Company on behalf of the Office of Public Counsel. I'd like to thank you for this opportunity to share some views on acquisition adjustments. Historically, the workship forum has been a place to share ideas, brainstorm, and to think outside the box a little bit, and that's what we try to do in presenting these comments.

When the Office of Public Counsel called me and asked me what my thoughts were on this subject, I was happy to share them with them because this is an issue that has bothered me from the time I started with the Commission almost 20 years ago because it seemed that year after year, case after case the story was the same. Customers would come in and say, we paid a significant amount of contributions in aid of construction, our service quality declined. We are experiencing this problem and this problem. And then we heard a new company is coming and taking over, and now we're being asked to pay a substantial rate increase to get adequate service.

And that was troubling to me because I thought, well, regulation shouldn't work this way. So why is this problem here? Who's getting the short end of the stick, and what could the Commission do to address it? And in looking at some the financials on these companies, I would say there would be a pretty good amount of CIAC that customers had put up and a lot of times some high cost debt and either little or no equity, which was reason for the higher I think than necessary capital costs.

And historically, the Commission has always said what should be passed on to ratepayers are the reasonable and prudent costs. And so if a company is undercapitalized, it's showing indifference and not making the maintenance commitments that it needs to make, well, those additional costs, are they reasonable and prudent, and should they be passed on to customers?

Commissioner Palecki, you brought up the example a little earlier where there was a $270,000 rate base where it was purchased for $5, and I think it's reasonable to assume that there must be some degradation to that system. And I don't think any Commission or any Staff after the fact could figure out when that company has been purchased how much additional operation expense is being incurred because there was a lack of maintenance, and now the new company has to send a repairman out more often, or something has to be added, that if there had been proper maintenance to begin with, it wouldn't have occurred. And so in thinking of who gets the short end of the stick, I'm thinking of developer who comes in, develops a system, he's selling his houses at market prices. I don't know about you, but I've bought a couple of houses, and when you do that, you're not sitting there thinking what is the basis of my utility water bill or sewer bill.

And so they are paying a market price. They are experiencing declining service after they have made the contributions in aid of construction, and then they have a significant rate increase. Later on, a company is going to come in and purchase that, and if they purchase it at a significant discount, they're whole, the developer is whole. So who's borne the cost in this cycle?

And, Commissioner Jaber, you brought the point -- I think you mentioned the word "windfall." If I was getting a return on $270,000 and getting to depreciate a $270,000 investment with a $5 investment of my own, I don't know how you could characterize that as anything but a windfall. That's just one example, an example that came up this morning.

So I think the Commission, the way they have been treating this in the past has a lot of merit. I agree completely. I think I understand where it is that you want to go, and I agree with that completely. I think it would be great if the large utilities that are represented here today were the ones that made the investments from the beginning. And I think that would lower the cost to everyone involved. The customers would get better service. They would be better capitalized, and all the things that we've talked about that would be good.

But I think there are a couple of shortcomings in what the current system is. One, the standards of extraordinary circumstances is undefined. If you look on the notice of workshop on Page 8 under negative acquisition adjustments, the third paragraph, it said, "The Commission found that it was not necessary to show hardship on the part of the seller" -- so I would assume that means if there was financial difficulty, that doesn't qualify as extraordinary circumstances -- "that the purchase price to rate base relationship is not an extraordinary factor" -- so if we assume that the system is run-down through lack of maintenance, it's being sold for pennies on the dollar, that's not extraordinary -- that the failure of the previous owner not to maintain the system is not an extraordinary circumstance. That, to me, implies mismanagement. And then considerable expenditures by the new owners is not an extraordinary circumstance.

Wherein, the example where there is a $270,000 rate base and a $5 investment, you would assume that it has been run-down and some additional investments are going to be needed, and you have to be concerned, I think, with the fact that maybe customers are going to end up paying twice for basically adequate service.

And I addressed the excessive returns part of it in the $5 example. And I guess just to get to that, I think it's good to have an incentive, but I don't think there has been any evidence presented that says it needs to be 50 percent on equity or 60 percent or just a windfall. So in the recommendations, we'll address that in a minute.

And finally, the last part is, there's nothing in the Commission's practice that solves the problem to begin with. I sort of see it as the Commission treating the symptoms rather than curing the disease. And so we have made a recommendation to try and help you deal with that a little bit of thinking outside the box.

The solutions that we're proposing, the recommendations are a 50-50 split of the negative acquisition adjustments, and that, I think, would help recognize that there's some protection to the ratepayer because there's going to be a 50-50 split of the negative acquisition adjustment, and recognize the fact that for an unmaintained system or a system not maintained the way it should be, there's probably going to be additional costs that are going to be incurred by the new operating company. And that would be, I think, by definition. That's why you do preventive maintenance, so you don't have to deal with those kinds of things.

And that 50-50 split would work up to 150 percent of the equity return on the leverage formula, basically granting them a 50 percent premium for an incentive.

And the final part of the comments that I presented were to have a minimum amount of equity investment or a personal guarantee that would ensure that the people that are operating these systems have a vested interest in the systems. A closely related issue that I dealt with on a number of occasions were where owner said they needed a personal guarantee in order to get a loan from a bank. And the reason the banks do that is, they want to know that you have a substantial interest; that even if you have some equity in your company, if they make a loan to you, they don't want you to be able to get mad at them and then just walk away.

They want a vested interest to know that they have a big piece of you, and that if, for whatever reason, you might think about walking away, you won't do it because you have a vested interest. And that's the point that I think about making a minimum equity investment requirement because these folks will then make sure they provide better service and won't be so willing to walk away from a system.

And in addition with that, I don't see any reason if the Commission had a policy of construction work in progress, AFPI, used and useful, that kept the companies whole, you gave them a fair return on equity, they know they would be kept whole, and by quantity versus quality of earnings, I'm saying a test can be developed. And we had developed one in the past where you can judge the company's financial integrity. You can change some of the AFUDC or the AFPI to cash earnings if that's what's going to be needed to keep the company financially sound. And in that regard, I think you are starting to send the proper price signals. I think water is going to become more of an issue rather than less of an issue in this State.

As we continue to grow, you can imagine the number of people that are going to be moving here in the next 30 years, and I think these would provide great opportunities for these water companies to come in and serve these people as long as they knew they were getting a fair return and they were going to have quality of earnings as well as quantity of earnings.

And I think that that all fits in with the goal of minimizing long-term costs to the ratepayers while balancing the interests of the ratepayers and the stockholders. And I'd be happy to answer any questions that you have.

CHAIRMAN JACOBS: Questions?

MR. FRIEDMAN: I've got one question. Mr. Cicchetti, can you explain to me how the customers are going to be worse off if the system is purchased for less than rate base? I mean, just because of the nature of the purchase, how are they worse off?

MR. CICCHETTI: Well, they have experienced declining service -- I'm assuming we have a system that's bought at a discount because there's been a decline in the quality of the system.

MR. FRIEDMAN: Well, that's my point. Can you say that every time there's a negative acquisition adjustment that it necessarily is caused by that?

MR. CICCHETTI: No, no.

MR. FRIEDMAN: Well, see. So don't you think the acquisition policy then has to be flexible enough so that merely because the purchase price was less than rate base, that doesn't mean that in every single case that your 50-50 split would be applicable, does it?

MR. CICCHETTI: Well, I think the benefit of having the 50-50 split is, there's a balancing there in that if there were some extraordinary circumstances where that shouldn't apply, you have the opportunity to come in and do a rebuttal and say, we should get more, or we shouldn't be limited by this 50-50 split. But I think it takes away the lack of standards, and you have some certainty there. You will get the 50-50 split. And if you think that that's not sufficient, then a company can come in and make their case otherwise.

