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April 2, 2001

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

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RECORDS AND
REPORTING

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

Dear Ms. Bayo:

Enclosed for filing is the original and fifteen (15) copies of the following documents:

1. Post-Workshop Comments on Behalf of Utilities, Inc.
2. Notice of Service.

Thank you for your assistance.

Sincerely yours,



Ben E. Girtman

Encls.

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FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Proposed rule 25-30.0371,)
Acquisition Adjustments)
_____)

DOCKET NO. 001502-WS

Filed: April 2, 2001

NOTICE OF SERVICE

COMES NOW Utilities, Inc., by and through its undersigned attorney, and files its
Notice of Service of Post-Workshop Comments.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been sent to the following
by U.S. mail) this 2nd day of April, 2001.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
WORKSHOP

DOCKET NO. 001502-WS
PROPOSED RULE 25-30.0371
ACQUISITION ADJUSTMENTS

POST-WORKSHOP COMMENTS
ON BEHALF OF
UTILITIES, INC.

SUBMITTED APRIL 2, 2001

I. General Comment

The current Commission policy with regard to the treatment of acquisition adjustment in rate base was confirmed in Order No. 25729, issued February 17, 1992, after hearing testimony in investigative Docket No. 891309. The order contained the following statements:

Our policy on acquisition adjustments since approximately 1983 has been that absent extraordinary circumstances, the purchase of a utility system at a premium or discount shall not affect rate base. The purpose of this policy, as stated in PAA Order No. 23376, has been to create an incentive for larger utilities to acquire small, troubled utilities. We believe that this policy has done exactly what it was designed to do. Since its implementation, many small utilities have in fact been acquired by larger utilities, and we have changed rate base in only a few cases. [Pages 1 and 2.]

* * *

On the point of statutory interpretation, we disagree with OPC. We do not think that Section 367.081(2)(a), Florida Statutes, limits us from including in rate base only that which an acquiring utility has invested in the system, i.e., the purchase price., as OPC asserts. This Commission has consistently interpreted the "investment of the utility" 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 on acquisition adjustments, we do not deviate from this interpretation, nor do exceed our statutory authority. [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 utilities. 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. [Page 3.]

* * *

At the July 29, 1991 oral presentations, OPC stated that any incentive for acquisition should be in the form of a higher rate of return. We do not believe that this would create the necessary incentive. To illustrate, if an acquired system with a net book value of \$100,000 was purchased for \$80,000 and we raised the return on equity by 200 basis points, a utility with 50% equity would benefit after taxes by approximately \$470. If the award were 400 basis points, the incentive after taxes would be approximately \$940. We do not think that this is an adequate incentive for the acquisition of any troubled system. [Page 4.]

In Florida Cities Water Co. v State, Pub. Serv. Comm'n, 705 So.2d 620 (Fla. 1st DCA 1998) and reaffirmed in Southern States Utilities v State, Pub. Serv. Comm'n, 714 So.2d 1046 (Fla. 1st DCA 1998), the court stated that under Chapter 120, Florida Statutes (Supp. 1996), a shift in rate-making policy must be supported by expert testimony, documentary evidence or other evidence appropriate to the nature of the issue involved. Therefore, if the Commission is to reject or change the above stated policy and the support for it which it confirmed in Order No. 25729, it must do so based on expert testimony, documentary evidence, or other evidence appropriate to the nature of the issue involved.

If the Commission wants to change its current policy, it would be necessary that it explain all of the following:

1. Why, "absent extraordinary circumstances, the purchase of a utility system at a premium or discount shall not affect rate base," is no longer a valid policy.
2. Why the existing policy, ("created as an incentive for larger utilities to acquire small, troubled utilities," and found to do "exactly what it was designed to do") no longer creates that incentive or does what it supposed to do.
3. Why, when "this Commission has consistently interpreted the 'investment of the utility' 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,” it no longer interprets it that way.

