

ORIGINAL



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May 14, 2001

Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
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RECORDS AND REPORTING

Re: Docket No. 991437-WU

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are the original and 15 copies of the Direct Testimonies of Ted L. Bidy and Hugh Larkin, Jr. being filed on behalf of the Citizens of the State of Florida.

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

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Sincerely,

Charles J. Beck,
Deputy Public Counsel

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase)
in water rates in Orange County)
by Wedgefield Utilities, Inc.)

Docket No. 991437-WU
Filed: May 14, 2001

DIRECT TESTIMONY

OF

HUGH LARKIN, JR.

On Behalf of the Citizens of the State of Florida

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1 DIRECT TESTIMONY OF HUGH LARKIN, JR.
2 ON BEHALF OF THE CITIZENS OF FLORIDA
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 WEDGEFIELD UTILITIES, INC.
5 DOCKET NO. 991437-WU
6

7 INTRODUCTION

8 Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

9 A. My name is Hugh Larkin, Jr. I am a Certified Public Accountant licensed in the States of Michigan
10 and Florida and the senior partner in the firm of Larkin & Associates, PLLC, Certified Public
11 Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.
12

13 Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES.

14 A. Larkin & Associates, PLLC, is a Certified Public Accounting and Regulatory Consulting Firm. The
15 firm performs independent regulatory consulting primarily for public service/utility commission
16 staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys
17 general, etc.). Larkin & Associates, PLLC, has extensive experience in the utility regulatory field
18 as expert witnesses in over 350 regulatory proceedings, including numerous water and sewer, gas,
19 electric, and telephone utilities.
20

21 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE
22 COMMISSION?

23 A. Yes. I have testified before the Florida Public Service Commission on numerous occasions over the
24 last 25 years. I have attached, as Appendix I, a copy of my qualifications and regulatory experience.
25

1 Q. BY WHOM WERE YOU RETAINED, AND WHAT IS THE PURPOSE OF YOUR TESTIMONY?

2 A. Larkin & Associates, PLLC, was retained to review the Proposed Agency Action (PAA) Order No.
3 PSC-00-1528-PAA-WU (PAA Order), issued August 23, 2000, and to address certain issues in that
4 Order which were protested by Wedgefield Utilities, Inc. (Wedgefield) and the Citizens of the State
5 of Florida ("Citizens"). I am submitting testimony with respect to negative acquisition adjustment
6 issues and the impacts of Citizens Witness Ted Biddy's recommendations with regards to used and
7 useful plant.

8

9 Q. HAVE YOU PREPARED ANY SCHEDULES OR EXHIBITS IN SUPPORT OF YOUR
10 TESTIMONY?

11 A. Yes. I have prepared Exhibit__(HL-1), Exhibit__(HL-2) and Exhibit__(HL-3). Exhibit__(HL-1),
12 consisting of four schedules, presents the impact of my recommended adjustment for the negative
13 acquisition adjustment on the revenue requirement presented in the Commission's PAA Order.
14 Exhibit__(HL-2), consisting of 7 schedules, presents the impact of Citizens' witness Ted Biddy's
15 recommended used and useful adjustments on the revenue requirement contained in the PAA Order.
16 Exhibit__(HL-3), consisting of 3 schedules, is the Citizens' primary recommendation. The exhibit
17 reflects the combined impact on the revenue requirement presented in the PAA Order of both Mr.
18 Biddy's recommendations with regards to used and useful plant and my recommendations with
19 regards to the negative acquisition adjustment.

20

21 Q. HOW WILL YOUR TESTIMONY BE ORGANIZED?

22 A. I will first address the negative acquisition adjustment and why an adjustment should be reflected.
23 Second, I will discuss the calculations necessary to reflect the impact of Ted Biddy's
24 recommendations with regards to used and useful plant. Finally, I will address the result of the
25 Citizens' primary recommendation, which is the reflection of the impact of both mine and Mr.

1 Bidly's recommendations on the revenue requirement calculation presented in the PAA Order.

2
3 NEGATIVE ACQUISITION ADJUSTMENT

4 Q. COULD YOU BEGIN BY BRIEFLY DESCRIBING WHAT AN ACQUISITION ADJUSTMENT
5 IS?

6 A. Yes. An acquisition adjustment is essentially the difference between the purchase price paid to
7 acquire a utility asset or group of assets and the depreciated original cost of those assets at the date
8 of acquisition. It is the difference between the purchase price paid, including acquisition costs, and
9 the rate base determined as of the date of transfer. If an acquiring utility pays less than the net book
10 value of the assets, a negative acquisition adjustment exists. Wedgefield has a substantial negative
11 acquisition adjustment on its books for the purchase of the utility system from Econ Utilities
12 Corporation.

13
14 Q. IN ORDER NO. PSC-96-1241-FOF-WS, THE COMMISSION DECIDED THAT AN
15 ACQUISITION ADJUSTMENT SHOULD NOT BE INCLUDED IN THE RATE BASE
16 CALCULATION IN DETERMINING THE NET BOOK VALUE OF THE PROPERTY
17 TRANSFERRED TO WEDGEFIELD UTILITIES, INC. HAS ANYTHING OCCURRED SINCE
18 THAT TIME THAT WOULD WARRANT READDRESSING THE NEGATIVE ACQUISITION
19 ADJUSTMENT ISSUE AS IT PERTAINS TO WEDGEFIELD UTILITIES, INC.?

20 A. Yes. As the order in the prior case pertained to the establishment of rate base for purposes of the
21 transfer, this issue has not been formally addressed in a utility rate case proceeding for Wedgefield.
22 Earlier this year, the Commission held formal workshops to readdress the acquisition adjustment
23 issue, Docket No. 001502-WS. Numerous interested parties, including Citizens, submitted reports
24 and participated in those workshops. To date, no formal rulemaking or order has been issued with
25 regards to the workshops. I was one of the witnesses who presented a report in the acquisition

1 adjustment workshop on behalf of the Citizens of the State of Florida. I recommend that the
2 Citizens' primary recommendation in that workshop be adopted by the Commission in this rate case
3 proceeding. I will specifically address the Citizens' position with regards to the appropriate going-
4 forward treatment of negative acquisition adjustment issues later in this testimony.

5
6 Q. ARE THERE ANY ADDITIONAL CIRCUMSTANCES THAT WARRANT THE RE-
7 EVALUATION OF THE NEGATIVE ACQUISITION ADJUSTMENT ISSUE AS IT PERTAINS
8 TO WEDGEFIELD?

9 A. Yes. As indicated in Order No. 23376, issued August 21, 1990, regarding the Investigation into
0 Acquisition Adjustment Policy and Order No. 25729, issued February 17, 1992 in the same docket,
1 the Commission's policy has been that "...absent extraordinary circumstances, the purchase of a
2 utility system at a premium or discount shall not affect rate base." The stated purpose of the policy
3 is to create an incentive for large utilities to acquire small, troubled utilities. Order No. 23376
4 indicates that:

5 In fact, the customers should derive certain benefits from the acquisition, such as:

- 6 1. Increased quality of service;
- 7 2. Lower operating costs;
- 8 3. Increased ability to attract capital for improvements;
- 9 4. A lower overall cost of capital; and
- 0 5. More professional and experienced managerial, financial, technical and
1 operational resources.

2 (90 FPSC 8:307)

3 I have seen no evidence of customers benefitting from the acquisition. In fact, the PAA Order
4 results in a rate increase of approximately 32%. This is an increase of almost 1/3rd over what
5 customers were paying prior to the acquisition.

1 Q. WHAT LEADS YOU TO QUESTION WHETHER OR NOT CUSTOMERS HAVE BENEFITTED
2 AS A RESULT OF THE ACQUISITION?

3 A. Besides the fact that the PAA Order results in a substantial 32% increase in rates, there has been
4 very little investment in the water system subsequent to the acquisition. In fact, the Company's
5 overall rate base has actually declined since the acquisition, not increased as one would anticipate.
6 One of the underlying purposes of providing an incentive to a purchasing utility to acquire a smaller
7 utility is so improvements can be made to the system and to customer service. The acquisition
8 occurred in early 1996, with the transfer effective during October 1996. According to Wedgefield's
9 MFR Schedule A-4, additions to water plant in service since 1996 have been \$43,514 in 1997,
10 \$119,745 in 1998, and \$12,700 for the first half of 1999. Combined, these additions result in a 2 ½
11 year total of \$175,959. During that same time period, accumulated depreciation of the water system
12 has increased by \$83,713 in 1997, \$84,554 in 1998, and \$43,272 in the first half of 1999. The
13 combined total increase in accumulated depreciation of the same 2 ½ year period was \$211,539,
14 which is \$35,580 higher than the level of water plant additions. Additionally, in the current case,
15 Wedgefield's proposed net operating income included a going level

16 B. used & useful depreciation expense of \$84,164. This exceeds the average level of plant additions
17 made by Wedgefield over the 2 ½ year period.

18
19 According to Wedgefield MFR Schedules A-11 and A-13, Contributions in Aid of Construction
20 (CIAC) for the water operations increased by \$124,240 during the period January 1997 through June
21 30, 1999, while accumulated amortization of CIAC increased by \$46,964, for a net offset to rate base
22 of \$77,276. Contributions made by customers during the 2 ½ year period net of amortizations were
23 only \$98,683 lower than the total amount of increase in water plant in service for the same period.
24 Overall, when plant in service, accumulated depreciation and net CIAC are all considered, rate base
25 has actually declined for Wedgefield since the acquisition, yet the PAA Order would result in an

1 increase in water rates of approximately 32%. Considering the decline in overall rate base and the
2 low level of additions to plant in service, it does not appear that the goal of encouraging acquisitions
3 to improve the system has occurred.

4
5 Q. DID YOU REVIEW THE ADDITIONS MADE BY WEDGEFIELD SINCE THE ACQUISITION?

6 A. The Company provided a listing of additions to plant in service since the acquisition in response to
7 OPC Interrogatory Set 1, Interrogatory No. 2. The listing consists primarily of minor amounts and
8 does not provide a description of the additions. In response to another interrogatory, the Company
9 did indicate that it refurbished two water softeners, including the replacement of the resin in them,
10 and painted the facility. The Company also removed an underground diesel fuel storage tank that
11 was deteriorating and purchased some additional land. The land purchase was discussed in the PAA
12 Order, which determined that a large portion of the land (75%) was not used and useful.

13
14 Q. DID YOU REVIEW THE COMPANY'S CONSTRUCTION BUDGET FOR RECENT YEARS
15 AND FOR FUTURE PERIODS TO DETERMINE IF THERE ARE ANTICIPATED
16 IMPROVEMENTS TO THE SYSTEM FORTHCOMING?

17 A. OPC POD Set 1, Request No. 3 asked the Company to provide its operating and construction
18 budgets for the most recent fiscal year and for all future periods. The Company responded that it
19 "does not prepare a formal operating budget for future periods; instead the Company closely
20 monitors operating expenses with a more historical focus." The Company also indicated that its
21 work order system serves as a construction budget, and that documentation had been provided in
22 response to Request No. 1. The response to Request No. 1 did not include any construction
23 projections or budgets. It appears from a review of the workorders provided that workorders are
24 prepared when a known project that is needed comes up. The Company provided no evidence of
25 advanced planning with regards to improving the water system.

1 Q. DID YOU REVIEW WEDGEFIELD'S MAINTENANCE PROGRAMS?

2 A. OPC POD Set 1, Request No. 8 asked the Company to provide copies of its maintenance programs
3 and preventative maintenance programs in effect for each year from the acquisition to date. The
4 Company responded: "Although, the Company does perform preventive maintenance and regular
5 maintenance, it does not have a formal, written maintenance or preventative maintenance program
6 document."

7

8 Q. ARE THE LACK OF FORMAL MAINTENANCE PROGRAMS AND CONSTRUCTION
9 BUDGETS A CONCERN?

10 A. Without formal system improvement plans or a formal preventive maintenance program, one must
11 question what benefits have actually occurred as a result of the acquisition. The Commission's
12 historically stated purpose for not reflecting negative acquisition adjustments, as discussed
13 previously, was to encourage the purchase of small troubled utilities by larger utilities, theoretically
14 to result in improvements to the system, lower operating costs and/or improved customer service.
15 Based on the low level of investment since the acquisition, the high increase in rates, and the fact
16 that there are no formally planned improvements to the system or formal preventative maintenance
17 programs, it is not readily apparent that improvements have occurred.

18

19 Q. DID YOU REQUEST COPIES OF CUSTOMER COMPLAINTS RECEIVED SUBSEQUENT TO
20 THE MERGER?

21 A. Yes. In response to OPC POD Set 1, Request No. 4, the Company provided documentation
22 regarding customer complaints from the date Utilities, Inc. assumed operation of the system to date.
23 There were 194 complaints listed. The complaints range from issues such as high chlorine level,
24 water odor, low water pressure, no water and water color/quality (i.e., green, brown or black water
25 coming from pipes). There were 31 complaints listed in 1996, 60 in 1997, 34 in 1998, 36 in 1999

1 and 33 in 2000.