MR. FRIEDMAN: So you're not suggesting that the 50-50 split is, this is the way it always is without any flexibility to go higher or lower?

MR. CICCHETTI: No, I would never think the Commission should lock themselves in to a situation where things -- where they wouldn't be able to exercise their judgment. I've been doing this long enough to know that things come out of the walls. And there's things we probably would never think of, and the Commission should be given the flexibility to deal with extraordinary circumstances where they come up. I just don't think extraordinary circumstances ought to be the rule rather than the exception.

MR. FRIEDMAN: So you're starting with the threshold, whereas the current policy starts with the threshold that rate base is the beginning point. You're saying in a negative acquisition adjustment situation that we start that point at 50 percent of the negative acquisition adjustment, then argue extraordinary circumstances from there?

MR. CICCHETTI: Well, I wouldn't suggest that extraordinary circumstances ought to be part of the equation unless one party wanted to move that there were extraordinary circumstances that needed to be addressed.

MR. FRIEDMAN: Isn't that the current policy? It's rate base unless one party says extraordinary circumstances apply.

MR. CICCHETTI: Right. But --

MR. FRIEDMAN: So aren't you just saying that now we are starting that criteria from 50 percent of the negative acquisition adjustment instead of rate base, but we're still going to have to evaluate extraordinary circumstances if somebody raises it?

CHAIRMAN JACOBS: This sounds like cross-examination to me. Does it to you?

MR. FRIEDMAN: That's what I do for a living.

CHAIRMAN JACOBS: I know.

COMMISSIONER JABER: I have a question for Mr. Cicchetti.

CHAIRMAN JACOBS: I don't want to interrupt your train of thought, though.

MR. FRIEDMAN: No, I think you-all got the point.

COMMISSIONER JABER: Mr. Cicchetti, under your proposal, is the Commission required to define extraordinary circumstances, and if so, how would you define it?

MR. CICCHETTI: No. The whole purpose is to move away from the criteria of extraordinary circumstances. And maybe I shouldn't have even used that term. The proposal that I've put forward would be a 50-50 split of the negative acquisition adjustment. And if somebody wanted to rebut why that wasn't appropriate, whether it was extraordinary circumstances or for whatever other reason, that they have that right. This wouldn't foreclose the Commission from doing something different. It would just be the policy, and it wouldn't rebut -- or it wouldn't keep anyone from rebutting that either.

COMMISSIONER JABER: Would there be any situation that exists where it would not be appropriate for the benefits to be shared between the customer and the company?

MR. CICCHETTI: I would imagine there could be. Off the top of my head, I couldn't think of any. But the whole idea here is, I think it is logical to assume that a system that's being bought for pennies on the dollar is a system in need of repair. The customers have suffered through that. And by doing it 50-50 we could, from that standpoint, hopefully, cover some of the additional costs that might be incurred that no one would be able to ferret out in terms of having to make repairs to a system that has been inadequately maintained, because on the new company's books, those are going to show up as legitimate expenses.

COMMISSIONER JABER: And in the other industries we don't have a sharing with respect to, you know, looking at acquisitions. There is no sharing of the benefits, per se. How would you justify treating the water industry different from, let's say, electric?

MR. CICCHETTI: The reason for that is -- my understanding is, this whole policy is here to deal with troubled utilities, and troubled utilities are a reality. And we don't have the same kind of circumstances in other industries that you have here. So this is tailored to deal with the problem that's, more or less, in general, as I see it, a function of developer-related or mom-and-pop smaller utilities that just -- we just don't have in the other industries.

COMMISSIONER PALECKI: So would you agree with what you've heard previously today, that it's generally good that mom-and-pop utilities get purchased by these larger, professional systems that are better able to provide the service?

MR. CICCHETTI: Yes.

COMMISSIONER PALECKI: Under your scenario, aren't you concerned that it might be a deterrent to some of these other professional water and sewer systems to make these purchases under the 50-50 sharing system that you propose?

MR. CICCHETTI: Well, I'm sure if I were in their shoes, I'd like more rather than less. And my point is, right now they are getting 100 percent of it unless extraordinary circumstances can be proven, which is an undefined and appears to be a very difficult standard to meet. And yet, there are concerns as to what impact that has to the customers. Is that fair in this whole cycle of how this whole thing has come about and is being treated?

So, yes, there might not be as much of an incentive. If you said to me, I'm going to invest in some risky stocks, and I'd rather have a 75, would you rather have a 75 percent return or a 30 percent return? Of course, you would say 75 percent return. But that's generally not going to be allowed over the long term. And so if I knew that especially in a regulated situation like this I was going to be able to get 30 percent, that would certainly, I think, be enough. This is the business that these companies are in, and they would be getting a premium. But what I'm talking about is a 50 percent premium over the allowed return that the Commission would be inclined to give them anyway. So how much is too much? At what point is a windfall unnecessary?

COMMISSIONER JABER: How would you respond to my earlier question in the day with respect to not making an acquisition adjustment at all, and then just prevent them from filing a rate case for a certain number of years?

MR. CICCHETTI: If I were a company executive, I guess I would be concerned with my fiduciary responsibility of saying, well, I've made an additional $250,000 investment, I want that. Am I foregoing -- what benefit am I getting by foregoing the return on the rate base when I've only paid a lower purchase price? So unless they could see some benefit from that, I don't know that that would be something that they would be willing to do.

I mean, if you were going to factor in a positive acquisition adjustment that they would be able to get over time, I'm sure, you know, you're going to compare the cost of foregoing a rate increase versus the benefit we're going to get from being able to incorporate the positive acquisition adjustment. But I would think from a company's standpoint, it's got to boil down to, it makes sense. So --

COMMISSIONER JABER: That's the company -- that's what they have to figure out and analyze.

MR. CICCHETTI: Right.

COMMISSIONER JABER: But what about from a consumer perspective? What's wrong with taking that approach? You don't make an acquisition adjustment at all, but to address the concerns about ongoing rate increases --

MR. CICCHETTI: Well, I take a little more analytical approach than the average customer. Maybe the average customer would say, I'm not going to see your rate increase; that's fine. A little more analytical approach, to me, is what is it really going to do for me in the long run? If by them not being able to have a rate increase for a certain period of time, is that going to impugn their financial integrity, which is ultimately going to cause me to have to pay more in the long run, then that's not something that I would want.

MR. LARKIN: Additionally, there may be a need for immediate investment. If you give them the negative acquisition adjustment and say, well, you have to stay out for five years, what incentive would they have to make the immediate investment they would have to meet -- make to bring the system up to acceptable standards if they couldn't get a return on it? So we would rather go with a situation where they are getting a return or a premium, and they know they can come back in if they make the appropriate investment and get a return on that. They are not disincentived (sic) from making that required investment. That's the only thing I would see that would be wrong with it.

MR. CICCHETTI: The only other thing, Commissioners, is whenever I heard that over the years, that a company would say, well, we won't raise rates for a certain period of time, that's what we will put on the table, is that really a hollow offer? Because if they don't raise rates when they need to raise rates and that produces financial distress, the cost to the ratepayer over the long run is going to be greater. You don't want to freeze rates and allow utilities to get into financial difficulties or bankruptcy, and then try and bail them out of that and have that be cheaper over the long run.

COMMISSIONER JABER: Well, we also don't want to take rate base down such that you create a financial difficulty for the acquiring company; right?

MR. CICCHETTI: Well, they didn't pay -- if they paid that level, that would be one thing. They're paying a lower level, and you want to give them an incentive in order to make that purchase. And what I'm saying is, 50 percent return on equity premium would do that.