4. Why the Commission no longer believes it should “not deviate from this interpretation,” and why it now believes to so deviate will not “exceed our statutory authority.”
5. Why the Commission believes its current policy no longer “provides a much needed incentive for acquisitions.”
6. Why the Commission no longer believes it is appropriate that “the buyer receive the benefit of depreciation on the full rate base.”
7. Why the Commission no longer believes that “without these benefits, large utilities would have no incentive to look for and acquire small, troubled utilities.”
8. Why the Commission no longer believes that “the customers of the acquired utility are not harmed by this policy.”
9. Why the Commission no longer believes that a higher rate of return on the purchase price is not “an adequate incentive for the acquisition of any troubled system.”

Under Florida Cities and Southern States, the above nine points are the hurdles the Commission must clear to reject or change current policy. If it cannot, then current policy should stand and the rule adopted to codify it should serve to clarify and standardize its implementation and to assure that it is carried out fairly and with finality.

II. Specific Comments on Allegations and Proposals

A. Allegation by OPC that Customers are Charged Twice

A concern raised by OPC is that if a negative acquisition adjustment is not included, customers may be “charged twice to receive adequate service.” This would be a legitimate concern were it not unfounded. The reasons given by OPC to support this allegation include: purchased assets may have deteriorated at a far greater rate than the books indicate; the assets may not have been properly maintained; they may have been in extreme disrepair from neglect; and lack of maintenance and investment. OPC’s allegations and concerns are based on the unfounded premise that the customers have already paid once. The customer has only “paid” for the assets and their maintenance if the rates charged by the seller were sufficient to provide a full return on all assets, their full depreciation and their maintenance. Typically, the seller is in a negative income and equity position, and may have been for years. Whatever the reason the seller may be in that position, the results are the same - the customer has not “paid” for the assets in question or for their maintenance. If the assets had been in less than adequate condition, then the customers were probably receiving less than adequate service. They paid less and got less. If the purchaser seeks rates sufficient to fund necessary capital improvements and maintenance, then customers would be paying, for the first time, for what they should already have been paying. However, they will be paying only on a going forward basis and in a different time period. There is no reason that the customer should be harmed under this circumstance. We must not make the mistake of equating customer opposition to the status quo in rates or to a warranted increase in rates, with “harm.” Customers may prefer a decrease in rates or may not like a warranted increase, but they are not “harmed” by it if it reflects the cost of providing service.

In addition, every concern raised by OPC can be remedied through traditional ratemaking adjustments in a rate case. Assets that are deteriorated and are of questionable use or value to the customer should be removed from rate base by an adjustment. Assets that have not been properly maintained or have been neglected can be required to be maintained by the Commission under its statutory authority. The Commission can exclude expenses in a rate case that result from improper maintenance or neglect. The Commission can exclude salaries of responsible personnel who act irresponsibly. The Commission can penalize a utility by reducing allowed return to the bottom of the range of reasonableness. The Commission can make rate increases conditional upon compliance with its mandates. The Commission has many remedies available to address the concerns raised by OPC. The advantage of these remedies is that, while they penalize the utility, at the same time they allow the utility to eventually recover all legitimate costs, if it makes amends and performs adequately. A negative acquisition adjustment, on the other hand, is permanent. Once applied as a “solution” to the expressed concerns, it acts as a disincentive for the utility to take any action to improve or maintain the purchased assets since a return or recovery through depreciation will not be forthcoming during the life of the assets.

B. Sharing Proposals

Proposals have been made by OPC, PSC Staff, and Commissioner Jaber that, in one form or another, amount to a “sharing” of the incentives available to a purchasing utility under current Commission policy. The proposals by PSC Staff and Commissioner Jaber amount to temporary sharing. The proposal by OPC amounts to permanent sharing.