2
3 Q. ARE THERE ANY ADDITIONAL CONCERNS REGARDING THE WATER SYSTEM ASSETS?

4 A. Yes. In his direct testimony, Citizens' witness Ted Bidy raises numerous concerns with regards
5 to the actual water utility assets and plant in service reported and included on the Company's books
6 as of the acquisition date.

7
8 Q. DID YOU PERFORM AN ANALYSIS TO DETERMINE THE COMPANY'S EFFECTIVE
9 RETURN ON EQUITY BASED ON ITS ACTUAL INVESTMENT IN THE SYSTEM
10 RESULTING FROM THE RATE INCREASE INCLUDED IN THE PAA ORDER?

11 A. Yes. Exhibit__(HL-1), Schedule 1 provides the return on equity the Company will receive on its
12 actual investment in the water utility system based on the amounts included in Order No. PSC-00-
13 16528-PAA-WU. As shown on Line 9 of Schedule 1, the owners will receive a 69% return on
14 equity on their actual investment in the system. In other words, if the negative acquisition
15 adjustment is flowed through to reflect the actual amount of investment in the system by the current
16 owners, a return on equity of 69% will result. Clearly this amount goes well beyond any reasonable
17 return on equity level. If the PAA Order becomes effective as is, not only will customers be required
18 to pay rates which are 32% higher than the current rates, they will also be effectively providing
19 Wedgefield a return on equity of 69% of its actual investment in the system. This is both unfair to
20 current ratepayers and unreasonable.

21
22 Q. HOW DID YOU DETERMINE THE AMOUNT OF NEGATIVE ACQUISITION ADJUSTMENT?

23 A. The amount was based on the negative acquisition adjustment actually booked by Wedgefield
24 Utilities, Inc. for the water system, with one exception. Wedgefield acquired the water and
25 wastewater assets of Econ Utilities Corporation for a price of \$545,000. At that time, the net book

1 value of the assets were \$2,845,391. This resulted in a combined water and wastewater negative
2 acquisition adjustment of \$2,300,391, \$1,182,366 (or 51.4%) of which was allocated to water
3 operations. Based on these amounts, Utilities Inc. paid approximately \$0.20 on the dollar for the
4 assets.

5
6 As part of the acquisition, Wedgefield was required to pay Econ Utilities Corporation up to an
7 additional \$600,000 based on post-acquisition collections of contributions in aid of construction
8 (CIAC) from every other lot (or 200 of 400 planned lots) in a planned development titled The
9 Commons. The \$600,000 is a cap amount and the ultimate amount payable could end up being
10 substantially less. Since the time of the acquisition, the name of the development has changed from
11 The Commons to The Reserve at Wedgefield. Of the \$600,000 of potential future payables,
12 \$150,000 pertained to water operations. The \$150,000 was based on connection fees of \$750 from
13 every other new water customer in the particular development. Wedgefield booked the potential
14 future payable as a credit to the purchase acquisition account, thereby reducing the \$1,182,366
15 negative acquisition adjustment allocated to water operations by \$150,000. This resulted in a
16 negative acquisition adjustment of \$1,032,366 associated with the water operations.

17
18 Subsequent to the original booking date, the Company determined that the amount payable to Econ
19 Utilities Corporation (now named Southeast Community Development Corporation) was less than
20 what it had originally booked. The amount originally booked as an offset against the water negative
21 acquisition adjustment was reduced by \$22,000. The original amount of \$750 per customer included
22 a \$110 meter fee, which Wedgefield determined it was not responsible for reimbursing.
23 Consequently, the amount of negative acquisition adjustment on Wedgefield's books for the water
24 system, prior to amortization, is \$1,054,366 ($\$1,182,366 - \$150,000 + \$22,000$).

1 Q. WHAT MODIFICATION HAVE YOU MADE TO THE NEGATIVE ACQUISITION
2 ADJUSTMENT?

3 A. I recommend that the post-acquisition additional payments that may be made by Wedgefield to the
4 previous owners not be offset against the acquisition adjustment until such time as the amounts are
5 actually payable to the previous owner. According to the response to OPC Interrogatory Set 1,
6 Interrogatory No. 3, of the 400 lots in the development, 12 lots were sold in 1998, 26 in 1999, 17 in
7 2000, and 8 in 2001. This results in a total amount paid or payable to the previous owners based on
8 actual lot sales to date of \$20,480 (63 taps / 2 for every other tap x \$640).

9
10 Q. HOW DID YOU DETERMINE THE AVERAGE NET NEGATIVE ACQUISITION
11 ADJUSTMENT FOR THE HISTORIC TEST YEAR ENDED JUNE 30, 1999?

12 A. The calculation is presented on Exhibit__(HL-1), Schedule 3. Based on the Company's response
13 to a data request, it appears the Company is amortizing the acquisition adjustment on its books over
14 a 17 ½ year period, which is a reasonable amortization period. As shown on Schedule 3, I began the
15 amortization in November 1996, as that was the first month after the transfer was officially approved
16 by the Florida Public Service Commission. In Column B of the schedule, I reduced the negative
17 acquisition adjustment for the amounts payable to the developer for the contributions in aid of
18 construction received for new connections in The Reserve at Wedgefield. I applied the offset at the
19 mid-point of the years in which the amounts were recorded as payables, as the connections would
20 occur throughout the year and the amounts are not paid to the previous owner immediately. For
21 example, the amounts payable to Southeast Community Development Corporation pertaining to
22 1998 were \$3,840 (12 total connections divided by 2 times \$640 per connection), and Wedgefield
23 reimbursed the prior owners \$2,560 that year. In 1999, the amounts payable for connections that
24 year were \$8,320 (26 connections divided by 2 times \$640 per connection) and the Company
25 reimbursed \$5,120 that year to Southeast Community Development Corporation. In future periods,

1 as additional connections are made in The Reserve at Wedgefield, the remaining unamortized
2 negative acquisition adjustment should be reduced by the amounts payable to the previous owner
3 based on the connections, with the remaining negative acquisition adjustment balance amortized
4 over the remaining amortization period at that time.

5
6 Q. WHAT WAS THE RESULTING UNAMORTIZED NEGATIVE ACQUISITION ADJUSTMENT
7 DURING THE HISTORIC TEST YEAR ENDED JUNE 30, 1999 BASED ON YOUR
8 CALCULATIONS?

9 A. As shown on Exhibit__(HL-1), Schedule 3, lines 33 and 34, the test year average unamortized
10 balance for the negative acquisition adjustment, for ratemaking purposes, should be \$1,031,642. The
11 test year negative amortization expense associated with the acquisition adjustment is \$67,276. These
12 amounts consider the reductions to the negative acquisition adjustment for the actual amounts
13 payable to the previous owner for the contributions in aid of construction and a 17 ½ year
14 amortization period.

15
16 Q. SHOULD THE FULL AMOUNT OF THE UNAMORTIZED NEGATIVE ACQUISITION
17 ADJUSTMENT AND THE ASSOCIATED NEGATIVE AMORTIZATION EXPENSE BE
18 REFLECTED IN CALCULATING THE REVENUE REQUIREMENT FOR WEDGEFIELD?

19 A. No, not entirely. As previous mentioned, the Commission has stated that the purpose of its current
20 policy of not reflecting an acquisition adjustment absent extraordinary circumstances "...is to create
21 an incentive for larger utilities to acquire small, troubled utilities." (90 FPSC 8:307) In order to
22 allow for a reasonable, but not excessive, incentive, the Citizens recommend that their position taken
23 in the recent acquisition adjustment workshops be adopted.

24
25 Q. COULD YOU PLEASE DESCRIBE THAT POSITION?

1 A. Yes. A sharing approach should be adopted in which the negative acquisition adjustment is split or
2 shared 50/50 between customers and the acquiring company. This still provides the acquiring
3 company a significant incentive to proceed with the acquisition. However, there should be a limit
4 placed on the potential level of return on equity an acquiring entity can earn on its actual investment.
5 The actual return on equity on the amount of actual investment should be limited so that it may not
6 exceed 150% of the leverage graph return on equity. In the PAA Order in the current case, the return
7 on equity was set at 9.82% based on the leverage graph formula. Consequently, the amount of return
8 on equity the current owners are allowed to earn should be limited to 14.73% (9.82% x 150%) of
9 their actual investment in the system. This is the maximum amount that Wedgefield should be
10 permitted to earn on its actual investment, or the cap. Under this recommendation, i.e., 50/50 split
11 of negative acquisition adjustment capped at 150% of leverage graph return on equity on actual
12 investment, the utility owners are still permitted to earn more than the allowed return on equity on
13 its actual investment. Additionally, ratepayers are not required to pay a return to the acquiring entity
14 on amounts that substantially exceeds what was actually paid for the system, or what the system was
15 worth. This approach would still encourage investments in smaller, troubled utilities, yet it will
16 protect ratepayers from having to pay essentially windfall profits to acquiring entities. For ease of
17 reference, I have attached as Appendix II to this testimony a copy of the Acquisition Adjustment
18 Workshop Report I filed in the recent acquisition adjustment workshops. This report provides
19 further detail with regards to Citizens' position on this issue.

20

21 Q. HAS THE COMMISSION ADOPTED SHARING MECHANISMS IN OTHER CASES?

22 A. Yes. The Commission has adopted several incentive plans in recent years under which it has
23 embraced the notion of sharing excess earnings between a Company's customers and its
24 shareholders. For example, in Docket No. 920260-TL, the Commission approved a Stipulation and
25 Agreement Between the Office of Public Counsel and Southern Bell Telephone and Telegraph

1 Company. That agreement called for the sharing of earnings within certain return on equity ranges
2 between shareholders and ratepayers, and a refund to ratepayers of amounts exceeding a return on
3 equity cap. In that case, the sharing mechanism was in effect for a four year period. Prior to that
4 point, the Commission had approved in Docket No. 880069-TL a rate stabilization plan for Southern
5 Bell under which revenues were shared between customers and shareholders after earnings exceeded
6 the top range set for return on equity.

7
8 In Order No. PSC-99-2131-S-EI, the Commission approved a Stipulation under which Gulf Power
9 Company would share revenues between customers and shareholders between certain levels and to
10 refund all revenues above the sharing level to ratepayers.

11
12 Q. IS IT TYPICAL FOR A CAP TO BE PLACED ON POTENTIAL EARNINGS UNDER SHARING
13 PLANS?

14 A. Yes, it is. In each of the Florida cases cited above, the Commission placed a cap on the level of
15 earnings the utilities could achieve, above which the full amount of overearnings were returned to
16 ratepayers. For purposes of sharing the negative acquisition adjustments in water utility cases, the
17 cap should be set so that the acquiring entity may not earn over 150% of the leverage graph formula
18 return on equity on its actual investment in the acquired system.

19
20 Q. SHOULD OTHER PROVISIONS BE CONSIDERED PRIOR TO ALLOWING WEDGEFIELD
21 THE OPPORTUNITY TO EARN ON AMOUNTS THAT EXCEED ITS ACTUAL INVESTMENT
22 IN THE SYSTEM?

23 A. Yes. Wedgefield should be required to demonstrate that the customers are better off as a result of
24 its purchase of the water system. If Wedgefield can not demonstrate this, the full negative
25 acquisition adjustment should be reflected in calculating rate base. The Company's ratepayers

1 should not be forced to provide Wedgefield an incentive above the actual investment level if they
2 do not receive some benefit in return.

3
4 Q. WHAT FACTORS SHOULD BE CONSIDERED?

5 A. Examples of factors that should be taken into consideration in determining if ratepayers are better
6 off as a result of the acquisition include the following:

- 7 • Did service quality improve as a result of the acquisition?
- 8 • Did costs charged to customers decline?
- 9 • Did the overall cost of capital decline as a result of the acquisition?
- 10 • Did new management result in better service to the customers and/or lower costs for the
11 customers?

12
13 Q. ARE THE CUSTOMERS BETTER OFF AS A RESULT OF THE MERGER?

14 A. I previously discussed several concerns in this testimony with regards to the high level of rate
15 increase being requested, the low level of additions to plant in service subsequent to the acquisition,
16 the effective decline in rate base, and the level of customer complaints. I have not seen any evidence
17 demonstrating that the customers are better off as a result of the acquisition. I highly recommend
18 that Wedgefield clearly and concisely demonstrate in its rebuttal testimony that ratepayers are better
19 off as a result of the acquisition. Absent such a showing, the entire negative acquisition adjustment
20 should be reflected in calculating revenue requirement. Ratepayers should not be expected to pay
21 a return on amounts which exceed the entity's actual investment in the system absent a clear and
22 concise showing that the ratepayers are better off as a result of the acquisition.