And so, no, I would -- if they paid $100,000, I wouldn't want you setting rates at $5. Now, in terms of -- I've heard some arguments. Well, it's a lot of CIAC, and it wears out. We didn't collect depreciation on it, so where do we get the funds to replace that? But that's the whole part of the business. You make investments, you recover your investment, and you get an appropriate return on it.

MR. BECK: Commissioner Jaber, let me just add. One other problem I see with that is that at the end of the day, at the end of whatever the stay-out period is, the company is still getting the complete windfall they are getting today. You know, with our plan there's a splitting of it. And don't forget, you're saying, you know, what if they didn't have -- you know, is that enough? We're suggesting, starting point of a reasonable rate of return and boosting it up 150 percent. I mean, for the company that's a considerable bonus, you know, for coming in there.

Under our plan, there's a sharing. There's a 50-50. So it's a win for the customers, a win for the company, I mean, a significant win for the company in our view. With a stay-out proposal at the end of -- what we get out of that, as I see, is the time value of no rate case for whatever that time period is. But at the end of the time, the windfall is still there. So if you had a case where a company is going to get a 50 percent return on their investment, on their equity investment, at the end of that time period, that's still there under what you've proposed. Under our proposal, they have gotten a significant bonus but not that much.

MR. HOFFMAN: Mr. Chairman?

CHAIRMAN JACOBS: Yes.

MR. HOFFMAN: May I ask Mr. Cicchetti a few questions?

CHAIRMAN JACOBS: Yes. Go right ahead.

MR. HOFFMAN: Thank you. Mr. Cicchetti, I read your comments and Mr. Larkin's comments. Are you gentlemen basically saying the same thing, taking the same positions for Public Counsel?

MR. CICCHETTI: I would say generally. I mean, I think there's some details that are a little different, and that was part of the idea of brainstorming and putting some different proposals on the table and trying to come up with an equitable solution.

MR. HOFFMAN: Do you think that this Commission should promote consolidation in the privately owned water and wastewater industry?

MR. CICCHETTI: Yes.

MR. HOFFMAN: Do you think the Commission should adopt a policy or rule that promotes consolidation?

MR. CICCHETTI: Yes.

MR. HOFFMAN: What do you see is the benefits for the customers of a troubled utility when that utility is purchased by a professionally run utility?

MR. CICCHETTI: I can detail them if you want to, but it's the ones that have been brought out many times.

MR. HOFFMAN: The ones that we've talked about all day, basically?

MR. CICCHETTI: Yes.

MR. HOFFMAN: Now, if you go back to Commissioner Palecki's example, which has been bandied about quite a bit, where we have the $270,000 book value and we've got the $5 purchase price. Now, let's say we've got a situation where we've got the well-run utility coming in and buying at the $5 the $270,000 book valued utility. You would agree that the customers are now being served by a better operation, would you not?

MR. CICCHETTI: Yes.

MR. HOFFMAN: Now, can you explain to me then under that scenario how the customers of the utility would be harmed, if at all?

MR. CICCHETTI: Well, for one thing, I'd be concerned that the operating expenses that the purchasing company was incurring would be greater than they would have otherwise been had the utility been maintained the way it should have been. I don't think it's fair to ratepayers to have to make them pay twice in order to get adequate service. And then if significant -- if the rate base is being set at the book value and then additional investments are being made, that's a rate shock, and they're paying both again for the run-down system as well as the improvements.

MR. HOFFMAN: Okay. Just a couple more and that's it. If those improvements were made, the ones that you just referenced, to bring the quality of service to acceptable levels, wouldn't they also have to have been made by the original owner if that utility was never sold?

MR. CICCHETTI: But if the original -- not necessarily. If the original owner didn't maintain the system and then came back and said, well, you know, I didn't do this and I didn't do that, now I have to repair it or replace it, the Commission can say that's not -- you didn't act in a reasonable and prudent manner, and we're not going to pass along all those additional costs. If you would have done what you were supposed to do, we wouldn't be back asking the customers to pay a second time for this.

MR. HOFFMAN: Okay. Can you say under my example whether the so-called troubled utility would be better off being sold to the professionally run utility or just maintaining the status quo under the poor operation and poor management?

MR. CICCHETTI: Well, you have a lot of qualifiers in there. If the Commission could say to the original owner, you will go in there, you will make these improvements, you will get this quality of service to where it would be or where it should be, given the amount of book value, then there could be a benefit or there would be a benefit in terms of increased management, expertise, and so on into the future. But it's also possible that having the smaller run system run right, run at a reasonable cost wouldn't be bad.

MR. BECK: Let me give an example of that. In a Southern States' case, there was a purchase of Orange Osceola, and I think Kim Dismukes, on our behalf, put in testimony analyzing that. And as I recall, she saw that there were over $500,000 of additional overheads that were allocated to the customers of Orange Osceola after the purchase of Southern States compared to what was before. Sometimes these questions aren't just all black and white.

MR. HOFFMAN: No, they're not, absolutely,

absolutely. What I'm trying to get into, I guess, is conceptually, I think that there's probably the factor of what alternatives are available to the existing utility if they are not bought by a more professionally run utility.

Last question, Mr. Cicchetti. I think in your statement you mentioned that the standard of extraordinary circumstances is undefined. And my question is, do you think that the Commission should try to go about defining what extraordinary circumstances are or establish criteria in the manner that Florida Water has been promoting today?

MR. CICCHETTI: If they were to decide they were going to keep the extraordinary circumstances criteria, I think it definitely would be better to be defined than undefined.

MR. HOFFMAN: Thanks, Mr. Cicchetti.

MR. CICCHETTI: You're welcome.

MR. GIRTMAN: Mr. Chair, may I ask a few questions of Mr. Cicchetti?

CHAIRMAN JACOBS: Go ahead, Mr. Girtman.

MR. GIRTMAN: You had cited an example or a hypothetical that was used earlier by, I think, Commissioner Palecki, the $270,000 rate base bought for $5.

MR. CICCHETTI: Yes.

MR. GIRTMAN: Can you cite us to any case where that's actually happened in Florida?

MR. CICCHETTI: I was looking at Mr. Seidman's exhibit and some testimony that he had filed not too long ago, and he had book value and purchase prices. I can't remember exactly what there were, but there were a number of them that weren't very far from that.

MR. GIRTMAN: Okay. Wasn't that number $30,000, not $270,000?

MR. CICCHETTI: I don't recall off the top of my head. I should have brought his testimony with me.

MR. GIRTMAN: All right. So you don't know of any case where those actual numbers happened in Florida; correct?

MR. CICCHETTI: No, but it's not out of the question either.

MR. GIRTMAN: Okay.

COMMISSIONER PALECKI: I believe in the handout I have it says the Tropical Isle's case, Docket Number 970409. Five dollar rate base -- or a $5 purchase price, rate base in excess of $270,000. So I believe it is an actual --

MR. SEIDMAN: Okay. Thank you, Commissioner. Which one is that again?

COMMISSIONER PALECKI: Tropical Isle.

MR. GIRTMAN: Is there an order number

referenced there, sir?

COMMISSIONER JABER: I'm sure you can find it, Mr. Girtman.

MR. GIRTMAN: I'm sorry. If it's not there, that's fine. I was just trying to save myself a little time. All right. Going to the point that Commissioner Jaber was leading to in regard to perhaps deferring a rate case. I don't want to commit my client to the concept, but I do want to explore it because it may have some merit.

There was -- I think you mentioned that there might be some legitimate expenses after the purchase that a utility makes; for example, environmental requirements that are imposed during that period of time or other upgrades and additions that the utility may make to improve service. Wouldn't it be a possible appropriate step to prevent a rate case on the acquired assets, but allow a rate adjustment based upon any additional adjustments for improvement of service or whatever, any plant additions, including DEP-required improvements after the date of acquisition but before the time limit barring rate case on acquired assets? Wouldn't that be feasible?

