BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation of Acquisition Adjustment Policy	)	DOCKET NO. 891309-WS
	)	ORDER NO. 25729
	)	ISSUED: 2/17/92

The following Commissioners participated in the disposition of this matter:

THOMAS M. BEARD, Chairman
BETTY EASLEY

ORDER CONCLUDING INVESTIGATION AND CONFIRMING ACQUISITION ADJUSTMENT POLICY

BY THE COMMISSION:

CASE BACKGROUND

On November 17, 1989, the Office of Public Counsel (OPC) filed a Petition to Initiate Rulemaking Proceedings or Alternatively to Issue an Order Initiating Investigation. OPC proposed a specific amendment to Rule 25-30.040(3)(o), Florida Administrative Code, regarding the treatment of acquisition adjustments in rate base.

By Order No. 22361, issued January 2, 1990, we denied OPC's request to initiate rulemaking and instead initiated an investigation of our policy on acquisition adjustments. As part of our investigation, we requested and received written comments from interested persons and held an informal workshop on March 28, 1990, to discuss the Commission's current policy and OPC's proposed changes. By proposed agency action (PAA) Order No. 23376 issued August 21, 1990, we declined to make any changes to our acquisition adjustment policy. On September 11, 1990, OPC filed a protest to Order No. 23376. Pursuant to Section 120.57(2), Florida Statutes, we afforded all parties the opportunity to be heard on this matter at an oral presentation on July 29, 1991. This Order contains our final disposition of this proceeding.

ACQUISITION ADJUSTMENT POLICY

Our policy on acquisition adjustments since approximately 1983 has been that absent extraordinary circumstances, the purchase of a utility system at a premium or discount shall not affect rate base. The purpose of this policy, as stated in PAA Order No. 23376, has been to create an incentive for larger utilities to

acquire small, troubled utilities. We believe that this policy has done exactly what it was designed to do. Since its implementation, many small utilities have in fact been acquired by larger utilities, and we have changed rate base in only a few cases.

OPC charges that the relationship between rate base and utility investment is broken upon the sale of a utility. An acquiring utility must therefore establish the extent to which its own investment is prudent without regard to the seller's rate base or investment level. OPC believes that investors in the selling utility recover their investment through the sale of the utility; the buyer's investment is represented by the purchase price. By not allowing the buyer to increase rate base to equal the purchase price through a positive acquisition adjustment, OPC claims, the Commission is not allowing the buyer to earn a return on imprudent investment.

OPC seems to view positive and negative acquisition adjustments somewhat differently. For positive acquisition adjustments, OPC believes that appropriate standards must be established for the buyer to show, and for the Commission to evaluate, the prudence of the acquisition at a premium so the sale of a utility does not increase customer rates without any new assets being devoted to utility service. But for negative acquisition adjustments, OPC believes that the Commission has no alternative except to automatically impose an adjustment.

OPC asserts that if the negative acquisition adjustment is not imposed upon the buyer, the Commission is creating a mythical investment above the actual commitment of capital by the buyer. This error, OPC argues, is further compounded by the buyer's recovering depreciation expense on this mythical investment.

OPC also argues that this Commission does not have the statutory authority to give the buyer the rate base of the seller. Section 367.081(2)(a), Florida Statutes, refers to "the investment of the utility." OPC claims that the seller is not the "utility" referred to in this definition, the buyer is. Therefore, OPC concludes, the "investment of the utility" must be the prudent investment made by the buyer.

The other parties to this proceeding, Southern States Utilities, Inc., Deltona Utilities, Inc., United Florida Utilities Corporation, and Jacksonville Suburban Utilities Corporation

(collectively, the utility companies) make several arguments in response to OPC. First, they point out that OPC suggests an inconsistent use of purchase price. Where a negative acquisition adjustment pertains, the investment of the utility means the purchase price paid by the buyer, but where a positive acquisition adjustment is considered, the investment of the utility means the net book value, or rate base, of the seller. The utility companies also argue that if the Commission were to adopt OPC's view, the incentive for larger utilities to rescue small, distressed utilities would be erased. Further, the utility companies assert that OPC's position conflicts with prior unchallenged Commission decisions allowing positive acquisition adjustments. In conclusion, the utility companies also argue that our current policy comports with our broad authority to interpret and implement our statutory authority in a manner which best serves the long term interests of the ratepayers.

On the point of statutory interpretation, we disagree with OPC. We do not think that Section 367.081(2)(a), Florida Statutes, limits us from including in rate base only that which an acquiring utility has invested in the system, i.e., the purchase price, as OPC asserts. This Commission has consistently interpreted the "investment of the utility" as contained in Section 367.081(2)(a), Florida Statutes to be the original cost of the property when first dedicated to public service, not only in the context of acquisition adjustments, but elsewhere as well. In our current policy on acquisition adjustments, we do not deviate from this interpretation, nor do we exceed our statutory authority. Furthermore, OPC has cited no authority to support its contention that we have misinterpreted the statute.

We still believe that our current policy provides a much needed incentive for acquisitions. The buyer earns a return on not just the purchase price but the entire rate base of the acquired utility. The buyer also receives the benefit of depreciation on the full rate base. Without these benefits, large utilities would have no incentive to look for and acquire small, troubled systems. The customers of the acquired utility are not harmed by this policy because, generally, upon acquisition, rate base has not changed, so rates have not changed. Indeed, we think the customers receive benefits which amount to a better quality of service at a reasonable rate. With new ownership, there are beneficial changes: the elimination of financial pressure on the utility due to its inability to obtain capital, the ability to attract capital, a

reduction in the high cost of debt due to lower risk, the elimination of substandard operating conditions, the ability to make necessary improvements, the ability to comply with the Department of Environmental Regulation and the Environmental Protection Agency requirements, reduced costs due to economies of scale and the ability to buy in bulk, the introduction of more professional and experienced management, and the elimination of a general disinterest in utility operations in the case of developer owned systems.

Some utilities that are actively acquiring troubled utilities have found that our policy has given them the ability to make some purchases at a premium because of the balancing effect created by purchases made at a discount. Thus, our current policy offers enough incentive for utilities to make multiple purchases at a discount and still purchase a troubled utility that can only be purchased at a premium.

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

In consideration of the foregoing, we conclude this investigation of our acquisition adjustment policy without making any change thereto. We note that our staff has opened a docket, Docket No. 911082-WS, wherein rules on acquisition adjustments will be addressed.

It is, therefore

ORDERED by the Florida Public Service Commission that this investigation of current Commission policy on acquisition adjustments is concluded and that policy, as described in the body of this Order, is hereby confirmed. It is further

ORDERED that this docket is closed.

By ORDER of the Florida Public Service Commission, this 17th day of FEBRUARY, 1992.

STEVE TRIBBLE, Director,
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900 (a), Florida Rules of Appellate Procedure.