23 Q. WHAT LEVEL OF REVENUE REQUIREMENT RESULTS FROM THE REFLECTION OF THE
24 NEGATIVE ACQUISITION ADJUSTMENT?

25 A. Exhibit __ (HL-1), Schedule 2, presents the recalculation of Wedgefield's revenue requirement under

1 three different scenarios. Each of the three scenarios are based on the amounts approved by the
2 Commission in the PAA Order. The only differences are for the negative acquisition adjustment.
3 The first scenario presented in Column A reflects the impact of reflecting 100% of the negative
4 acquisition adjustment, including the reduction in rate base for the full unamortized negative
5 acquisition adjustment and the increase in net operating income for the amortization of the negative
6 acquisition adjustment. This scenario would result in rates being based on the current owners' actual
7 investment in the system. As shown on line 7 of the schedule, a rate decrease of \$51,147 would be
8 necessary to reflect the Commission's authorized return on equity on the present owners' actual
9 investment in the system. This decrease of \$51,147 would be comparable to the \$82,897 rate
10 increase in pre-interim rates reflected in the PAA Order. In the Interim Order in the current case,
11 Order No. PSC-00-0910-PCO-WU, issued May 8, 2000, the Commission implemented an interim
12 rate increase of \$103,394. The rate decrease of \$51,147 calculated on Schedule 2 is to the rates in
13 effect prior to the interim increase and would result in a \$154,541 reduction to the interim rates
14 currently in effect.

15
16 The second scenario in Column B reflects the impact of a 50/50 sharing between the current owners
17 and ratepayers of the negative acquisition adjustment. As shown on line 7, the 50/50 sharing
18 approach would result in a \$15,863 increase in revenue requirement as compared to the \$82,897
19 increase in the PAA Order. This is \$87,531 lower than the interim rates currently in effect.
20 However, as shown on Schedule 1 of Exhibit __ (HL-1), the 50/50 sharing approach would result in
21 Wedgefield earning an effective return on equity of 23.44%.

22
23 Citizens primary recommendation, which is that the amount of earnings on the actual investment be
24 limited to 150% of the allowed return on equity level, is presented in Column (C) of Schedule 2.
25 As shown on line 7, a rate decrease of \$40,022 would still allow Wedgefield to earn 150% of the

1 Commission allowed return on equity, or a 14.73% return on equity, on its actual investment in the
2 system. This would be a decrease of \$143,416 to the interim rates currently in effect. However, the
3 allowance of a return on equity of 150% of the leverage graph formula amount on the actual
4 investment should only be allowed if the Company clear demonstrates that ratepayers are better off
5 as a result of the acquisition. If Wedgefield can not demonstrate such, then the entire negative
6 acquisition adjustment should be reflected.

7
8 Q. DID YOU TAKE INTO CONSIDERATION THE FACT THAT A PORTION OF PLANT IS NOT
9 USED AND USEFUL IN CALCULATING THE NEGATIVE ACQUISITION ADJUSTMENT?

10 A. Yes. As shown on Exhibit__(HL-1), Schedule 4, I calculated the effective used and useful
11 percentage on rate base (excluding working capital and allocated plant which would not be subject
12 to the used and useful impacts) contained in the PAA Order, which was 70.98%. I applied this
13 percentage to the negative acquisition adjustment in order to determine the effective used and useful
14 negative acquisition adjustment. This step is necessary to ensure that the Company is not double
15 hit with the used and useful offset to rate base.

16
17 USED AND USEFUL PLANT IN SERVICE

18 Q. DID YOU CALCULATE THE IMPACT ON REVENUE REQUIREMENT RESULTING FROM
19 CITIZENS WITNESS TED BIDDY'S RECOMMENDED USED AND USEFUL LEVEL?

20 A. Yes. Exhibit__(HL-2) presents the calculations necessary to determine revenue requirement
21 resulting from Mr. Bidy's recommended used and useful percentages. The amounts in the
22 calculations are based on Order No. PSC-00-1528-PAA-WU with the exception of the calculations
23 which are impacted by the used and useful percentages.

24
25 Q. WHAT ITEMS IN THE ORDER ARE IMPACTED BY THE USED AND USEFUL

1 PERCENTAGE?

2 A. The revision to the used and useful percentages impacts plant in service, accumulated depreciation,
3 contributions in aid of construction, depreciation expense, property tax expense, and income taxes,
4 including the interest synchronization adjustment.

5

6 Q. HOW DO MR. BIDDY'S RECOMMENDED USED AND USEFUL PERCENTAGES COMPARE
7 TO THOSE CONTAINED IN THE PAA ORDER?

8 A. Order No. PSC-00-1528-PAA-WU found that water treatment plant, including source of supplies
9 and pumping plant, was 76% used and useful. This percentage was applied to Plant Accounts 304.2,
10 307.2, 311.2, 304.3 and 320.3. The PAA Order determined that the water distribution system
11 included in Plant Accounts 331.4, 333.4 and 335.4 was 77% used and useful. Based Citizens
12 Witness Ted Biddy's analysis, source of supply wells and pumping plant (Accounts 304.2, 307.2 and
13 311.2) is 66.44% used and useful; water treatment plant (Accounts 304.3 and 320.3) is 61.1% used
14 and useful; and water distribution plant (Accounts 331.4, 333.4 and 335.4) is 66.4% used and useful.
15 Mr. Biddy also determined that Wedgefield' storage facilities are 67.25% used and useful.
16 However, I was unable to isolate the sub-components of the other plant accounts that pertained
17 specifically to the storage facilities. As the storage facilities are included in one of the other
18 accounts in which the used and useful percentages are applied, they still have a used and useful
19 percentage applied to them.

20

21 Q. WHAT IS THE IMPACT OF MR. BIDDY'S RECOMMENDED USED AND USEFUL
22 PERCENTAGES ON REVENUE REQUIREMENT?

23 A. As shown on Exhibit__(HL-2), the revenue requirement, as revised to reflect Mr. Biddy's used and
24 useful recommendations, is \$63,053. This is \$19,844 less than the \$82,897 increase reflected in the
25 PAA Order and \$40,341 less than the interim rates currently in effect.

1 CITIZENS RECOMMENDATION

2 Q. DID YOU PREPARE AN EXHIBIT REFLECTING THE IMPACT OF BOTH YOUR
3 RECOMMENDED ADJUSTMENT FOR THE NEGATIVE ACQUISITION ADJUSTMENT AND
4 TED BIDDY'S RECOMMENDED USED AND USEFUL PERCENTAGES?

5 A. Yes. Exhibit__(HL-3) reflects the impact of both Ted Bidy's recommended used and useful
6 percentages and my recommendations with regards to the negative acquisition adjustment. Mr.
7 Biddy's recommendations impact the average level of used and useful rate base, which, in turn,
8 impacts the calculation of the net used and useful negative acquisition adjustment.

9
10 Q. WHAT REVENUE REQUIREMENT RESULTS FROM THE COMBINATION OF MR. BIDDY'S
11 AND YOUR RECOMMENDATIONS?

12 A. Exhibit__(HL-3), Schedule 1 reflects the calculated revenue requirement resulting from the
13 reflection of both of our recommendations. Column B first reflects the impact assuming that 100%
14 of the negative acquisition adjustment is reflected, resulting in a revenue sufficiency of \$51,738.
15 In other words, if rates were set to reflect Wedgefield's actual investment in the used and useful
16 assets, rates (prior to the interim increase) would need to be reduced by \$51,738. This translates to
17 a \$155,132 reduction in the interim rates currently in effect.

18
19 Column (B) presents the revenue requirement based on a 50/50 sharing between shareholders and
20 ratepayers of the negative acquisition adjustment, resulting in a revenue requirement of \$5,658.
21 However, the 50/50 sharing would still result in Wedgefield earning an exorbitantly high return on
22 equity on its actual investment.

23
24 Q. WHAT IS THE REVENUE REQUIREMENT BASED ON THE LIMITATION OR CAP SET AT
25 150% RETURN ON EQUITY ON THE ACTUAL INVESTMENT?

1 A. Column C of Schedule 1 presents my primary recommendations, which results from placing the
2 earnings cap at 150% of the leverage graph formula return on equity on the current owner's actual
3 investment in the system. This amount was determined by reflecting 100% of negative acquisition
4 adjustment and increasing the return on equity to 150% of the leverage graph formula amount. This
5 results in the current owners still being permitted to earn a 14.73% return on equity on their actual
6 investment in the used and useful portion of the system. As shown on the schedule, Wedgefield's
7 water rates, prior to the interim increase, should be reduced by \$41,805. Since the Interim Order
8 implemented a rate increase of \$103,394 or 40.19%, a reduction to the current interim rates of
9 \$145,199 (\$103,394 + \$41,805) is necessary. As previously discussed, Wedgefield should
10 demonstrate clearly and concisely that ratepayers are actually better off under the current operation
11 of the system as compared to pre-acquisition circumstances. If Wedgefield can not clearly
12 demonstrate this, then the full negative acquisition adjustment should be reflected. Ratepayers
13 should not be required to fund an incentive to Wedgefield if they do not receive anything in return
14 for that incentive.

15


16 Q. DOES THAT COMPLETE YOUR TESTIMONY?

17 A. Yes it does.

DOCKET NO. 991437-WU
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing has been furnished by U.S.

Mail or hand-delivery to the following parties on this 14th day of May, 2001.



Charles J. Beck

Patricia Cristensen
Division of Legal Services
Fla. Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Ben Girtman, Esq.
1020 E. Lafayette St., #207
Tallahassee, FL 32301-4552

APPENDIX I

APPENDIX I

QUALIFICATIONS OF HUGH LARKIN, JR.

Q. WHAT IS YOUR OCCUPATION?

A. I am a certified public accountant and a partner in the firm of Larkin & Associates, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan.

Q. PLEASE DESCRIBE YOUR EDUCATION AND EXPERIENCE.

A. I graduated from Michigan State University in 1960. During 1961 and 1962, I fulfilled my military obligations as an officer in the United States Army.

In 1963 I was employed by the certified public accounting firm of Peat, Marwick, Mitchell & Co., as a junior accountant. I became a certified public accountant in 1966.

In 1968 I was promoted to the supervisory level at Peat, Marwick, Mitchell & Co. As such, my duties included the direction and review of audits of various types of business organizations, including manufacturing, service, sales and regulated companies.

Through my education and auditing experience of manufacturing operations, I obtained an extensive background of theoretical and practical cost accounting.

I have audited companies having job cost systems and those having process cost systems, utilizing both historical and standard costs.

I have a working knowledge of cost control, budgets and reports, the accumulation of overheads and the application of same to products on the various recognized methods.

Additionally, I designed and installed a job cost system for an automotive parts manufacturer.

I gained experience in the audit of regulated companies as the supervisor in charge of all railroad audits for the Detroit office of Peat, Marwick, including audits of the Detroit, Toledo and Ironton Railroad, the Ann Arbor Railroad, and portions of the Penn Central Railroad Company. In 1967, I was the supervisory senior accountant in charge of the audit of the Michigan State Highway Department, for which Peat, Marwick was employed by the State Auditor General and the Attorney General.

In October of 1969, I left Peat, Marwick to become a partner in the public accounting firm of Tischler & Lipson of Detroit. In April of 1970, I left the latter firm to form the certified public accounting firm of Larkin, Chapski & Company. In September 1982 I re-organized the firm into Larkin & Associates, a certified public accounting firm. The firm of Larkin & Associates performs a wide variety of auditing and accounting services, but concentrates in the area of utility regulation and ratemaking. I am a member of the Michigan Association of Certified Public Accountants and the American Institute of Certified Public Accountants. I testified before the Michigan Public Service Commission and in other states in the following cases:

U-3749	Consumers Power Company - Electric Michigan Public Service Commission
U-391	Detroit Edison Company Michigan Public Service Commission
U-4331	Consumers Power Company - Gas Michigan Public Service Commission
U-4332	Consumers Power Company - Electric Michigan Public Service Commission
U-4293	Michigan Bell Telephone Company Michigan Public Service Commission
U-4498	Michigan Consolidated Gas sale to Consumers Power Company Michigan Public Service Commission
U-4576	Consumers Power Company - Electric Michigan Public Service Commission
U-4575	Michigan Bell Telephone Company Michigan Public Service Commission
U-4331R	Consumers Power Company - Gas - Rehearing Michigan Public Service Commission
6813	Chesapeake and Potomac Telephone Company of Maryland, Public Service Commission, State of Maryland

Formal Case No. 2090	New England Telephone and Telegraph Co. State of Maine Public Utilities Commission
Dockets 574, 575, 576	Sierra Pacific Power Company, Public Service Commission, State of Nevada
U-5131	Michigan Power Company Michigan Public Service Commission
U-5125	Michigan Bell Telephone Company Michigan Public Service Commission
R-4840 & U-4621	Consumers Power Company Michigan Public Service Commission
U-4835	Hickory Telephone Company Michigan Public Service Commission
36626	Sierra Pacific Power Company v. Public Service Commission, et al, First Judicial District Court of the State of Nevada
American Arbitration Assoc.	City of Wyoming v. General Electric Cable TV
760842-TP	Southern Bell Telephone and Telegraph Company, Florida Public Service Commission
U-5331	Consumers Power Company Michigan Public Service Commission
U-5125R	Michigan Bell Telephone Company Michigan Public Service Commission
770491-TP	Winter Park Telephone Company, Florida Public Service Commission
77-554-EL-AIR	Ohio Edison Co., Public Utility Commission of Ohio
78-284-EL-AEM	Dayton Power and Light Co., Public Utility Commission of Ohio