MR. BECK: Commissioner -- pardon me, Mark -- I would like to -- the other companies were allowed to put their witnesses all on, and I'm thinking some of the questions that are coming out would probably be better after we finished our presentation. In particular, Steve Burgess is going to talk about our office's position overall. If they want to take the witnesses off beyond what they filed, because we have filed testimony by our witnesses, I would like to ask that we finish our presentation and then answer as a panel.

CHAIRMAN JACOBS: Actually, I think it's probably a good idea. We're getting a bit long. Go ahead.

MR. LARKIN: I guess I'm next. And I'm not going to go over my comments. But what we're trying to do is, we're trying to find a middle ground. And we're trying to find something that is acceptable to Public Counsel and still provides an incentive to the company to buy, quote, troubled utilities. And we think the 50 percent premium is a step away from where we think regulation should be. And we think that rates should be based on cost where that cost is equal to what has been dedicated to public service, and it should be on the actual price if it's at a discount to that.

Now, what we're getting into here is arguing with what our alternative position is. And we're not going to get anywhere if everybody says, well, we want to continue and just codify what has been the policy, and then sweeten it by throwing on positive acquisition adjustments. We understood and we thought that this was a workshop dealing with, how do you deal with troubled utilities? Well, a troubled utility is one that has to sell at a discount. It's not one that sells at a premium because that -- obviously, if it's got a market value above its book value, there's something positive about it. So we don't think that that part of the company's -- all of the company's case really belongs in this workshop, because it's about, should we change our policy, or how can we codify this policy which will eliminate some of the problems?

COMMISSIONER JABER: Mr. Larkin, let me clarify at least from where I'm coming from, because to the degree you need to add on to your comments, I'd love to hear your input. The questions that were sent out to you-all are the questions I'm interested in answering. So one Commissioner speaking, I'm not just interested in talking about troubling utilities. So I want to be real clear that I think that Staff has done a real good job identifying very broad questions, and I'd love to hear your input on that.

MR. LARKIN: Well, I think I have already --

COMMISSIONER JABER: And you did. You commented, but I just -- you were going down a path of, I thought the workshop was supposed to address troubled utilities, and I wanted to tell you that I want to hear a little bit more than that.

MR. LARKIN: Okay. Let me touch on positive acquisition adjustments. People don't pay above book value for things that don't have an above book value basis. They have a basis that either is going to generate revenues that will justify that premium, or there is a particular asset that causes that premium to be paid. And the risk of recovering that premium should be on the utility that pays it, and it should not be shifted to the ratepayer by putting a positive premium, a positive acquisition adjustment rate base. So I think that would be our position on that.

And a negative acquisition -- again, I don't want to go over what our -- what the theory is for recording a negative acquisition adjustment. What we want to do is, is to put a middle ground where we can say, here's where we want to come halfway to where the company is. There's no way that you can eliminate some review of these transactions. There's no rule that you could put into place that would just negate people looking at the transaction and determining whether it's at arm's length and whether the discount is a legitimate transaction that isn't compensated for some other manner to the seller. So these transactions will always be looked at in some level.

What we want to get to is where if we get 50 percent of the benefit, then the ratepayer, I think we could fairly represent to them that they are going to get a limited benefit from this even though they will have to pay additional costs to improve the system to bring it up to the quality that it should be at.

COMMISSIONER JABER: Do you think your proposal actually encourages the companies to get the very best deal they can get for the sale of the utility? I guess what I have in mind is, in the wholesale electric industry, the wholesale economy sales, the more the companies sell on the wholesale market, the more there is to share between the residential end user and the company. And do you see your proposal as being an incentive for the company to get the best deal it can?

MR. LARKIN: Well, if you are going to get 50 percent of whatever you get, wouldn't you struggle to get $100 and 50 percent of that rather than 50 percent of a dollar? It seemed to me I would.

COMMISSIONER JABER: So if that sharing was 25-75, maybe we would provide a better incentive for the companies.

MR. LARKIN: Well, but then there would be no incentive for the ratepayer to just overlook arguing about whether it's appropriate to even give them anything at all.

COMMISSIONER JABER: Why wouldn't better quality of service be an extra --

MR. LARKIN: Well, I mean, that's always -- because they have to pay for better quality of service. The acquisition adjustment doesn't give them anything. The acquisition adjustment is just the beginning. Then there has to be an investment in either maintenance or additional facilities to bring that system up to adequate service, and the ratepayer is going to pay for 100 percent of that.

If this were the case, if negative acquisition adjustments were the end of it, ratepayers got terrifically improved service without any additional rate increases, without any additional expenses, I think the company could make that case, and we would be hard-pressed to argue the other side of it. But usually what happens is, is the negative acquisition adjustment, and then costs go up, and there's a rate case, and rates go up from what they were paying before. It's not a situation where rates remain stable over a long period of time after the acquisition.

COMMISSIONER JABER: So if there was a sharing proposal that wasn't necessarily 50-50 and there was no --

there was a commitment that there wouldn't be a rate case for 24 months, you would be happy with that? The Citizens, of course, on behalf of the Citizens.

MR. LARKIN: I guess we'd have to look at each individual, but 24 months is not a very long period of time. It takes you 24 months to install some of these systems.

COMMISSIONER PALECKI: I have a very elementary question, but I'm very new to this industry, and if you'd bear with me, I'd appreciate it. But does the Office of Public Counsel represent the Citizens in water and wastewater cases that are not regulated by the Public Service Commission?

MR. BURGESS: That's kind of a good question. Recent legislation extended the Public Counsel's responsibility into the areas where the regulation is provided for by the county, and my understanding is that is currently under challenge.

COMMISSIONER PALECKI: The question I really have is whether you've seen a difference in the number of consolidations that we've had in counties that are not regulated by the Commission, and whether there's a difference in the quality of service that you've seen from the Public Counsel's side, quality of service in those counties and as well the rates.

MR. BURGESS: I couldn't answer that. I don't have enough of a base of observation to responsibly give you an answer to that.

MR. WILLIS: Commissioner Palecki, I'd like to take a shot at that.

COMMISSIONER PALECKI: All right.

MR. WILLIS: And I'd like to give you a "for instance." We just took jurisdiction of Polk County under our control in 1996. When we did that, we probably took over about 14 small mom-and-pop utilities, and we have had an ongoing process of dealing with those companies of trying to upgrade their systems, get their systems up to par, trying to give them money to replace hydro pneumatic tanks that aren't fit to be there that are about ready to explode.

In essence, what we saw in Polk County were systems that were just deplorable. And you have -- you know, the Commissioners who have seen those recently coming through, the Alturas, the Keen sales, all those small, little mom-and pop's we've been dealing with in these SARC cases, you've seen all the pro forma adjustments, and they're trying to get them adequate facilities to provide quality of service to these customers. And that's what we see in almost every county that we take control of.

COMMISSIONER JABER: And for several of those, it was hard to find a receiver; right?

MR. WILLIS: That's exactly right. It's hard to find a receiver. Sometimes it's hard to find the company who owns those utility companies. And it's amazing to see, when you talk to these customers at mom-and-pop's, how they tell the Commission that it's just wonderful that we actually got control, because -- for instance, the Alturas system, we went down there and held a customer meeting. They had bubbles in the water. They had air in the water. They had all kinds of problems with pressure problems, outages. Its all dealt with a bad filter that nobody even took responsibility for when it happened to be DEP, but the Commission Staff was the actual party that dealt into it and got DEP out there to look at it to find out it was their filter, an EDB filter, that was causing the problem.