1. OPC’s Proposal

Under current Commission policy, a utility is allowed to earn a return on the net book value (NBV) of the purchased assets and to recover depreciation expense on the NBV. The OPC has proposed that when a utility is purchased at a price that is below the NBV of the purchased system, that the resulting negative acquisition adjustment be shared 50/50 between the purchasing utility and the customers. That is, the utility would be “allowed” to earn on the purchase price plus up to 50% of the differential between NBV and the purchase price. However, OPC also proposes that this allowance be limited, such that the return on the sum of NBV + 50% of the differential never be greater than 150% of the allowable rate of return on the purchase price, alone. Furthermore, the recovery of depreciation expense would be limited to that on the purchase price plus 50% of the differential between purchase price and NBV. OPC’s proposal is offered as an “incentive” to a purchasing utility.

What does this proposal mean? Let’s look at a hypothetical purchase of a utility:

Net Book Value:	\$700,000
Depreciation Rate:	3 %
Purchaser’s equity ratio:	40 %
Allowed Return on Equity:	9.94 %
150% of Return on Equity	14.91 %
If Debt Cost is 8%:	
Return on Rate Base - 100%	8.78 %
- 150%	10.76 %

<u>Cash available under current policy:</u>	
Allowed Return on NBV	\$61,432
Depreciation Expense	<u>21,000</u>
	\$82,432

		Cash
<u>Cash Available under OPC proposal:</u>		<u>Deficit</u>
Purchase @ 90% of NBV	\$ 78,310	\$ 4,122
Purchase @ 50% of NBV	\$ 53,424	29,008
Purchase @ 20% of NBV	\$ 27,670	54,762

Now, recall the Commission's rationale for its present policy, in Order No. 25729, issued February 17, 1992, "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 utilities."

In general, there is no incentive to a purchaser to know that they will be required to maintain and replace existing assets with less cash than the seller would have been allowed to have available for those purposes. Specifically, OPC's proposal is a disincentive for a purchaser to bargain for the best purchase price possible. The lower the purchase price, the less the purchaser benefits under OPC's proposal. Further, OPC's proposal actually encourages a purchaser to "reward" the seller with a higher purchase price. So, instead of the purchaser having a greater amount of cash available to maintain and replace plant (through rates to which the seller would have been entitled), the purchaser may instead end up paying more to the seller, since it can't earn or recover depreciation on the full NBV.

OPC's proposal is not viable. It results in a permanent understatement of rate base. It will discourage purchases in the public interest. It results in rates set below the cost to the utility of installing the assets. Rate deficits will be further exacerbated because used and useful factors may be applied to a reduced basis rather than actual plant costs. Conservation will be discouraged through rates that reflect less than cost.

2. PSC Staff's Proposal

PSC Staff has proposed that when a utility is purchased below NBV, the negative acquisition adjustment be included in rate base and amortized, above the line, over a five year period. We disagree, in principle, with including a negative acquisition adjustment in rate base without a showing of extraordinary circumstances.

Under Staff's proposal, the negative acquisition adjustment would be eliminated after five years, and rate base would be restored to the level it would have been (for the purchased assets) under the seller. Effectively, as long as the purchasing utility does not request a rate increase within five years of a purchase, rates are unaffected and the customer is unaffected. If a rate increase is requested within that five year period, the utility's rate base, with regard to the purchased assets, would be reduced by the amount of unamortized acquisition adjustment.

It is unclear what the full rate-making and regulatory impact might be from this initial proposal, so we reserve further comment on this concept until all the details could be presented and considered.

3. Commissioner Jaber's Proposal

Commissioner Jaber has proposed that rate base not be affected by an acquisition adjustment, but, as a hedge against rate shock, that there be a moratorium on rate increases by the purchasing entity for some specified period. With regard to rate treatment of the acquisition adjustment itself, it seems to be consistent with current Commission policy. That is, it recognizes that, absent extraordinary circumstances, a purchase at a discount or premium shall not affect rate base. To mitigate rate shock, Commissioner Jaber's proposal would stay any action by the purchasing utility to increase its rates for a specified period of time (two years), even if the utility would be entitled to such an increase.