0R78-1	Trans Alaska Pipeline, Federal Energy Regulatory Commission (FERC)
78-622-EL-FAC	Ohio Edison Co., Public Utility Commission of Ohio
U-5732	Consumers Power Company - Gas, Michigan Public Service Commission
77-1249-EL-AIR, et al	Ohio Edison Co., Public Utility Commission of Ohio
78-677-EL-AIR	Cleveland Electric Illuminating Co., Public Utility Commission of Ohio
U-5979	Consumers Power Company, Michigan Public Service Commission
790084-TP	General Telephone Company of Florida, Florida Public Service Commission
79-11-EL-AIR	Cincinnati Gas and Electric Co., Public Utilities Commission of Ohio
790316-WS	Jacksonville Suburban Utilities Corp., Florida Public Service Commission
790317-WS	Southern Utility Company, Florida Public Service Commission
U-1345	Arizona Public Service Company, Arizona Corporation Commission
79-537-EL-AIR	Cleveland Electric Illuminating Co., Public Utilities Commission of Ohio
800011-EU	Tampa Electric Company, Florida Public Service Commission
800001-EU	Gulf Power Company, Florida Public Service Commission

U-5979-R	Consumers Power Company, Michigan Public Service Commission
800119-EU	Florida Power Corporation, Florida Public Service Commission
810035-TP	Southern Bell Telephone and Telegraph Company, Florida Public Service Commission
800367-WS	General Development Utilities, Inc., Port Malabar, Florida Public Service Commission
TR-81-208**	Southwestern Bell Telephone Company, Missouri Public Service Commission
810095-TP	General Telephone Company of Florida, Florida Public Service Commission
U-6794	Michigan Consolidated Gas Company, 16 refunds Michigan Public Service Commission
U-6798	Cogeneration and Small Power Production - PURPA, Michigan Public Service Commission
0136-EU	Gulf Power Company, Florida Public Service Commission
E-002/GR-81-342	Northern State Power Company Minnesota Public Utilities Commission
820001-EU	General Investigation of Fuel Cost Recovery Clauses, Florida Public Service Commission
810210-TP	Florida Telephone Corporation, Florida Public Service Commission
810211-TP	United Telephone Co. of Florida, Florida Public Service Commission
810251-TP	Quincy Telephone Company, Florida Public Service Commission

810252-TP	Orange City Telephone Company, Florida Public Service Commission
8400	East Kentucky Power Cooperative, Inc., Kentucky Public Service Commission
U-6949	Detroit Edison Company - Partial and Immediate Rate Increase Michigan Public Service Commission
18328	Alabama Gas Corporation, Alabama Public Service Commission
U-6949	Detroit Edison Company - Final Rate Recommendation Michigan Public Service Commission
820007-EU	Tampa Electric Company, Florida Public Service Commission
820097-EU	Florida Power & Light Company, Florida Public Service Commission
820150-EU	Gulf Power Company, Florida Public Service Commission
18416	Alabama Power Company, Public Service Commission of Alabama
820100-EU	Florida Power Corporation, Florida Public Service Commission
U-7236	Detroit Edison-Burlington Northern Refund Michigan Public Service Commission
U-6633-R	Detroit Edison - MRCS Program, Michigan Public Service Commission
U-6797-R	Consumers Power Company - MRCS Program, Michigan Public Service Commission
82-267-EFC	Dayton Power & Light Company, Public Utility Commission of Ohio

U-5510-R	Consumers Power Company - Energy Conservation Finance Program, Michigan Public Service Commission
82-240-E	South Carolina Electric & Gas Company, South Carolina Public Service Commission
8624	Kentucky Utilities, Kentucky Public Service Commission
8648	East Kentucky Power Cooperative, Inc., Kentucky Public Service Commission
U-7065	The Detroit Edison Company (Fermi II) Michigan Public Service Commission
U-7350	Generic Working Capital Requirements, Michigan Public Service Commission
820294-TP	Southern Bell Telephone Company, Florida Public Service Commission
Order RH-1-83	Westcoast Gas Transmission Company,Ltd., Canadian National Energy Board
8738	Columbia Gas of Kentucky, Inc., Kentucky Public Service Commission
82-168-EL-EFC	Cleveland Electric Illuminating Company, Public Utility Commission of Ohio
6714	Michigan Consolidated Gas Company Phase II, Michigan Public Service Commission
82-165-EL-EFC	Toledo Edison Company, Public Utility Commission of Ohio
830012-EU	Tampa Electric Company, Florida Public Service Commission
ER-83-206**	Arkansas Power & Light Company, Missouri Public Service Commission

U-4758	The Detroit Edison Company (Refunds), Michigan Public Service Commission
8836	Kentucky American Water Company, Kentucky Public Service Commission
8839	Western Kentucky Gas Company, Kentucky Public Service Commission
83-07-15	Connecticut Light & Power Company, Department of Utility Control State of Connecticut
81-0485-WS	Palm Coast Utility Corporation, Florida Public Service Commission
U-7650	Consumers Power Company - (Partial and Immediate), Michigan Public Service Commission
83-662**	Continental Telephone Company, Nevada Public Service Commission
U-7650	Consumers Power Company - Final Michigan Public Service Commission
U-6488-R	Detroit Edison Co. (FAC & PIPAC Reconciliation), Michigan Public Service Commission
Docket No. 15684	Louisiana Power & Light Company, Public Service Commission of the State of Louisiana
U-7650 Reopened	Consumers Power Company (Reopened Hearings) Michigan Public Service Commission
38-1039**	CP National Telephone Corporation Nevada Public Service Commission

83-1226	Sierra Pacific Power Company (Re application to form holding company) Nevada Public Service Commission
U-7395 & U-7397	Campaign Ballot Proposals Michigan Public Service Commission
820013-WS	Seacoast Utilities Florida Public Service Commission
U-7660	Detroit Edison Company Michigan Public Service Commission
U-7802	Michigan Gas Utilities Company Michigan Public Service Commission
830465-EI	Florida Power & Light Company Florida Public Service Commission
U-7777	Michigan Consolidated Gas Company Michigan Public Service Commission
U-7779	Consumers Power Company Michigan Public Service Commission
U-7480-R	Michigan Consolidated Gas Company Michigan Public Service Commission
U-7488-R	Consumers Power Company - Gas Michigan Public Service Commission
U-7484-R	Michigan Gas Utilities Company Michigan Public Service Commission
U-7550-R	Detroit Edison Company Michigan Public Service Commission
U-7477-R	Indiana & Michigan Electric Company Michigan Public Service Commission
U-7512-R	Consumers Power Company - Electric Michigan Public Service Commission
18978	Continental Telephone Company of the South - Alabama, Alabama Public Service Commission

9003	Columbia Gas of Kentucky, Inc. Kentucky Public Service Commission
R-842583	Duquesne Light Company Pennsylvania Public Utility Commission
9006*	Big Rivers Electric Corporation Kentucky Public Service Commission *Company withdrew filing
U-7830	Consumers Power Company - Electric (Partial and Immediate) Michigan Public Service Commission
7675	Consumers Power Company - Customer Refunds Michigan Public Service Commission
5779	Houston Lighting & Power Company Texas Public Utility Commission
U-7830	Consumers Power Company - Electric - "Financial Stabilization" Michigan Public Service Commission
U-4620	Mississippi Power & Light Company (Interim) Mississippi Public Service Commission
U-16091	Louisiana Power & Light Company Louisiana Public Service Commission
9163	Big Rivers Electric Corporation Kentucky Public Service Commission
U-7830	Consumers Power Company - Electric - (Final) Michigan Public Service Commission
U-4620	Mississippi Power & Light Company - (Final) Mississippi Public Service Commission
76-18788AA & 76-18788AA	Detroit Edison (Refund - Appeal of U-4807) Ingham County Circuit Court Michigan Public Service Commission

U-6633-R	Detroit Edison (MRCS Program Reconciliation) Michigan Public Service Commission
19297	Continental Telephone Company of the South - Alabama, Alabama Public Service Commission
9283	Kentucky American Water Company Kentucky Public Service Commission
850050-EI	Tampa Electric Company Florida Public Service Commission
R-850021	Duquesne Light Company Pennsylvania Public Service Commission
TR-85-179**	United Telephone Company of Missouri Missouri Public Service Commission
6350	El Paso Electric Company The Public Utility Board of the City of El Paso
6350	El Paso Electric Company Public Utility Commission of Texas
85-53476AA & 85-534855AA	Detroit Edison-refund-Appeal of U-4758 Ingham County Circuit Court Michigan Public Service Commission
U-8091/ U-8239	Consumers Power Company-Gas Michigan Public Service Commission
9230	Leslie County Telephone Company, Inc. Kentucky Public Service Commission
85-212	Central Maine Power Company Maine Public Service Commission
850782-EI & 850783-EI	Florida Power & Light Company Florida Public Service Commission

ER-85646001 & ER-85647001	New England Power Company Federal Energy Regulatory Commission
Civil Action * No. 2:85-0652	Allegheny & Western Energy Corporation, Plaintiff, - against – The Columbia Gas System, Inc. Defendent
Docket No. 850031-WS	Orange Osceola Utilities, Inc. Before the Florida Public Service Commission
Docket No. 840419-SU	Florida Cities Water Company South Ft. Myers Sewer Operations Before the Florida Public Service Commission
R-860378	Duquesne Light Company Pennsylvania Public Service Commission
R-850267	Pennsylvania Power Company Pennsylvania Public Service Commission
R-860378	Duquesne Light Company - Surrebuttal Testimony - OCA Statement No. 2D Pennsylvania Public Service Commission
Docket No. 850151	Marco Island Utility Company Before the Florida Public Service Commission
Docket No. 7195 (Interim)	Gulf States Utilities Company Public Utility Commission of Texas
R-850267 Reopened	Pennsylvania Power Company Pennsylvania Public Service Commission
Docket No. 87-01-03	Connecticut Natural Gas Corporation Connecticut Department of Public Utility Control
Docket No. 5740	Hawaiian Electric Company Hawaii Public Utilities Commission
1345-85-367	Arizona Public Service Company Arizona Corporation Commission

Docket 011	Tax Reform Act of 1986 - California No. 86-11-019 California Public Utilities Commission
Case No. 29484	Long Island Lighting Company New York Department of Public Service
Docket No. 7460	El Paso Electric Company Public Utility Commission of Texas
Docket No. 870092-WS*	Citrus Springs Utilities Before the Florida Public Service Commission
Case No. 9892	Dickerson Lumber EP Company - Complainant vs. Farmers Rural Electric Cooperative and East Kentucky Power Cooperative - Defendants Before the Kentucky Public Service Commission
Docket No. 3673-U Commission	Georgia Power Company Before the Georgia Public Service
Docket No. U-8747	Anchorage Water and Wastewater Utility Report on Management Audit
Docket No. 861564-WS Commission	Century Utilities Before the Florida Public Service
Docket No. FA86-19-001	Systems Energy Resources, Inc. Federal Energy Regulatory Commission
Docket No. 870347-TI	AT&T Communications of the Southern States, Inc. Florida Public Service Commission
Docket No. 870980-WS	St. Augustine Shores Utilities Inc. Florida Public Service Commission
Docket No. 870654-WS*	North Naples Utilities, Inc. Florida Public Service Commission

Docket No. 870853	Pennsylvania Gas & Water Company Pennsylvania Public Utility Commission
Civil Action* No. 87-0446-R	Reynolds Metals Company, Plaintiff, v. The Columbia Gas System, Inc., Commonwealth Gas Services, Inc., Commonwealth Gas Pipeline Corporation, Columbia Gas Transmission Corporation, Columbia Gulf Transmission Company, Defendants - In the United States District Court for the Eastern District of Virginia - Richmond Division
Docket No. E-2, Sub 537	Carolina Power & Light Company North Carolina Utilities Commission
Case No. U-7830	Consumers Power Company - Step 2 Reopened Michigan Public Service Commission
Docket No. 880069-TL	Southern Bell Telephone & Telegraph Florida Public Service Commission
Case No. U-7830	Consumers Power Company - Step 3B Michigan Public Service Commission
Docket No. 880355-EI	Florida Power & Light Company Florida Public Service Commission
Docket No. 880360-EI	Gulf Power Company Florida Public Service Commission
Docket No. FA86-19-002	System Energy Resources, Inc. Federal Energy Regulatory Commission
Docket Nos. 83-0537-Remand & 84-0555-Remand	Commonwealth Edison Company Illinois Commerce Commission
Docket Nos. 83-0537 Remand & 84-0555 Remand	Commonwealth Edison Company Surrebuttal Illinois Commerce Commission