We actually got the company to go out and get good bids for a hydro pneumatic tank. I mean, we went well beyond -- and that's what we have to do with these companies. It just doesn't exist -- the help for these small companies doesn't exist in those counties that we don't regulate in, but we find that more often.

COMMISSIONER JABER: Talk to me about rates, Marshall. What were the rates in Polk County like?

MR. RENDELL: They were historically very low. We had about five or six Staff-assisted rate cases come through, and we're still working on a couple in Polk County. And it was not uncommon to see rate increases of anywhere between 150 to 300 percent. And I know Commissioner Jacobs had some concern about some of these, but the counties just were not regulating. They weren't providing any type of financial relief for these companies. And so when we went in there and did the Staff-assisted rate cases, they were amazed that, you know, they could recover this, and they could actually start getting in compliance. But most of them were on the verge of being noncompliant with DEP standards. They had tanks blow up. They had their systems just completely just run-down, and they weren't able to get the financing available to put the money into it. So when they come in and got the rates increased, they were able to start working on it.

Now, there have been a couple that came in and got a rate increase, and then turned around and sold to a larger utility. That's also common in counties where we don't have jurisdiction. They get their rate relief, then they'll turn around and sell it. So that's also a common occurrence.

MR. BURGESS: I don't contradict anything

Mr. Rendell or Mr. Willis has said. The only thing that I would think that might be a reasonable caution is lumping all counties with one broad brush of either Commission-regulated or county-regulated. I presume just like different Commissions around the country have different levels of professionalism in how well they regulate, perhaps the counties have some -- a little bit of difference in how well they do that too. And I --

MR. WILLIS: And that's probably true, Mr. Burgess. I don't deny that. That's probably true. I just have -- our experience deals with the ones who have turned jurisdiction over to the Commission.

MR. LARKIN: I would assume, too, that the reason you got jurisdiction is that the County Commissioners didn't want to deal with those issues of raising the rates of bringing those systems up to the standard because they are elected officials.

MR. RENDELL: That was one reason, and we've actually had counties that didn't know they have jurisdiction. They were out there -- had no idea. So they weren't regulating until we stumbled upon them. So there's been all kinds of different instances.

MR. BURGESS: Commissioners, I don't have much to --

MR. LARKIN: Yeah, just a couple other points I wanted to make about -- people have referred you to other states. Look at Pennsylvania, look at the -- they have a policy, but it's not working. Well, Pennsylvania is not comparable to Florida. There aren't mom-and-pop water utilities that are half built out there. They are all mature, and if there are 50 or 60 regulated water utilities in the whole State, I'd be surprised. So you can't look at California, or Kentucky is another one, and say, adopt that policy, because they just don't have the same kind of problem. They just don't have the same kind of unregulated or underregulated mom-and-pop utilities that haven't kept their systems up to snuff.

Now, there might be one or two in the whole state of Pennsylvania, but there aren't 50 or 60 or 100. So I don't think you can look at these states and say they found the solution or their way of dealing with this is the solution we should adopt because it isn't, because the problems are entirely different. Pennsylvania is going to lose two congressional seats because of population growth in Florida and Texas. And so it's an entirely different situation you find, and I don't think those states are comparable, and neither is Indiana.

MR. BURGESS: Commissioners, I just wanted to wrap up our position by saying that what we came here to do was, try to present what we considered to be a reasonable effort at balancing competing interests. We also represented customers that are very concerned about distressed water and wastewater systems. And we think that the customers are far better served when a distressed is owned by a more responsible and a more professional management system.

We do think, though, that that interest -- sometimes it competes with and has to be balanced against the requirement that customers not be required to pay owners of a system more than a reasonable compensatory rate of return subject to 376.

And additionally, as a hedge against our effort is a hedge against customers having to possibly pay twice for the same capital investment; that is, to pay a historic book value for an existing plant that's dilapidated and needs to be replaced before it's time, and then to turn around and have to pay for the additional investment that's necessary because the system was allowed to run-down.

And it's because we understand the primary interest of allowing any kind of incentive to be for the purpose of purchasing historically troubled or distressed systems that we have limited our approach to the negative acquisition adjustment from the positive side. Basically, it is our understanding, as Mr. Larkin has pointed out, that there would be no general need to provide that kind of incentive to a company that could demand a higher than book value for the purchase of that particular system; that it wouldn't fall into the category of what we consider troubled and wouldn't call for a special incentive, a special monetary incentive, to provide the motivation for a purchaser to come in there. In other words, that would simply be a business decision that would be outside the need to apply any exterior motivation.

We are also concerned that if positive acquisitions became allowed as a matter of course in an easy fashion that they would become the norm; that that's what you would see. In other words, our concern is that the buyer would have no incentive to drive a hard bargain, so to speak. If I am allowed -- if I am a utility company, I have already demonstrated -- by being in the business, I have demonstrated that I am -- I find the return on my investment in a utility system to be an acceptable return for the risk that I have when I put money into the system. That means that I find it to be a favorable investment. If I can get a positive acquisition adjustment every time I buy it, I have no problem at all putting more money at stake because I find that to be an acceptable return for the risk of that money.

And our concern is that if they are allowed as a mater of course that they will take place as a matter of course. One of the things that we heard is the state of North Carolina allows acquisition adjustments as a matter of course, and we heard also that in North Carolina there's only positive acquisition adjustments. Perhaps the two are related. That's our concern with the allowance of a positive acquisition adjustment as a matter of course. And that's one of the -- those are the reasons that we find the distinction between the positive and negative and why we think that there should be a balancing -- a continuing incentive to get more responsible companies to purchase troubled companies, but at the same time, balance that with the interest of the customers.

COMMISSIONER JABER: I've thought about the concern with respect to some companies abusing the positive acquisition adjustment. And is one approach to that capping it or limiting the amount of the adjustment or somehow taking it out of rate base later on if certain things were made -- for example, if the company says, Commission, OPC, I've got to do $200,000 worth of improvements to comply with a DEP consent order that was left behind from the previous utility, so I need that positive acquisition adjustment to get me some of the cash flow, and five years down the road, PSC looks and determines that the improvements have not been made. Maybe the acquisition adjustment can be removed at that time.

MR. BURGESS: I need to be a little bit cautious when we go beyond the plan that we brought before the Commission, and so I preface any comments with it.

COMMISSIONER JABER: I understand.

MR. BURGESS: I'm a little bit concerned about saying more than would be a position -- on-the-fly saying more than would be a position that we would accept. As far as the -- specifically with the idea of examining later whether the utility met the transactions that it had indicated it had used to demonstrate to the Commission that a particular treatment was appropriate, I think is a favorable thing, would be favorable to the customers.

I think it would just be part and parcel to -- if you're going to use four points as proof that you're entitled to some particular treatment, then we should be entitled to come back later and see if -- because those points of proof are generally, as you are pointing out, promises a future action. And when that's the case, yes, I think you need to come back later and examine and determine whether that future action actually transpired.

COMMISSIONER JABER: So then wouldn't it be more appropriate to allow the positive acquisition adjustment, and then check to see -- similar to like a true-up.

MR. BURGESS: I don't think that you need -- I think the problem with allowing the acquisition adjustment to begin with is, it creates the problem -- I mean, it depends on what you are talking about as far as when you say what you would allow it for. I mean, if you allowed it for -- that sounds more like what you are is allowing some type of pro forma investment to a company because they say they are going to invest in something. But that would be a tool outside of an acquisition adjustment. I mean, that would be just something -- as Troy and Marshall had talked about, some of those companies are trying to encourage them to make certain investments, and they are talking about various pro forma plant investments. That's a tool that's different, and can be and I think should be independent from allowing the acquisition adjustment.