The disadvantage to Commissioner Jaber's proposal is that it stays any action to increase rates, regardless of the purpose. For example, if existing rates are insufficient to meet cash flow requirements, then a moratorium on rate increases may be detrimental to customer service and the utility's ability to provide it. If rates are insufficient to allow the utility to comply with environmental or health and safety requirements, then a moratorium on rate increases may be detrimental to customer service and the utility's ability to provide it.

It is unclear what the full rate-making and regulatory impact might be from this initial proposal, so we reserve further comment on this concept until all the details could be presented and considered.

4. Summary of Utilities, Inc.'s Position on Proposals

It is Utilities, Inc.'s position that OPC's proposal is not viable. It would reverse the effect of current Commission policy and discourage rather than encourage the purchase of troubled systems. It would also result in rates that reflect less than the cost incurred in making service available. This would discourage conservation in opposition to the expressed intent of existing Florida statutes.

With regard to the proposals by PSC Staff and Commissioner Jaber, to the extent that these proposals support the existing Commission policy, Utilities, Inc. supports them. However, it is unclear what the full rate-making and regulatory impact might be from these two initial proposals, so we reserve further comment on these concepts until all the details could be presented and considered.

Utilities, Inc. prefers the adoption of a rule which implements the current policy and puts finality back into the decisions of the Commission. When the Commission issues a final order, people rely on it. They make significant decisions based upon the expected finality of that order. It has been amply demonstrated that the Commission's current policy works. If there are refinements to that policy which are necessary, they must be demonstrated as being necessary. Changing the entire Commission policy on this subject would be counterproductive.

III. Summary Comments on the Workshop

To assist the Commission and Staff in reviewing acquisition adjustment policy and related rule proposals, the following summary of comments made at the workshop is offered:

A. Need for Simplicity, Clarity, Certainty, Predictability, Finality, and Fairness

In addition to the written responses and comments previously provided by Utilities, Inc. prior to the workshop on February 7, 2001, its representatives also provided comments at the workshop regarding various aspects of the rule under development.

1. For any rule on acquisitions to provide the necessary incentives, the rule must be understandable and must promote simplicity, clarity, certainty, predictability, finality, and fairness. It should have standards that are measurable and quantifiable, and there must be consistent application of those standards.
2. Utility companies must be able to know what the final terms of the acquisition will be before committing to purchase a utility, and they must have the ability to opt out of the purchase if the Commission's treatment of acquisition adjustment is not as it had anticipated.
3. Lack of clarity of the policy and lack of finality of the decision introduce significant uncertainties into the transaction and make it difficult for a purchaser to agree to negotiate for, much less acquire, a troubled utility,
4. There needs to be a decision up front that is final. But when you string out those conditions and uncertainties in the acquisition process, it creates all kinds of problems. The final decision on any negative acquisition adjustment issue should be made at the time of approving the transfer. Staff agreed that if you are going to set rate base at transfer, it should be final. [Page 135, lines 4-6.]
5. If potential purchasers of troubled utilities are faced with a procedure which introduces significant uncertainty into the acquisition process, the incentive is for them to not close until after the Commission issues a final order on all aspects of the transfer, including the acquisition adjustment issues, and if the outcome is contrary to their expectations, they must have the option to back out of the transaction. To force a purchaser to agree to acquire a utility system subject to significant unknowns such as no final decision on acquisition adjustment would be inherently unfair and imprudent.
6. The burden of proof must be on the proponent of the acquisition adjustment, whether positive or negative.
7. The size of the acquiring utility, and the size of the acquired utility, per se, have nothing to do with whether an acquisition adjustment should be considered.

8. The less subjectivity there is to the regulatory scheme, the less risk there is and the more encouraging the environment is for acquiring troubled utilities.