Docket No. 880537-SU	Key Haven Utility Corporation Florida Public Service Commission
Docket No. 881167-EI***	Gulf Power Company Florida Public Service Commission
Docket No. 881503-WS	Poinciana Utilities, Inc. Florida Public Service Commission
Cause No. U-89-2688-T	Puget Sound Power & Light Company Washington Utilities & Transportation Committee
Docket No. 89-68	Central Maine Power Company Maine Public Utilities Commission
Docket No. 861190-PU	Proposal to Amend Rule 25-14.003, F.A.C. Florida Public Service Commission
Docket No. 89-08-11 Utility Control	The United Illuminating Company State of Connecticut, Department of Public
Docket No. R-891364	The Philadelphia Electric Company Pennsylvania Public Utility Commission
Formal Case No. 889	Potomac Electric Power Company Public Service Company of the District of Columbia
Case No. 88/546*	Niagara Mohawk Power Corporation, et al Plaintiffs, v. Gulf+Western, Inc. et al, defendants (In the Supreme Court County of Onondaga, State of New York)
Case No. 87-11628*	Duquesne Light Company, et al, plaintiffs, against Gulf + Western, Inc. et al, defendants (In the Court of the Common Pleas of Allegheny County, Pennsylvania Civil Division)
Case No. 89-640-G-42T*	Mountaineer Gas Company West Virginia Public Service Commission

Docket No. 890319-EI	Florida Power & Light Company Florida Public Service Commission
Docket No. EM-89110888	Jersey Central Power & Light Company Board of Public Utilities Commissioners
Docket No. 891345-EI	Gulf Power Company Florida Public Service Commission
BPU Docket No. ER 8811 0912J	Jersey Central Power & Light Company Board of Public Utilities Commissioners
Docket No. 6531	Hawaiian Electric Company Hawaii Public Utilities Commissioners
Docket No. 890509-WU	Florida Cities Water Company, Golden Gate Division Florida Public Service Commission
Docket No. 880069-TL	Southern Bell Telephone Company Florida Public Service Commission
Docket Nos. F-3848, F-3849, and F-3850	Northwestern Bell Telephone Company South Dakota Public Utilities Commission
Docket Nos. ER89-* 678-000 & EL90-16-000	System Energy Resources, Inc. Federal Energy Regulatory Commission
Docket No. 5428	Green Mountain Power Corporation Vermont Department of Public Service
Docket No. 90-10	Artesian Water Company, Inc. Delaware Public Service Commission
Case No. 90-243-E-42T*	Wheeling Power Company West Virginia Public Service Commission
Docket No. 900329-WS	Southern States Utilities, Inc. Florida Public Service Commission
Docket Nos. ER89-* 678-000 & EL90-16-000	System Energy Resources, Inc. (Surrebuttal) Federal Energy Regulatory Commission
Application No. 90-12-018	Southern California Edison Company California Public Utilities Commission

Docket No. 90-0127	Central Illinois Lighting Company Illinois Commerce Commission
Docket No. FA-89-28-000	System Energy Resources, Inc. Federal Energy Regulatory Commission
Docket No. U-1551-90-322	Southwest Gas Corporation Before the Arizona Corporation Commission
Docket No. R-911966	Pennsylvania Gas & Water Company The Pennsylvania Public Utility Commission
Docket No. 176-717-U	United Cities Gas Company Kansas Corporation Commission
Docket No. 860001-EI-G	Florida Power Corporation Florida Public Service Commission
Docket No. 6720-TI-102	Wisconsin Bell, Inc. Wisconsin Citizens' Utility Board
(No Docket No.)	Southern Union Gas Company Before the Public Utility Regulation Board of the City of El Paso
Docket No. 6998	Hawaiian Electric Company, Inc. Before the Public Utilities Commission of the State of Hawaii
Docket No. TC91-040A	In the Matter of the Investigation into the Adoption of a Uniform Access Methodology Before the Public Utilities Commission of the State of South Dakota
Docket Nos. 911030-WS & 911067-WS	General Development Utilities, Inc. Before the Florida Public Service Commission
Docket No. 910890-EI	Florida Power Corporation Before the Florida Public Service Commission

Docket No. 910890-EI	Florida Power Corporation, Supplemental Before the Florida Public Service Commission
Case No. 3L-74159	Idaho Power Company, an Idaho corporation In the District Court of the Fourth Judicial District of the State of Idaho, In and For the County of Ada - Magistrate Division
Cause No. 39353*	Indiana Gas Company Before the Indiana Utility Regulatory Commission
Docket No. 90-0169 (Remand)	Commonwealth Edison Company Before the Illinois Commerce Commission
Docket No. 92-06-05	The United Illuminating Company State of Connecticut, Department of Public Utility Control
Cause No. 39498	PSI Energy, Inc. Before the State of Indiana - Indiana Utility Regulatory Commission
Cause No. 39498	PSI Energy, Inc. - Surrebuttal testimony Before the State of Indiana - Indiana Utility Regulatory Commission
Docket No. 7287	Public Utilities Commission - Instituting a Proceeding to Examine the Gross-up of CIAC Before the Public Utilities Commission of the State of Hawaii
Docket No. 92-227-TC	US West Communications, Inc. Before the State Corporation Commission of the State of New Mexico
Docket No. 92-47	Diamond State Telephone Company Before the Public Service Commission of the State of Delaware
Docket Nos. 920733-WS & 920734-WS	General Development Utilities, Inc. Before the Florida Public Service Commission

Docket No. 92-11-11	Connecticut Light & Power Company State of Connecticut, Department of Public Utility Control
Docket Nos. EC92-21-000 & ER92-806-000	Entergy Corporation Before the Federal Energy Regulatory Commission
Docket No. 930405-EI	Florida Power & Light Company Before the Florida Public Service Commission
Docket No. UE-92-1262	Puget Sound Power & Light Company Before the Washington Utilities & Transportation Commission
Docket No. 93-02-04	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 93-02-04	Connecticut Natural Gas Corporation, Supplemental State of Connecticut, Department of Public Utility Control
Docket No. 93-057-01	Mountain Fuel Supply Company Before the Utah Public Service Commission
Cause No. 39353 (Phase II)	Indiana Gas Company Before the Indiana Utility Regulatory Commission
PU-314-92-1060	US West Communications, Inc. Before the North Dakota Public Service Commission
Cause No. 39713	Indianapolis Water Company Before the Indiana Utility Regulatory Commission
93-UA-0301*	Mississippi Power & Light Company Before the Mississippi Public Service Commission

Docket No. 93-08-06	SNET America, Inc. State of Connecticut, Department of Public Utility Control
Docket No. 93-057-01	Mountain Fuel Supply Company - Rehearing on Unbilled Revenues - Before the Utah Public Service Commission
Case No. 78-T119-0013-94	Guam Power Authority vs. U.S. Navy Public Works Center, Guam - Assisting the Department of Defense in the investigation of a billing dispute. Before the American Arbitration Association
Application No. 93-12-025 - Phase I	Southern California Edison Company (Before the California Public Utilities Commission)
Case No. 94-0027-E-42T West Virginia)	Potomac Edison Company (Before the Public Service Commission of
Case No. 94-0035-E-42T West Virginia)	Monongahela Power Company (Before the Public Service Commission of
Docket No. 930204-WS**	Jacksonville Suburban Utilities Corporation (Before the Florida Public Service Commission)
Docket No. 5258-U	Southern Bell Telephone and Telegraph Company (Before the Georgia Public Service Commission)
Case No. 95-0011-G-42T*	Mountaineer Gas Company (Before the West Virginia Public Service Commission)
Case No. 95-0003-G-42T*	Hope Gas, Inc. (Before the West Virginia Public Service Commission)

Docket No. 95-02-07	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 95-057-02*	Mountain Fuel Supply Before the Utah Public Service Commission
Docket No. 95-03-01	Southern New England Telephone Company State of Connecticut, Department of Public Utility Control
BRC Docket No. EX93060255 OAL Docket PUC96734-94	Generic Proceeding Regarding Recovery of Capacity Costs Associated with Electric Utility Power Purchases from Cogenerators and Small Power Producers Before the New Jersey Board of Public Utilities
Docket No. U-1933-95-317	Tucson Electric Power Before the Arizona Corporation Commission
Docket No. 950495-WS	Southern States Utilities Before the Florida Public Service Commission
Docket No. 960409-EI	Prudence Review to Determine Regulatory Treatment of Tampa Electric Company's Polk Unit 1
Docket No. 960451-WS	United Water Florida Before the Florida Public Service Commission
Docket No. 94-10-05	Southern New England Telephone Company State of Connecticut Department of Public Utility Control
Docket No. 96-UA-389	Generic Docket to Consider Competition in the Provision of Retail Electric Service Before the Public Service Commission of the State of Mississippi

Docket No. 970171-EU	Determination of appropriate cost allocation and regulatory treatment of total revenues associated with wholesale sales to Florida Municipal Power Agency and City of Lakeland by Tampa Electric Company Before the Florida Public Service Commission
Case No. PUE960296 *	Virginia Electric and Power Company Before the Commonwealth of Virginia State Corporation Commission
Docket No. 97-035-01	PacifiCorp, dba Utah Power & Light Company Before the Public Service Commission of Utah
Docket No. G-03493A-98-0705*	Black Mountain Gas Division of Northern States Power Company, Page Operations Before the Arizona Corporation Commission
Docket No. 98-10-07	United Illuminating Company State of Connecticut Department of Public Utility Control
Docket No. 98-10-07	Connecticut Light & Power Company State of Connecticut Department of Public Utility Control
Docket NO. 99-02-05	Connecticut Light & Power Company State of Connecticut Department of Public Utility Control
Docket No. 99-03-36	Connecticut Light & Power Company State of Connecticut Department of Public Utility Control
Docket No. 99-03-35	United Illuminating Company State of Connecticut Department of Public Utility Control

Docket No. 99-03-04	United Illuminating Company State of Connecticut Department of Public Utility Control
Docket No. 99-08-02	Yankee Energy System, Inc. State of Connecticut Department of Public Utility Control
Docket No. 99-08-09	CTG Resources, Inc. State of Connecticut Department of Public Utility Control
Docket No. 99-07-20	Connecticut Energy Corporation / Energy East State of Connecticut Department of Public Utility Control
Docket No. 99-09-03 Phase II	Connecticut Natural Gas State of Connecticut Department of Public Utility Control
Docket No. 99-09-03 Phase III	Connecticut Natural Gas State of Connecticut Department of Public Utility Control
Docket No. 99-04-18 Phase II	Southern Connecticut Gas Company State of Connecticut Department of Public Utility Control
Docket No. 99-057-20*	Questar Gas Company Public Service Commission of Utah
Docket No. 99-035-10	PacifiCorp dba Utah Power & Light Company Public Service Commission of Utah
Docket No. T-1051B-99-105	U.S. West Communications, Inc. Arizona Corporation Commission

*Case Settled

**Issues Stipulated

APPENDIX II

ACQUISITION WORKSHOP
REPORT OF HUGH LARKIN, JR.
ON BEHALF OF THE
FLORIDA OFFICE OF PUBLIC COUNSEL

INTRODUCTION/BACKGROUND

What is an Acquisition Adjustment?

An acquisition adjustment is essentially the difference in the purchase price paid to acquire a utility asset or group of assets and the depreciated original cost of those assets at the date of acquisition. It is the difference between the purchase price paid, including acquisition costs, and the rate base determined as of the date of transfer. If an acquiring utility pays less than the net book value of the assets, a negative acquisition adjustment exists.

The Commission's stated policy concerning the treatment of acquisition adjustments for ratemaking purposes has been that, absent "extraordinary circumstances," a subsequent purchase of a utility system at a premium or discount does not affect the rate base calculation:

An acquisition adjustment results when the purchase price differs from the rate base calculation. It is Commission policy that in the absence of extraordinary circumstances a subsequent purchase of a utility system at a premium or discount shall not affect the rate base calculation.

(90 FPSC 6:22)

The Citizens strongly recommend that this policy be revised with regard to negative acquisition adjustments.

Why Current Policy Should be Revised

When a negative acquisition adjustment exists, the acquiring utility purchased the assets at less than the net book value. If the negative acquisition adjustment is not reflected, the stockholders of the purchasing entity will receive a return on amounts they have not funded. They did not fund the full amount of the depreciated original cost rate base. In some situations, they may have paid significantly less than that amount. The acquiring utility will effectively, and in actuality, earn a return on assets in which it has no investment. In several cases, the result has been that the acquiring entity has been allowed to earn a return on amounts that have hugely exceeded its actual investment. The Citizens have strongly recommended on numerous historic occasions that negative acquisition adjustments be reflected for ratemaking purposes. They have consistently recommended that in instances in which the acquiring utility's actual investment is less than the net book value of the system, the return earned by the acquiring utility be based on its actual purchase price, plus acquisition costs. Those arguments have been largely ignored.