MR. LARKIN: And that switches the responsibility for who should be responsible for making those investments.

CHAIRMAN JACOBS: So we have -- I'm sorry. Were you --

COMMISSIONER JABER: I'm done.

CHAIRMAN JACOBS: One of the interesting aspects I'll be interested in -- and when you brought them up kind of reminded me that I wanted to ask this question because

I do have a concern that positive acquisition adjustments might become too much of a prevailing factor in these transactions. By the same token, the concern that a negative acquisition adjustment could be too onerous as well, but particularly let's focus on the positive. Could we begin to determine what conduct -- whether or not the market conduct is being influenced by these acquisition adjustments?

And the thought I had was, could you look in North Carolina, and could you see if market prices there changed to any significant level prior to policy and then after the policy?

MR. BURGESS: I guess you could do that. My reaction is, it's more fundamentally intuitive than that. If you are buying somebody -- if you and I are sitting across the bargaining table, and you're the purchaser, and I'm the seller, and it doesn't matter to you how much you pay for it, that price is going to be higher than if it does matter to you. And that's what I'm getting at is if you can pass on that price, if you can put whatever you give me and get a return on it that is acceptable to you, then it really doesn't matter to you how much you pay. And that's a big concern of ours.

COMMISSIONER JABER: But you know the difference is timing because if you -- I mean, why would a prudent business -- of course, the problems are always with the imprudent businessmen or women, but if you are a legitimate, prudent businessman, then you want to pay the least amount because that's capital outlay immediately as opposed to recovering through rates over a period of time. So I completely appreciate what you are saying because I don't want the abuses either, but the more and more I've thought about the issue I'm thinking, well, legitimate businesspeople wouldn't want to outlay that kind of money up front anyway.

MR. BURGESS: I would disagree with that. I think, as I see it, what we're talking about is businesspeople who find the level of return that they get for their equity in a water and wastewater system in the state of Florida. They find that level of return for every earning they get on their dollar, they find that an acceptable return for the risk that they have. And so they are perfectly willing to pay an additional amount if they know that they are going to get that same return on the additional dollars, or so it seems to me.

If I've got a particular investment that I find to be an acceptable investment, I'd put more money into it. I'd be willing to put more money into it. I mean, I'm just going by the concerns that are raised to me intuitively, and that's what seems intuitive to me.

COMMISSIONER PALECKI: So you're saying that a purchaser will do some sort of model and that present value analysis to determine whether or not it's a wise investment, and if they're willing to pay more than the rate base, they know the facts going into the deal.

MR. BURGESS: Yes. If they assume that they're going to get a return on it, then they will find it acceptable. And if they know they are not and they make that decision anyway to pay some amount more, then they found that acceptable too.

COMMISSIONER PALECKI: Do the companies agree with that?

MR. SEIDMAN: Commissioner Palecki, looking at the statistics of what's happened in this State, you know, from the information that's been provided for this workshop, we've had something in the order of about 62 acquisitions where the price paid was in excess of rate base. And the Commission has allowed only in four of those cases for anything to be passed on to the customers. There hasn't been any proliferation of the utilities coming to the Commission and saying, you know, please pass on positive acquisition adjustments.

MR. CICCHETTI: Commissioners, I would just point out, I think it was pointed out also in the Staff's analysis, that it goes back to historically there was just a swapping of assets between related companies, which is why positive acquisition adjustments are frowned upon today. And so if there was a policy that said, you know, we're going to allow positive acquisition adjustments, you would have to be concerned about swapping of assets back and forth whether they're related parties or not.

MR. HOFFMAN: Commissioner, just a couple of things. I think we should pull back for a second and remember what Mr. Grantmyre and Mr. Tweed had to say about these North Carolina cases. And nobody is handing out positive acquisition adjustments like candy up there. These are specific cases where the Commission established a test that was satisfied by virtue of the benefits that the acquiring utility demonstrated. And they -- based on those facts, the positive acquisition adjustment was granted.

You can't have a system where positive acquisition adjustments are thrown out as a matter of course. I mean, that's potentially replete with monkey business. You've got to have an arm's length transaction, and that's part of the test in North Carolina. And if you have got that arm's length transaction and you can show those benefits, then maybe you should get it. And that's what we're saying.

One more thing that Mr. Burgess talked about was coming back on the four points, and I keep coming back to that. And I think that that's just a real disincentive to consolidation. There is no incentive for the customers of the Public Counsel's Office to not come back in four or five years and open a docket. That's their job, and they do their job well. There's no incentive for them not to do it, and if they have a door open to do it, it's very likely they will. And here we are again litigating that case again.

CHAIRMAN JACOBS: Let me share a focus for just a moment because there's something -- a point that's intrigued me. There's a party here that we don't talk much about, and that's the owner of the acquiring system in the instance where there was poor maintenance of the system. That party is -- and I guess we kind of made reference to it by mention of the name -- of windfalls, but that party who has essentially not contributed proper operation and maintenance expenses to this system that would be at a reasonable level, and yet in the instance, if -- and here's what I want to focus on.

More so than the idea that there will be some arbitrary award of positive acquisitions, what I'm more interested in are the comments that we've heard earlier that there's a bidding up of the price of these systems because of outside interest in investment. And I think that's a very legitimate and a reasonable trend. However, it seems a bit strange to me that that owner could sit there and not maintain that system and wait for this bidder to come along and take advantage of this increase in price. That seems to be absolutely disingenuous to the whole process. It absolutely seems disingenuous to customers who are being served there. And if there was anything that I would like to do is to try and find a way to eliminate the ability of that party to reap the benefit of what otherwise would be a very promising market. I would be interested in thoughts on that.

MR. SEIDMAN: I'm not sure I understand. You're concerned about a system where -- we'll call him the seller --

CHAIRMAN JACOBS: Right.

MR. SEIDMAN: -- a potential seller, has not done a good job, we'll say, taken advantage of the system. He hasn't put any money in. He's kept the utilities -- getting whatever revenues. And you're concerned about somebody that's going to come along and pay him more than rate base?

CHAIRMAN JACOBS: Right.

MR. SEIDMAN: In most of those cases, they get paid less than rate base.

CHAIRMAN JACOBS: If that's the case, then I guess I'm comfortable. I'm not sure that that's always the case.

MR. SEIDMAN: But what happens if we have a proposal Public Counsel is working with is, nothing happens to that seller, but the purchaser who's going to bail you out gets penalized by not getting the ability to earn on the full rates.

CHAIRMAN JACOBS: Now, let me take my scenario a bit further. The way I would remove that penalty is to swing the onerous -- whatever onerous consequences of this transaction back to the seller. And we talked about some ideas, but one would be, if we award -- you know, I don't know how you would do this, but, I mean, because the only way we could do this is ex post facto. So I guess we'd have to begin to have some preview of these transactions, and you would have to have some way of looking at this. But, in my mind, you would have some kind of performance measures.

Here's what -- given the life cycle of this system, here's what reasonable expenses, O&M expenses would have been or what reasonable upkeep of this would have been, and here's how this system deviates from that. And on the front end, we will tell you -- we would measure up this system that you're looking to buy and say, it fails on these measures. So if you go in and pay top dollar for that system and then come in for -- I mean, market value, and they will be looking to get a positive acquisition adjustment on that, in my mind, then you assumed the risk, but I want to remove the risk from you by letting you know up front that this guy is not a good candidate for you to come in seeking a positive acquisition adjustment for.

COMMISSIONER JABER: If a company has paid over rate base for a company like that, an acquiring company, then they really don't deserve anything at all because that's just a bad deal they made.