9. The current policy works - don't change it. For the last decade, the existing Commission policy on acquisition adjustments has met most of the foregoing objectives. That Commission policy works, and Utilities, Inc. encourages the continuation of the current policy. It provides the necessary incentives, and it is fair to the customers because the transfer of rate base is transparent to the customers. Quoting from Commission Order No, 25729;

We still believe that our current policy provides a much needed incentive for acquisitions. The buyer earns a return on not only 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 those benefits, large utilities would have no incentive to look for and acquire small, troubled systems. The customers of the acquired utility are not harmed by this policy because, generally, upon acquisition, rate base has not changed, so rates have not changed. Indeed, we think the customers receive benefits which amount to a better quality of service at a reasonable rate.

[Docket No. 891309-WS, Order No. 25729 issued February 17, 1992, page 3, Order Concluding Investigation and Confirming Acquisition Adjustment Policy.]

10. The analysis provided by Commission Staff regarding acquisition adjustment policies in other states shows that Florida's approach is far more successful at encouraging the acquisition of troubled utilities than the policies in other states. Over 100 cases have been brought before the Florida Commission where the acquisition adjustment policy has been considered. The states cited by Staff each had less than ten percent of the number of acquisitions as have occurred in Florida under this Commission's existing policy.

11. The Florida Public Service Commission already has a policy that promotes and facilitates consolidation. Consolidation is working in Florida.

B. Comments on OPC Objections

OPC has acknowledged the existence of benefits for the customers when a troubled utility is purchased by a professionally run utility. [Page 155, lines 5-12.] However, the reasons OPC asserts why the customers would be harmed (if at all) by such an acquisition, are that the customers would have to “pay twice” in order to get adequate service and that they would experience “rate shock” with a subsequent rate increase for the purchaser. [Page 155, line 23 to page 156, line 11.]

Customers of troubled systems already be paying lower than compensable rates for lower than adequate service, but they are not paying twice for that service, either before or after the transfer. [Page 188, lines 3-13.] If the customers have been paying less than fully compensable rates, is the acquiring utility to be punished for the fact that the customers have not been paying the full cost of adequate service? If the current owner of a utility system is charging less than fully compensable rates, that owner would be entitled to seek rate relief from the Commission and would be entitled to receive it. There is no difference when a new owner purchases the system. The rates are still inadequate, and the new owner should be able to seek rate relief.

If there is a windfall, it is received by the troubled utility’s customers who have been paying less than fully compensable rates. They may be suffering not as good service, but they are not paying fully compensable rates, either.

OPC has asserted that developers recover the cost of building a utility by including that cost in the price of their lots or houses sold. This Commission has never allowed a utility to recover the cost of utility plant that has been expensed for tax purposes as a cost of sales. If the utility plant has not been expensed, it cannot be recovered through sales. When a developer sells a lot or a house, the market supply and demand for housing in that area determine whether buyers will pay the developer’s asking price or not. Whether that price provides sufficient resources for the developer to recover the cost of sales and provide a margin of profit that just happens to be equal to or greater than the cost of utility plant is pure speculation.

IV. Conclusion

Utilities, Inc. appreciates the opportunity to provide input on the consideration of the issue of acquisition adjustments.

As demonstrated above in the Summary of Utilities, Inc.'s Position on Proposals, OPC's proposal is not viable. It would discourage rather than encourage the purchase of troubled systems, and by allowing customers to receive service priced below the cost of providing that service, it would encourage greater consumption and discourage conservation in opposition to the expressed intent of existing conservation laws.

To the extent that the proposals by PSC Staff and Commissioner support the existing Commission policy, Utilities, Inc. supports them. However, it is unclear what the full rate-making and regulatory impact might be from these two initial proposals, so we reserve further comment on these concepts until all the details could be presented and considered.

In the development of this rule and in the future application of this policy, it is important that the Commission respond to the need for simplicity, clarity, certainty, predictability, finality, and fairness.

Utilities, Inc. prefers the adoption of a rule which implements the current policy and puts finality back into the decisions of the Commission. When the Commission issues a final order, people rely on it. They make significant decisions based upon the expected finality of that order. It has been amply demonstrated that the Commission's current policy works. If there are refinements to that policy which are necessary, they must be demonstrated as being necessary. Changing the entire Commission policy on this subject would be counterproductive.