Factors Causing Purchase Price to be Less than Book Value

Numerous factors can lead to the actual arms-length negotiated purchase price being significantly less than the net book value of an acquired system. For example, the purchased assets may have deteriorated at greater than the depreciation rate used has reflected. The assets may have deteriorated in value far greater than the books have indicated. The assets may not have been properly maintained. This is often caused by the prior owners' primary motivation being the sale of real estate, not the utility business. The prior owner may have been concerned more with marketing real estate and not maintaining a water system. These factors may cause the utility to be troubled. The system may be in extreme disrepair from years of neglect. If an

acquiring entity is able to purchase a system at an amount below the net book value, there is obviously a reason for that. In effect, by not allowing for a negative acquisition adjustment in calculating the revenue requirement, the utility's captive customers are essentially forced to pay more for a system on an on-going basis than the system is actually worth. The acquiring entity would be paying what it felt, based on an arms-length transaction, the assets are worth, yet charging customers based on a differing, higher amount. In addition, ratepayers will be required to pay higher maintenance costs and potentially higher system addition costs to bring the neglected system up to a proper standard.

Extraordinary Circumstances Test

The Commission's current policy is that absent extraordinary circumstances, the purchase of a utility at either a premium or discount should not impact the rate base calculation. Historically, the notion of extraordinary circumstances has been near impossible to meet. The main cause of this impossibility is the fact that the Commission has never set a definition for the term. What exactly qualifies as an extraordinary circumstance, and to what extent must the circumstance be extraordinary? In fact, the notion of extraordinary circumstance has not been used consistently. Acquiring utilities have brought forth the argument in numerous cases in Florida that they were purchasing a "troubled" system. They have used this "troubled" system argument as a means of avoiding recognition of a negative acquisition adjustment in rates. Should not the fact that a utility is troubled qualify that the circumstance is extraordinary? Apparently not, based on past rulings. It has been virtually impossible for customers to prove that an acquisition meets the extraordinary circumstance test. The vague notion of extraordinary circumstance should be

dismissed when setting a going-forward acquisition adjustment policy. It is a moving target or theory that is near impossible to achieve, particular when extraordinary is an abstract concept that is impossible to quantify or substantiate.

PROPOSED NEW NEGATIVE ACQUISITION ADJUSTMENT POLICY

The Commission has stated that the purpose of its policy "...is to create an incentive for larger utilities to acquire small, troubled utilities." (90 FPSC 8:307) There indeed are some situations in which it is desirable for a larger, well run utility to acquire small utilities. This is particularly true with respect to small troubled utilities. However, the current policy is far too generous. It sets no limit on the level of excess earnings an acquiring utility can achieve on its actual amount invested or the amount of additional maintenance cost that ratepayers must pay. The Citizens are recommending that a new policy be adopted with regard to negative acquisition adjustments that would balance both the interests of the acquiring utility and the interests of the ratepayers of the utility being acquired. The Citizens recommend that a new "sharing" approach be adopted by the Commission.

In recent years, the Commission has adopted several incentive plans under which it has embraced the notion of sharing excess earnings between a Company's customers and its shareholders. For example, in Docket No. 920260-TL, the Commission approved a Stipulation and Agreement Between the Office of Public Counsel and Southern Bell Telephone and Telegraph Company. That agreement called for the sharing of earnings within certain ROE ranges between shareholders and ratepayers, and a refund to ratepayers of amounts exceeding an ROE cap. In that case, the sharing mechanism was in effect for a four year period. Prior to that

point, the Commission had approved in Docket No. 880069-TL a rate stabilization plan for Southern Bell under which revenues were shared between customers and shareholders after earnings exceeded the top range set for ROE.

In Order No. PSC-99-2131-S-EI, the Commission approved a Stipulation under which Gulf Power Company would share revenues between customers and shareholders between certain levels and to refund all revenues above the sharing level to ratepayers. A sharing approach should be considered when dealing with the acquisition of water utilities at a cost less than net book value.

In situations in which a troubled utility is being purchased, the Citizens propose that the negative acquisition adjustment be split or shared equally between customers and the acquiring company. This would still provide the acquiring company an incentive to proceed with the acquisition; they would still be earning a return on an amount that exceeds their actual investment, possibly significantly so. However, consistent with other sharing mechanisms adopted by the Commission, there should be limits placed on the potential level of return on equity the acquiring entity can earn on its actual investment. In other incentive plans adopted by this Commission, earnings or revenues between certain levels have been shared between ratepayers and shareholders, with amounts exceeding set caps being returned entirely to ratepayers.

Under the Citizens' proposal, the actual return on equity on the amount of actual investment would not be permitted to exceed 150% of the leverage graph ROE. For example, if the leverage graph formula resulted in an allowed return on equity of 10%, the amount of return on equity would not be permitted to exceed a 15% return on the Company's actual investment in the acquired assets. This would be the cap.

For calculating rate base, the starting point would be the amount recorded on the books of the acquired utility. A 50% factor would then be applied to the amount of unamortized negative acquisition adjustment related to the purchase. Likewise, depreciation expense would be based on the level of plant included on the books of the acquired entity, and 50% of the annual amortization expense associated with the negative amortization adjustment would be reflected as a reduction of depreciation expense. Once the resulting revenue requirement is determined, a quick test would need to be performed. This would be done by including the full amount of unamortized negative acquisition adjustment in the rate base calculation and 100% of the amortization of the acquisition adjustment in the net operating income calculation. Applying the full negative acquisition adjustment would result in the actual investment of the acquiring utility being reflected. A rate of return would then be applied to rate base which includes return on equity based on 150% of the leverage graph formula. Rates would then be set based on the lower of the two calculated revenue requirement amounts. This will ensure that the ratepayers are not paying a return on equity of over 150% of the calculated leveraged graph amount on the actual investment of the acquiring utility. This would effectively and adequately balance the interests of both the ratepayers and the acquiring utility. It would also still provide an incentive for larger utilities to acquire smaller troubled utilities. They would be permitted to potentially earn up to 150% of the leverage graph return on equity on their actual investment.

Other Provisions of Proposed Policy

Certain additional provisions should be included as part of any new negative acquisition policy. First and foremost, the utility being acquired should be a troubled utility. If the utility

being acquired is well-run, well-maintained, in compliance with environmental requirements and customer satisfaction is high, there is no need to put additional incentives in place to encourage other utilities to buy the system. In those situations, there is no need to allow the acquiring utility to recovery a return on equity on amounts that exceed their actual investment. No additional incentive should be necessary.

On a similar plane, the acquiring utility must be required to demonstrate that customers would be better off as a result of the purchase. If the acquiring utility can not demonstrate this, the full negative acquisition adjustment should be reflected in calculating rate base. Ratepayers should not be forced to provide the acquiring utility an incentive above the actual investment level if they do not receive some benefit in return. Examples of factors that should be taken into consideration in determining if ratepayers are better off as a result of the acquisition include the following:

- Will service quality improve as a result of the acquisition? In answering this question, one should also take into consideration whether there was any problem with the quality of service to begin with.
- Will net operating costs decline? This could occur from overhead being spread over a larger customer base. The answer must also take into consideration any additional, new costs that may be allocated from the larger acquiring entity.
- Will the new entity be better able to attract capital that is needed for system improvements?
- Will the overall cost of capital decline as a result of the acquisition?
- Will more professional and experienced management result in better service to the customers and/or lower costs for the customers?

At a future date, such as three to five years after the initial acquisition takes place, an evaluation should be made to ensure that the customers were, in fact, better off. The utility would be required to prove that customers were better off subsequent to the purchase. They would need to demonstrate that the assertions it made at the time of purchase actually transpired. If it is then

determined that ratepayers were not in actuality better off, then the full unamortized negative acquisition adjustment should be reflected. No sharing should be allowed in such circumstances. It would not be fair or reasonable to require ratepayer to pay an incentive via paying a return on amounts higher than the actual investment if they received nothing in return. If the acquiring utility does not make improvements to the system or increase customer satisfaction via higher quality of service at lower cost, an incentive should not be put into place to encourage such sales. This would put potentially acquiring utilities on notice that they will not be permitted to achieve higher incentive levels of return if they do not actually make improvements.

Under the Citizens' proposed policy, both ratepayers and shareholders of acquiring utilities would be in a win-win situation. Customers of troubled utilities would be assured a better level of service, and shareholders will be able to earn a return on amounts that exceed their actual investment. In fact, they may potentially receive returns of up to 150% of the leverage graph ROE level on their actual investment. This recommended sharing would be a more than reasonable compromise that would be in all parties interest as opposed to a select group.

Brief Summary of Citizens Proposal

- Negative acquisition adjustment is shared 50/50 between ratepayers and shareholders as a means to still encourage the purchase of small troubled utilities.
- The amount of sharing will be limited such that customers do not pay a return on equity exceeding 150% of the leverage graph formula on the acquiring utility's actual investment in the system.
- The acquired utility must be considered troubled prior to the allowance of any sharing,

otherwise the full negative acquisition adjustment should be reflected.

- The acquiring utility must provide evidence demonstrating that the customers will be better off as a result of the purchase, otherwise the full negative acquisition adjustment should be reflected.
- At a future point in time (such as 3 to 5 years after acquisition), a review should be done to ensure that the customers actually were better off. If not, the sharing would immediately end and the full negative acquisition adjustment would be reflected.

RESPONSES TO QUESTIONS POSED BY THE COMMISSION

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

The primary goal should be to insure that the interests of both the ratepayers of the acquired entity and shareholders of the acquiring utility are taken into consideration, and a fair balance between the two is achieved. In the cases of utilities acquiring small troubled water and wastewater systems at a cost which is below the net book value of the acquired assets, an incentive mechanism could be used. However, a reasonable sharing and cap should be put into place to ensure that the acquiring utility does not receive excessive levels of return on its actual investment. The Citizens' proposed policy would accomplish this goal.

2. **Should the Commission still be promoting acquisitions?**

In the case of small troubled water and wastewater utilities, there are valid arguments for

promoting acquisitions by larger, well-run utilities. This is particularly true in cases in which the quality of service is poor and the system has been neglected and run-down. However, reasonable limits should be set on the level of return on equity on actual investment the acquiring utility is permitted to achieve.

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

No, the same general rules should apply to all three situations. However, it is highly doubtful that a large utility would be considered “troubled” to any reasonable degree. Consequently, since any incentives for acquisitions should be limited to the acquisition of troubled utilities, it is doubtful that situation number two would apply.

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

Yes. The Commission should adopt the incentive/sharing mechanism recommended by Citizens. This method was addressed in previous sections of this report. It would allow for a fair and reasonable balance between the ratepayers of the entity being acquired and the shareholders of the acquiring utility, while still incorporating significant incentives for the acquisition.

5. Should the Commission be addressing the accounting treatment for acquisition

adjustments? Should the amortization period for acquisition adjustments relate to the composite remaining life of the assets purchased?

The Uniform System of Accounts sets forth accounting requirements for book purposes.

Utilities are required to record acquisition adjustments on their books under the USOA.

As a general rule, the amortization period should be set over the remaining life of the assets being purchased. However, there may be special circumstances that would cause a different amortization period to be reasonable. Consequently, special exceptions to the general rule could be considered on a case by case basis if warranted.

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

No, it would not. The recommendation sponsored by Citizens is a more reasonable approach as it balances both ratepayer and shareholder interests, while still providing a reasonable incentive for the acquisition of troubled utilities.

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

The acquisition adjustment policy recommended by Citizens should be adopted. This policy was laid out previously in this report.

EXHIBITS

EXHIBIT__(HL-1)

REVENUE REQUIREMENT ADJUSTED FOR
NEGATIVE ACQUISITION ADJUSTMENT

TABLE OF CONTENTS

Schedule No.	Schedule Title / Description
1	Calculation of Return on Equity Based on Actual Investment and 50/50 Sharing of Negative Acquisition Adjustment
2, p.1	Revenue Requirement - Adjusted for Negative Acquisition Adjustment Impact
2, p.2	Calculation of Rate of Return Limitation Based on 150% of Allowed ROE
3	Calculation of Negative Amortization Expense and Average Unamortized Balance
4	Used & Useful Negative Acquisition Adjustment - Water

Wedgefield Utilities, Inc.