CHAIRMAN JACOBS: Do we even look at that now? I mean, is that part of the --

MR. SEIDMAN: There's been four cases out of 62 were there's been any positive acquisition at all allowed by the Commission.

MR. BURGESS: I do have to address one thing that Mr. Seidman said, and that is that our proposal to split the acquisition adjustment is a penalty to a company. Understand that under our proposal the utility, the purchasing utility, would earn higher than a properly measured cost of equity for the equity it has invested. It would be earning a premium under our approach. So there's no penalty involved.

MR. SEIDMAN: That's only because under your approach you consider the base to be the purchase price.

MR. BURGESS: I agree with that entirely.

MR. SEIDMAN: Okay. But the Commission has ruled in a previous docket, and I don't know if they still support it, but it's on the books, that the basis is original cost.

MR. GIRTMAN: Mr. Chairman, excuse me if you have additional questions. I had something I wanted --

CHAIRMAN JACOBS: Let me kind of take a poll again. Do we still have a bit more on your presentation?

MR. BURGESS: No, Commissioner. I had completed with my remarks.

CHAIRMAN JACOBS: Okay. So we're going to kind of round up and conclude now? Because otherwise I'm going to give the stenographer a break.

MR. FRIEDMAN: I've got a couple of questions I'd like to ask to clarify the Public Counsel's position, two questions. It shouldn't take long or be complicated.

CHAIRMAN JACOBS: Okay. So this is in the vein of kind of rounding up to conclude, I assume.

MR. FRIEDMAN: That's my intent.

CHAIRMAN JACOBS: Okay. I believe you. I believe you.

MR. FRIEDMAN: Okay. Mr. Burgess, what's the Public Counsel's position on the finality of a determination? Assuming that the rule that comes out has both positive and negative aspects to acquisition adjustments, what's the Public Counsel's position on whether a determination once made is forever binding?

MR. BURGESS: That's not something that I've considered, so it would not be -- it would be premature for me to answer that. I really couldn't speak for the Public Counsel. My reaction, my personal reaction, is if you have a definitive point in time that is a reasonable time for all parties to deliberately engage on a particular issue, I have no problem with some point being -- providing the finality that you are looking for.

MR. FRIEDMAN: What's the Public Counsel's -- assuming again that there's both positive and negative aspects to a rule on acquisition adjustment, what would be the Public Counsel's position on the burden of proof, the burden of proving you were entitled to a positive or that burden of proving that a negative should be applied?

MR. BURGESS: Some of it depends on the forum that you're talking about. If it would be in a forum that is a rate case, then I would assume that the burden of proof would be on the utility to prove its need for additional rate relief. So that would be, you know, all elements of that.

My own personal reaction, as you know, from some of the cases we've been involved in, you and I particularly, is I've accepted the burden of proof or at least the burden of coming forward. It's something that I'm willing to accept, you know, in circumstances that are appropriate.

MR. FRIEDMAN: Thank you.

MR. GIRTMAN: Mr. Chairman, just a couple of points. Mr. Burgess had made the comment that in effect that if positive acquisition adjustments became too easy to get, there would be no incentive for the buyer to drive a hard bargain. Well, the evidence shows that they are not easy to get. They should not be easy to get. The standard of requiring extraordinary circumstances has been an effective barrier to that.

Positive acquisition adjustments should not be impossible to get, but it should be a heavy burden. Likewise, with negative acquisition adjustments, there should be a heavy burden to impose one of those. And you talk about an incentive of the buyer. If negative acquisition adjustments were too easy to come by, it certainly would be a disincentive for a purchasing utility to drive a hard bargain. He knows he's not going to get the benefit of it. Just pay rate base; be done with it.

So we should keep the same standard that we have for both positive and negative acquisition adjustments.

Make them hard to get; not impossible under appropriate circumstances.

The second point is that I've heard many times in this proceeding, in the Cyprus Lakes proceeding, in the first Wedgefield proceeding, and the second Wedgefield proceeding, that the customers pay twice. I have never seen evidence that the customers paid twice. I've seen that the customers have paid an inadequate rate and gotten inadequate service. If a customer has paid adequate rates and the utility owner has siphoned that money off and has done what he should have done, this Commission ought to jump down his throat. But the customers don't pay twice for anything. Thank you.

COMMISSIONER JABER: Staff, you were going to address the hypothetical, and then at the end, would you also tell us what's happening after this for the next steps after this workshop?

MR. WILLIS: Sure, we can. We talked about the hypothetical before lunch about the idea of including a negative acquisition adjustment. And what I've handed out -- and there are copies back here at the table if anybody doesn't have one. What I've done here is, I've taken some numbers I heard thrown out this morning. The hypothetical is the net book value of $260,000 with the purchase price of 5,000, which, in essence, has a negative acquisition adjustment of $255,000, which in this case I just chose five years to amortize that over.

The idea here was that when that happened and when that was approved, the company would have a negative acquisition adjustment at that point of 255,000. Each year, if you go through year one through five and year six, you will see a zero where you see negative acquisition adjustment. It's being amortized off, and rate base is climbing. It's going up every year.

Now, for instance, if this occurred -- under my idea if a company stayed out for five years and the Commission approved a five-year accelerated write-off of this acquisition adjustment, the company would be able to incur the benefits of staying out for five years if they were earning on that negative acquisition adjustment portion.

If, for instance, they had to come in in year three because DEP came down on them and required them to make material improvements to their system because of some environmental improvements, for instance, in year three, they would take the amortized portion of the negative acquisition adjustment. At that point, instead of 255, it would be 153. They would come in at that point, and for instance, if they had to make $200,000 worth of improvement, the rate base would be 200,000 plus the

99,000 in rate base that would have been there in year three.

In other words, the negative acquisition adjustment would not be implemented unless the company came in for rate relief at that point. Here, there's an incentive to stay out, but if you have to come in, if something comes up, you are taken care of and so are the consumers because the consumers are going to get the benefit of the negative adjustment, the unamortized portion of it being implemented at the point the company has to come in. It would still be implemented at the accelerated rate.

And if the Commission were to consider a less than accelerated rate, for instance, six to ten years, you might consider putting the amortization to that below the line, which is a further incentive for the company to do this. It's written off at a lower rate. The consumers would reap a benefit if the company came in within a ten-year period by a lower rate base at that point, and in that point there would be improvements. It's just an alternative to throw out there. And that's what this basically depicts.

In this case after five years, the negative acquisition adjustment is gone, and you end up with rate base. Under the current scenario, the way the Commission has it now, your rate base, if there were no extraordinary circumstances, in year one would be $210,000 instead of $25,000. And that's the big difference here. It's got the incentive to stay out. The consumers will see some benefit if the company has to come in before that point, because rate base will be reduced back to what the unamortized portion of the acquisition adjustment is. And there could be a further incentive to have the amortization expense being below the line, which I see as -- could be -- you know, you could modify this where you could actually put the amortization out to maybe ten years if you put the amortization expense of the adjustment below the line. And the consumers would see benefit for a ten-year period for that. But it's an idea that I think has some merit, and I'm just throwing it out there.

MR. HOFFMAN: Mr. Chairman, may I ask a question?

CHAIRMAN JACOBS: Briefly. Go ahead.

MR. HOFFMAN: Mr. Willis, conceptually, would it make sense to you to have a symmetrical type of proposal for a positive acquisition adjustment?

MR. WILLIS: I think you have to look at positive and negatives in a different light. And if you look at them, they are because positive acquisition adjustments you can see a direct benefit because normally there are synergies produced. And that's why the Commission would recognize a positive acquisition adjustment. There are benefits because you have administrative costs that are being reduced because you have two companies coming together. There are cost savings involved where a company can actually show a positive acquisition adjustment. Those are distinct synergies.