Calculation of Return on Equity Based on Actual Investment
and 50/50 Sharing of Negative Acquisition Adjustment
Test Year Ended June 30, 1999

Docket No 991437-WU
Exhibit__(HL-1)
Schedule 1

Line No.	Description	50/50 Sharing	Actual Investment	Reference:
1	Average Rate Base, per Decision	1,044,871	1,044,871	(1)
2	Average Used & Useful Unamortized Negative Acquisition Adjustment	<u>(366,156)</u>	<u>(732,311)</u>	Schedule 4
3	Adjusted Rate Base	<u>678,715</u>	<u>312,560</u>	
4	Net Operating Income, per Decision (after increase)	87,574	87,574	(1)
5	Increase in Income Taxes - Interest Synchronization	(5,663)	(11,326)	(2)
6	Negative Acquisition Adj. Amortization, Net of Tax	14,893	29,785	Line A 5
7	Adjusted Net Operating Income	<u>96,804</u>	<u>106,033</u>	
8	Rate of Return	<u>14.26%</u>	<u>33.92%</u>	Line 7 / Line 3
9	Return on Equity	<u>23.44%</u>	<u>69.00%</u>	
<u>Calculation of Used & Useful Negative Amortization Expense, Net of Tax:</u>				
A.1	Negative Acquisition Adj. Amortization Expense	33,638	67,276	Schedule 3
A.2	% Used and Useful (Schedule 4)	<u>70.98%</u>	<u>70.98%</u>	Schedule 4
A.3	Acquisition Adj. Amortization Expense - U&U	23,878	47,756	
A.4	Increase in Income Taxes @37.63% combined	<u>(8,985)</u>	<u>(17,971)</u>	A.3 x 37.63%
A.5	Net of Tax Impact	<u>14,893</u>	<u>29,785</u>	

Source/Notes:

(1) Order No. PSC-00-1528-PAA-WU

(2) Decrease in rate base (Line 2) x weighted cost of debt (4.11%) x combined income tax rate (37.63%)

Wedgefield Utilities, Inc.
Revenue Requirement - Adjusted for
Negative Acquisition Adjustment Impact
Test Year Ended June 30, 1999

Docket No. 991437-WU
Exhibit__(HL-1)
Schedule 2
Page 1 of 2

<u>Line No.</u>	<u>Description</u>	<u>Full Amount (A)</u>	<u>50/50 Sharing (B)</u>	<u>150% ROE Limitation (C)</u>	<u>Reference:</u>
1	Rate Base, as Adjusted	312,560	678,715	312,560	Schedule 1
2	Commission Approved Rate of Return	<u>8.38%</u>	<u>8.38%</u>	<u>10.50%</u>	(1)
3	Operating Income Required	26,193	56,876	32,819	Line 1 x Line 2
4	Operating Income Available, as Adjusted	<u>56,657</u>	<u>47,428</u>	<u>56,657</u>	Line A.4
5	Operating Income Deficiency (Sufficiency)	(30,464)	9,448	(23,838)	Line 3 - Line 4
6	Revenue Conversion Factor	<u>1.6789</u>	<u>1.6789</u>	<u>1.6789</u>	(2)
7	Revenue Requirement	<u>(51,147)</u>	<u>15,863</u>	<u>(40,022)</u>	Line 5 x Line 6
A.1	Operating Income, Prior to Increase <u>Impacts from Negative Acquisition Adjustment:</u>	38,198	38,198		(1)
A.2	Increase in Income Taxes - Interest Synchronization	(11,326)	(5,663)		Schedule 1
A.3	Negative Acquisition Adj. Amortization, Net of Tax	<u>29,785</u>	<u>14,893</u>		Schedule 1
A.4	Adjusted Net Operating Income	<u>56,657</u>	<u>47,428</u>		

Source/Notes:

- (1) Cols. (A) and (B) per Order No. PSC-00-1528-PAA-WU. Col. (C), see p. 2 of schedule
(2) Derived from Order No. PSC-00-1528-PAA-WU.

Wedgefield Utilities, Inc.
 Calculation of Rate of Return Limitation Based on
 150% of Allowed ROE
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-1)
 Schedule 2
 Page 2 of 2

Line No.	Description	Ratio	Cost Rate	Weighted Cost
1	Long Term Debt	40.67%	8.32%	3.38%
2	Short-Term Debt	11.10%	6.55%	0.73%
3	Common Equity	43.15%	14.73%	6.36%
4	Customer Deposits	0.58%	6.00%	0.03%
5	Deferred Income Taxes	4.50%	0.00%	0.00%
6	Rate of Return on Actual Investment Limit			<u>10.50%</u>

Source/Notes:

Rate of Return on Equity equals per Order amount of 9.82% x 150%

Wedgefield Utilities, Inc.
 Calculation of Negative Amortization Expense
 and Average Unamortized Balance
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-1)
 Schedule 3

Amortization Period = 17.5 years or 210 months

Line No	Month	Beginning Balance (A)	Reductions for CIAC Payments (B)	Adjusted Balance (C) = (A + B)	Remaining Months (D)	Monthly Amortization (E) = (C / D)	Month-End Unamortized Balance (F) = (C - E)	
1	Nov-96	(1,182,366)		(1,182,366)	210	5,630	(1,176,736)	
2	Dec-96	(1,176,736)		(1,176,736)	209	5,630	(1,171,105)	
3	Jan-97	(1,171,105)		(1,171,105)	208	5,630	(1,165,475)	
4	Feb-97	(1,165,475)		(1,165,475)	207	5,630	(1,159,845)	
5	Mar-97	(1,159,845)		(1,159,845)	206	5,630	(1,154,214)	
6	Apr-97	(1,154,214)		(1,154,214)	205	5,630	(1,148,584)	
7	May-97	(1,148,584)		(1,148,584)	204	5,630	(1,142,954)	
8	Jun-97	(1,142,954)		(1,142,954)	203	5,630	(1,137,323)	
9	Jul-97	(1,137,323)		(1,137,323)	202	5,630	(1,131,693)	
10	Aug-97	(1,131,693)		(1,131,693)	201	5,630	(1,126,063)	
11	Sep-97	(1,126,063)		(1,126,063)	200	5,630	(1,120,433)	
12	Oct-97	(1,120,433)		(1,120,433)	199	5,630	(1,114,802)	
13	Nov-97	(1,114,802)		(1,114,802)	198	5,630	(1,109,172)	
14	Dec-97	(1,109,172)		(1,109,172)	197	5,630	(1,103,542)	
15	Jan-98	(1,103,542)		(1,103,542)	196	5,630	(1,097,911)	
16	Feb-98	(1,097,911)		(1,097,911)	195	5,630	(1,092,281)	
17	Mar-98	(1,092,281)		(1,092,281)	194	5,630	(1,086,651)	
18	Apr-98	(1,086,651)		(1,086,651)	193	5,630	(1,081,020)	
19	May-98	(1,081,020)		(1,081,020)	192	5,630	(1,075,390)	
20	Jun-98	(1,075,390)	3,840	(1,071,550)	191	5,610	(1,065,940)	
21	Jul-98	(1,065,940)		(1,065,940)	190	5,610	(1,060,330)	
22	Aug-98	(1,060,330)		(1,060,330)	189	5,610	(1,054,719)	
23	Sep-98	(1,054,719)		(1,054,719)	188	5,610	(1,049,109)	
24	Oct-98	(1,049,109)		(1,049,109)	187	5,610	(1,043,499)	
25	Nov-98	(1,043,499)		(1,043,499)	186	5,610	(1,037,889)	
26	Dec-98	(1,037,889)		(1,037,889)	185	5,610	(1,032,279)	
27	Jan-99	(1,032,279)		(1,032,279)	184	5,610	(1,026,668)	
28	Feb-99	(1,026,668)		(1,026,668)	183	5,610	(1,021,058)	
29	Mar-99	(1,021,058)		(1,021,058)	182	5,610	(1,015,448)	
30	Apr-99	(1,015,448)		(1,015,448)	181	5,610	(1,009,838)	
31	May-99	(1,009,838)		(1,009,838)	180	5,610	(1,004,228)	
32	Jun-99	(1,004,228)	8,320	(995,908)	179	5,564	(990,344)	
33	Test Year Negative Amortization Expense (Lines 21 through 32)						<u>67,276</u>	
34	Test Year Average Unamortized Balance - Negative Acquisition Adjustment (Sum Lines 20 through 32 / 13)							<u>(1,031,642)</u>

Source/Notes:

Order No. PSC-96-1241-FOF-WS (10/7/96) indicated, at page 2, that the final closing was scheduled to take place within 10 days of the Commission's approval of the transfer. Consequently, the above schedule begins amortization of the negative acquisition adjustment in November 1996.

Col. (A): Beginning balance per response to OPC POD, Set 1, Request No. 6, excluding the Payable to Developer for CIAC Offset of \$150,000.

Col. (B): Response to OPC Interrogatories, Set 1, Interrogatory No. 3. Assumes payments to developer for the contributions occurred at the mid-point of the year.

Wedgefield Utilities, Inc.
Used & Useful Negative Acquisition Adjustment - Water
Test Year Ended June 30, 1999

Docket No. 991437-WU
Exhibit__(HL-1)
Schedule 4

<u>Line No.</u>	<u>Description</u>	<u>Amount</u>	<u>Reference:</u>
1	Rate Base, per Order, Excl. Working Capital and Allocated Plant	1,002,171	(1)
2	Non-Used & Useful, per Commission	409,636	(1)
3	Total Rate Base w/o Used & Useful Adjustments	<u>1,411,807</u>	
4	Percentage Used & Useful	<u>70.9850%</u>	Line 1 / Line 3
5	TY Average Unamortized Negative Acquisition Adjustment	(1,031,642)	Schedule 3
6	% of Rate Base Non-Used & Useful, per Order	<u>70.98%</u>	Line 4
7	Unamortized Negative Acquisition Adjustment - Used & Useful	<u>(732,311)</u>	

Source/Notes:

(1) Order No. PSC-00-1528-PAA-WU, Schedule No. 1-A.

Amounts Based on Per Commission Order Used & Useful, not on OPC Recommendation

Workpaper - Company Amortization of Acquisition Adjustment - OPC POD Set 1, No. 7

Date	Acct. 115 Accum. Amort Neg. AA	Acct 406 Amortization Expense		
06/30/1997	16105	16105		
09/30/1997	44908	44908		
12/31/1997	59877	59877	14969.25	59877
			120890	4989.75
03/31/1998	14718	14718		
06/30/1998	29436	29437		
09/30/1998	44155	44155		
10/31/1998	49060.56	49060.56		
11/30/1998	53966.61	53966.61		
12/31/1998	58872.67	58872.67		
			250209.8	58872.67
01/31/1999	4893.68	4893.68		
02/28/1999	4893.68	4893.68		
03/31/1999	4893.68	4893.68		
04/30/1999	4893.68	4893.68		
05/31/1999	4893.68	4893.68		
06/30/1999	4893.68	4893.68		
07/31/1999	4881.31	4881.31		
08/31/1999	4881.31	4881.31		
09/30/1999	4881.31	4881.31		
10/31/1999	4881.31	4881.31		
11/30/1999	4881.31	4881.31		
12/31/1999	4881.31	4881.31		
			58649.94	58649.94
01/31/2000	4868.94	4868.94		
02/28/2000	4868.94	4868.94		
03/31/2000	4868.94	4868.94		
04/30/2000	4868.94	4868.94		
05/31/2000	4868.94	4868.94		
06/30/2000	4868.94	4868.94		
07/31/2000	4828.72	4828.72		
08/31/2000	4828.72	4828.72		
09/30/2000	4828.72	4828.72		
10/31/2000	4828.72	4828.72		
11/30/2000	4828.72	4828.72		
12/31/2000	4828.72	4828.72		
			58185.96	58185.96
01/31/2001	5012.39	5012.39		
02/28/2001	5012.39	5012.39		
03/31/2001	5012.39	5012.39		
	502971.91	60148.68		
		148111.75		

EXHIBIT__(HL-2)

REVENUE REQUIREMENT ADJUSTED FOR
USED AND USEFUL REVISIONS

TABLE OF CONTENTS

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4	Non-Used & Useful Plant in Service
5	Non-Used & Useful Accumulated Depreciation
6	Non-Used & Useful Depreciation Expense
7	Non-Used & Useful Property Tax Expense

Wedgefield Utilities, Inc.
Revenue Requirement - Adjusted for
Used & Useful Revisions
Test Year Ended June 30, 1999

Docket No. 991437-WU
Exhibit__(HL-2)
Schedule 1

<u>Line No.</u>	<u>Description</u>	<u>Per OPC Amount</u>	<u>Reference:</u>
1	Rate Base, as Adjusted	920,418	Schedule 2
2	Commission Approved Rate of Return	<u>8.38%</u>	(1)
3	Operating Income Required	77,131	Line 1 x Line 2
4	Operating Income Available, as Adjusted	<u>39,575</u>	Schedule 3
5	Operating Income Deficiency (Sufficiency)	37,556	Line 3 - Line 4
6	Revenue Conversion Factor	<u>1.6789</u>	(1)
7	Revenue Requirement	<u><u>63,053</u></u>	Line 5 x Line 6

Source/Notes:

(1) Order No. PSC-00-1528-PAA-WU

Wedgefield Utilities, Inc.
 Non-Used & Useful Plant - Summary
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-2)
 Schedule 2

Line No.	Description	Non-Used & Useful Amount	Reference:
1	Plant in Service	790,202	Schedule 4
2	Land (Per Order)	8,888	(1)
3	Accumulated Depreciation	(241,767)	Schedule 5
4	CIAC	(23,601)	(2)
5	Accumulated Amortization - CIAC	367	(3)
6	Total, per OPC	534,089	
7	Total, per Order	409,636	(1)
8	Additional Reduction to Rate Base	(124,453)	Line 7 - Line 6
9	Rate Base, per Order	1,044,871	(1)
10	Adjusted Rate Base	920,418	

Source/Notes:

- (1) Order No. PSC-00-1528-PAA-WU
- (2) 1998 Contributed Property of \$70,240 (See Co. Sch. A-7-(a)) x 33.6% Non-Used & Useful for Transmission & Distribution Plant.
- (3) Per Company amount of \$1,092 (See Co. Sch. A-7-(a)) x 33.6% Non-Used & Useful for Transmission & Distribution Plant.