When you look at a negative acquisition adjustment, I don't know how you would qualify what the synergies are. How can you say giving a company a negative acquisition adjustment is synergies to a company? I don't understand how you would quantify that. And that's why I have to look at a positive in a different light than you do a negative because there are different reasons for doing each, in my mind.

MR. HOFFMAN: Thanks.

CHAIRMAN JACOBS: Any questions? I was being somewhat facetious. You can ask more questions if you want to.

MR. HOFFMAN: No, thank you, Mr. Chairman.

CHAIRMAN JACOBS: Great. Okay. Staff, where do we go from here?

MR. WILLIS: Well, we hadn't really decided exactly where we are going to go from here, but I would propose this. Staff is going to take the transcript from this and look at this further, and try and develop a rule which we would like to bring before the Commission. It may be what we brought already. I don't know. We're going to have to sit down and meet on this between divisions. It's going to be a conglomeration of three divisions here at the Commission trying to get this rule together. And I envision we'll have something by summertime.

We'll be putting a CASR together with that kind of time schedule on it. I would request, though, that if any of the parties, Public Counsel, or the utilities, if you have an idea that you would like to propose in a rule form or how you think our rule should look based on comments today, we would certainly appreciate your input. And I would like to have that probably within about two to three weeks, if possible. If you think that's too short a time, we can give you a month.

COMMISSIONER JABER: Actually, Mr. Willis, what I was going to ask you is if it would be helpful to have written comments on your hypothetical --

MR. WILLIS: I think that would be very helpful.

COMMISSIONER JABER: -- on Public Counsel's proposal, because I don't -- and forgive me, I don't know when everyone filed their comments. I don't know if they came in at the same time or not.

MR. WILLIS: They all came in on the same day.

COMMISSIONER JABER: So you have not had an opportunity to comment on any proposals, and the companies have not commented on Public Counsel's sharing proposal. So is two or three weeks enough time to do all of that?

MR. WILLIS: Since our transcript isn't going to come out for, I think, three weeks because of some other conflicts they may have, I would be willing to easily give four to five weeks for comments. I don't know if they would like to have a copy of the transcript before they do comments. If that's so -- I mean, I welcome any input you-all might want to give as far as timing for comments.

MR. GIRTMAN: Commissioner Jaber, would you also like comments on your proposal?

COMMISSIONER JABER: My question, yes. And I'm sure any of the Commissioners questions.

MR. BURGESS: Commissioner, we would like the opportunity to address that and the companies and Mr. Willis' proposal and other ideas that have come up. And, of course, we'd like to deliberate on it, but I do want to say sort of off the cuff that Mr. Willis' proposal is a creative approach, seems to go in the direction of trying to share the benefit, seems to incorporate some of your concern of doing that in a fashion that may encourage rate stability over a period of time. And again, I don't want to speak out of turn because we may ultimately look at it and have some objection to it, but I think it's certainly something that's very much worth taking a look at.

COMMISSIONER JABER: Well, there's one more thing everyone should look at, and it's the novel idea of negotiated rulemaking.

CHAIRMAN JACOBS: I would also ask if you have thoughts or comments on how do we minimize the impact of acquisition adjustment policy on market value. After all, this is designed to promote, I think, a very legitimate public policy, and it's the consolidation of these smaller systems. It is not designed to promote market value for a company. And I'll be very interested in comments about how to minimize the impact of this policy on market values.

COMMISSIONER PALECKI: Well, Mr. Chairman, I have kind of a -- just something that's bothering me is that I've heard from every party here that they believe the Commission should adopt policy that does promote consolidation of these small systems, yet there has been no directive whatsoever from the Legislature on that. I'm bothered that.

To me, I'm not sure the Commission should be making policy in this area by a rule that would modify our acquisition adjustment policy. I'm still not sure we shouldn't treat all industries the same for ratemaking purposes, water and wastewater, telecommunications, and electric and gas. You know, everyone has agreed that this is good policy, that we should promote these consolidations, but is that policy that the Commission should be making or that the Legislature should be making? And that's bothering me.

MR. BECK: Commissioner, I'd like to make clear from our point -- this is Charlie Beck -- that we were specifically addressing only troubled wastewater utilities when we said we were in favor of the consolidation. It's not anything beyond that.

MR. SEIDMAN: Is this going to be coming out in the form of a Staff recommendation?

MR. WILLIS: Well, it will eventually.

MR. SEIDMAN: Eventually. I was wondering, you know, we do have a policy. Order Number 25729 set out a policy. It may not be a rule, but it's there. It's a Commission policy. It's been there for 12 years. When you're coming up with a proposal for rule language, to me, it would be helpful if you are going to change -- if that rule is going to be something different than what this policy has been for 12 years, that it be spelled out why it's being changed, you know, the purpose of it, whether it's better, what's wrong with what you would have now, because Order 25729 set out specific things that the Commission found at that time.

It had reasons for what it did, and it's spelled out. And I would like to see those reasons addressed as being, you know, we don't agree with this anymore. Our opinion, our legal opinion, is different. Something that tells you why anything you are going to do that's different is going to be proposed.

COMMISSIONER JABER: Yeah, I think, Mr. Seidman, the law requires us to do that.

MR. SEIDMAN: I'm all for it then.

COMMISSIONER JABER: One of the things, Commissioner Palecki, we have done in the telecommunications industry that would be helpful here, if you'd like to give the parties direction, is to let them add in their post-workshop comments whether additional statutory authority is necessary or changes need to be made. I can tell you --

COMMISSIONER PALECKI: I would welcome that, yes.

COMMISSIONER JABER: -- historically the words "acquisition adjustments," and you correct me if I'm wrong, are not in 367. There's broad statutory authority in 367 that we've cited to in transfers and amendments and things like that about the transfer being in the public interest, and then our general ratemaking authority has been used to make adjustments to rate base. But certainly they can comment on whether statutory changes are necessary.

MR. GIRTMAN: Mr. Chairman, could we ask for clarification so we're all reading from the same script? Perhaps if Marshall could send out to us, like he did before, you know, request for comment on specific statement. I want to make sure I get all of them that we respond to, and it would help, like you've already sent out the first time.

COMMISSIONER JABER: Why would you restrict yourself like that? Go back to the transcript and comment on the hypothetical, comment on Public Counsel's proposal, and any questions you want that have been raised. That would be helpful to me, I know. I think we need to tell them when they are due, though, don't we?

MR. WILLIS: I think it's more appropriate. I was looking at March 19th, and the reason for the time period is giving the court reporter an extended period of time to get this out because they have many depositions and short on people, and they have requested more time, and I don't have a problem giving that. So transcripts will probably be out in about three weeks, and that would give them two more weeks to get comments in beyond that.

MR. HOFFMAN: When was that?

MR. WILLIS: March 19th, it's a Monday.

CHAIRMAN JACOBS: Okay. Anything else?

COMMISSIONER PALECKI: And I would like to see the issue of whether there is further direction needed from the Legislature with regard to adopting policy promoting consolidation.

CHAIRMAN JACOBS: Very well. Thank you everyone. I think it's been very informative. Have a good day. We're adjourned.

(Workshop concluded at 3:50 p.m.)

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STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, TRICIA DeMARTE, Official Commission Reporter, do hereby certify that the Workshop in Docket No. 001502-WS was heard by the Florida Public Service Commission at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript, consisting of 199 pages, constitutes a true transcription of my notes of said proceedings.

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

DATED THIS 28th DAY OF FEBRUARY, 2001.

Tricia DeMarte

TRICIA DeMARTE
FPSC Official Commission Reporter
(850) 413-6736