Wedgefield Utilities, Inc.
 Net Operating Income Impact - Non-Used & Useful
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-2)
 Schedule 3

Line No.	Description	Amount	Reference:
1	NOI, Prior to Increase, per Order	38,198	(1)
2	Increase in Income Taxes - Interest Synchronization	(1,925)	(2)
3	Decrease in Depreciation Expense	3,837	Schedule 6
4	Decrease in Property Tax Expense	1,458	Schedule 7
5	Impact on Income Taxes from Depreciation Expense and Income Taxes	<u>(1,993)</u>	(Line 3 + Line 4) x 37.63%
6	Adjusted Net Operating Income	<u><u>39,575</u></u>	

Source/Notes:

- (1) Order No. PSC-00-1528-PAA-WU
- (2) Decrease in rate base of \$124,453 x weighted cost of debt (4.11%) x combined income tax rate (37.63%)

Wedgefield Utilities, Inc.
 Non-Used & Useful Plant in Service
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-2)
 Schedule 4

Line No.	Description	Per Company Average Test Year Amount (A)	Per Order Adjust. (B)	Adj. Amt. (C)	Per OPC Non-Used & Useful % (D)	Non-Used & Useful Amount (E)
SOURCE OF SUPPLY & PUMPING						
1	304.2 Structures & Improvements	831,131	(24,925)	806,206	33.56%	270,563
2	307.2 Wells & Springs	151,114	(34,117)	116,997	33.56%	39,264
3	311.2 Pumping Equipment	125,116	(109,435)	15,681	33.56%	5,263
WATER TREATMENT PLANT						
4	304.3 Structures & Improvements	404		404	38.90%	157
5	320.3 Water Treatment Equipment	191,698		191,698	38.90%	74,571
TRANSMISSION & DISTRIBUTION PLANT						
6	331.4 Transmission & Distribution Mains	1,012,205	(13,189)	999,016	33.60%	335,669
7	333.4 Services	125,216		125,216	33.60%	42,073
8	335.4 Hydrants	67,890	(504)	67,386	33.60%	22,642
9	Non-Used & Useful Plant In Service, per OPC					<u>790,202</u>

Source/Notes:

Col. (A): Co. Schedule A-5

Col. (B): Derived from Order No. PSC-00-1528-PAA-WU and Staff Audit Report Audit Exceptions Adopted in the Order.

Col. (C): Percentages Recommended by OPC Witness Ted Bidy.

Wedgefield Utilities, Inc.
 Non-Used & Useful Accumulated Depreciation
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-2)
 Schedule 5

Line No.	Description	Per Company Average Test Year Amount (A)	Per Order Adjust. (B)	Adj. Amt. (C)	Per OPC Non-Used & Useful % (D)	Non-Used & Useful Amount (E)
SOURCE OF SUPPLY & PUMPING						
1	304.2 Structures & Improvements	(211,036)	24,925	(186,111)	33.56%	(62,459)
2	307.2 Wells & Springs	(58,048)	34,117	(23,931)	33.56%	(8,031)
3	311.2 Pumping Equipment	(66,847)	844	(66,003)	33.56%	(22,151)
WATER TREATMENT PLANT						
4	304.3 Structures & Improvements	(37)		(37)	38.90%	(14)
5	320.3 Water Treatment Equipment	(64,880)		(64,880)	38.90%	(25,238)
TRANSMISSION & DISTRIBUTION PLANT						
6	331.4 Transmission & Distribution Mains	(319,155)	49	(319,106)	33.60%	(107,220)
7	333.4 Services	(35,401)		(35,401)	33.60%	(11,895)
8	335.4 Hydrants	(14,192)	28	(14,164)	33.60%	(4,759)
9	Non-Used & Useful Accumulated Depreciation, per OPC					<u>(241,767)</u>

Source/Notes:

Col. (A): Co. Schedule A-9

Col. (B): Derived from Order No. PSC-00-1528-PAA-WU and Staff Audit Report Audit Exceptions Adopted in the Order.

Col. (C): Percentages Recommended by OPC Witness Ted Biddy.

Wedgefield Utilities, Inc.
 Non-Used & Useful Depreciation Expense
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-2)
 Schedule 6

Line No.	Description	Per Company Test Year Amount (A)	Per Order Adjust. (B)	Adj. Amt. (C)	Per OPC Non-Used & Useful % (D)	Non-Used & Useful Amount (E)
SOURCE OF SUPPLY & PUMPING						
1	304.2 Structures & Improvements	25,186	(755)	24,431	33.56%	8,199
2	307.2 Wells & Springs	5,032	(1,137)	3,895	33.56%	1,307
3	311.2 Pumping Equipment	6,289	(511)	5,778	33.56%	1,939
WATER TREATMENT PLANT						
4	304.3 Structures & Improvements	12		12	38.90%	5
5	320.3 Water Treatment Equipment	8,717		8,717	38.90%	3,391
TRANSMISSION & DISTRIBUTION PLANT						
6	331.4 Transmission & Distribution Mains	12,747	(33)	12,714	33.60%	4,272
7	333.4 Services	3,121	(51)	3,070	33.60%	1,032
8	335.4 Hydrants	1,507	(22)	1,485	33.60%	499
9	Non-Used & Useful Depreciation Expense, per OPC					20,644
10	Non-Used & Useful Depreciation Expense, per Order					16,807
11	Additional Reduction to Depreciation Expense					<u>3,837</u>

Source/Notes:

Col. (A): Co. Schedule B-13

Col. (B): Derived from Order No. PSC-00-1528-PAA-WU and Staff Audit Report Audit Exceptions Adopted in the Order.

Col. (C): Percentages Recommended by OPC Witness Ted Bidy.

Wedgefield Utilities, Inc.
Non-Used & Useful Property Tax Expense
Test Year Ended June 30, 1999

Docket No. 991437-WU
Exhibit__(HL-2)
Schedule 7

<u>Line No.</u>	<u>Description</u>	<u>Amount</u>	<u>Reference:</u>
1	Total Plant in Service, Including Land, per Order	2,681,445	(1)
2	Non-Used & Useful Plant in Service and Land	<u>799,090</u>	Schedule 2, Lines 1 and 2
3	Percentage Non-Used & Useful	29.80%	Line 2 / Line 1
4	Total Property Tax Expense, per Order	<u>18,065</u>	
5	Non-Used and Useful Property Taxes, per OPC	5,384	Line 3 x Line 4
6	Non-Used and Useful Property Taxes, per Order	<u>3,926</u>	(1)
7	Additional Reduction to Property Tax Expense	<u><u>1,458</u></u>	Line 5 - Line 6

Source/Notes:

Calculation follows the same methodology used in Order No. PSC-00-1528-PAA-WU

(1) Order No. PSC-00-1528-PAA-WU

EXHIBIT__(HL-3)

REVENUE REQUIREMENT ADJUSTED FOR
NEGATIVE ACQUISITION ADJUSTMENT
AND USED AND USEFUL RECOMMENDATION

TABLE OF CONTENTS

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1	Revenue Requirement - Adjusted for Negative Acquisition Adjustment and Used & Useful
2, p.1	Adjusted Rate Base
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3	Adjusted Net Operating Income

Wedgefield Utilities, Inc.

Revenue Requirement - Adjusted for Negative Acquisition Adjustment
and Used & Useful
Test Year Ended June 30, 1999

Docket No 991437-WU
Exhibit__(HL-3)
Schedule 1

<u>Line No.</u>	<u>Description</u>	<u>Full Amount (A)</u>	<u>50/50 Sharing (B)</u>	<u>150% ROE Limitation (C)</u>	<u>Reference:</u>
1	Rate Base, as Adjusted	279,048	599,733	279,048	Schedule 2
2	Commission Approved Rate of Return	<u>8.38%</u>	<u>8.38%</u>	<u>10.50%</u>	(1)
3	Operating Income Required	23,384	50,258	29,300	Line 1 x Line 2
4	Operating Income Available, as Adjusted	<u>54,200</u>	<u>46,888</u>	<u>54,200</u>	Schedule 3
5	Operating Income Deficiency (Sufficiency)	(30,816)	3,370	(24,900)	Line 3 - Line 4
6	Revenue Conversion Factor	<u>1.6789</u>	<u>1.6789</u>	<u>1.6789</u>	(2)
7	Revenue Requirement	<u>(51,738)</u>	<u>5,658</u>	<u>(41,805)</u>	Line 5 x Line 6

Source/Notes:

(1) Cols. (A) and (B) per Order No. PSC-00-1528-PAA-WU. Col. (C), see Exhibit__(HL-1), Schedule 2, page 2.

(2) Derived from Order No. PSC-00-1528-PAA-WU.

Wedgefield Utilities, Inc.
Adjusted Rate Base
Test Year Ended June 30, 1999

Docket No. 991437-WU
Exhibit__(HL-3)
Schedule 2
Page 1 of 2

<u>Line No.</u>	<u>Description</u>	<u>Amount</u>	<u>Reference:</u>
	<u>50/50 Sharing of Negative Acquisition Adjustment:</u>		
1	Rate Base, per Order	1,044,871	(1)
2	Reduction to Rate Base for Non- Used & Useful	(124,453)	Exhibit__(HL-2), Schedule 2
3	Reduction to Rate Base for Negative Acquisition Adj.	<u>(320,685)</u>	Line 7 / 2
4	Adjusted Rate Base, per OPC	<u>599,733</u>	
	<u>Reflect 100% of Negative Acquisition Adjustment:</u>		
5	Rate Base, per Order	1,044,871	(1)
6	Reduction to Rate Base for Non- Used & Useful	(124,453)	Exhibit__(HL-2), Schedule 2
7	Reduction to Rate Base for Negative Acquisition Adj.	<u>(641,370)</u>	See Page 2
8	Adjusted Rate Base, per OPC	<u>279,048</u>	

Source/Notes:

(1) Order No. PSC-00-1528-PAA-WU

Wedgefield Utilities, Inc.
 Calculation of Used & Useful Negative
 Acquisition Adjustment
 Test Year Ended June 30, 1999

Docket No. 991437-WU
 Exhibit__(HL-3)
 Schedule 2
 Page 2 of 2

Line No.	Description	Amount	Reference:
1	TY Average Unamortized Negative Acquisition Adjustment	(1,031,642)	Exh__(HL-1), Sch. 3
2	% of Rate Base Used & Useful, per OPC	62.17%	Line 9
3	Unamortized Negative Acquisition Adjustment - Used & Useful	<u>(641,370)</u>	Line 1 x Line 2
<u>Calculation of Per OPC Used & Useful Rate Base</u>			
4	Rate Base, per OPC (Excluding Negative Acquisition Adjustment)	920,418	Exh__(HL-2), Sch. 2
5	Less: Working Capital and Allocated Plant	<u>(42,700)</u>	(1)
6	Subtotal	877,718	Line 4 + Line 5
7	Plus OPC Used & Useful Adjustment	<u>534,089</u>	Exh__(HL-2), Sch. 2
8	Subtotal	<u>1,411,807</u>	Line 6 + Line 7
9	% Used and Useful	<u>62.17%</u>	Line 6 / Line 8

Source/Notes:

(1) Order No. PSC-00-1528-PAA-WU

Wedgefield Utilities, Inc.
Adjusted Net Operating Income
Test Year Ended June 30, 1999

Docket No. 991437-WU
Exhibit__(HL-3)
Schedule 3

Line No.	Description	50/50 Sharing Amount	Full Amount	Reference:
1	NOI, Prior to Increase, per Order	38,198	38,198	(1)
2	Increase in Income Taxes - Interest Synchronization	(7,656)	(13,387)	(2)
3	Decrease in Depreciation Expense	3,837	3,837	Exh__(HL-2), Sch. 6
4	Decrease in Property Tax Expense	1,458	1,458	Exh__(HL-2), Sch. 7
5	Used & Useful Neg. Acq. Adj. Amortization Exp.	20,913	41,825	Line 10
6	Impact on Income Tax Expense	(9,862)	(17,731)	(Lines 3, 4, 5) x 37.63%
7	Adjusted Net Operating Income	<u>46,888</u>	<u>54,200</u>	
8	Negative Acquisition Adjustment Amort. Exp.	33,638	67,276	Exh__(HL-1), Sch. 3
9	% Used and Useful	<u>62.17%</u>	<u>62.17%</u>	Schedule 2, page 2
10	Acquisition Adj Amortization Expense - U&U	<u>20,913</u>	<u>41,825</u>	Line 8 x Line 9

Source/Notes:

(1) Order No. PSC-00-1528-PAA-WU

(2) Decrease in rate base (See Sch. 2) x weighted cost of debt (4.11%) x combined income tax rate (37.63%)