

State of Florida



Public Service Commission  
CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD  
TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

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DATE: JANUARY 9, 2002

TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK & ADMINISTRATIVE SERVICES (BAYÓ)

FROM: DIVISION OF ECONOMIC REGULATION (BRADY) *pb 10*  
OFFICE OF THE GENERAL COUNSEL (HARRIS) *can 10 pg*

RE: DOCKET NO. 021023-WS - JOINT APPLICATION FOR APPROVAL OF ACQUISITION BY PHILADELPHIA SUBURBAN CORPORATION OF STOCK OF AQUASOURCE UTILITY, INC., AND RESULTING TRANSFER OF CONTROLLING INTEREST OF ARREDONDO UTILITY COMPANY, INC., CRYSTAL RIVER UTILITIES, INC., JASMINE LAKES UTILITIES CORPORATION, LAKE SUZY UTILITIES, INC., AND OCALA OAKS UTILITIES, INC.  
COUNTY: MULTIPLE

AGENDA: 01/21/03 - REGULAR AGENDA - INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\ECR\WP\021023.RCM

CASE BACKGROUND

AquaSource Utility, Inc. (AquaSource), a Texas corporation, is a subsidiary of AquaSource, Inc., which is a subsidiary of DQE, a Pennsylvania based energy service company. AquaSource directly, or indirectly through subsidiaries, owns and operates water and wastewater systems in twelve states. In Florida, AquaSource furnishes regulated water service in portions of Highlands, Lake, and Polk counties and regulated wastewater service in portions of Lake, Lee and Polk Counties. AquaSource's five regulated Florida subsidiaries are Arredondo Utility Company, Inc., Crystal River Utilities, Inc., Jasmine Lakes Utilities Corporation, Lake Suzy Utilities, Inc., and Ocala Oaks Utilities, Inc. All six

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corporations (AquaSource and its five regulated Florida subsidiaries) will collectively be referred to as the "Regulated Companies."

As of December 31, 2002, the Regulated Companies were serving approximately 11,132 water and 9,426 wastewater customers. Estimated combined 2002 revenues are \$3,544,041 with an estimated combined net operating income of \$131,945.

On October 7, 2002, Philadelphia Suburban Corporation (Philadelphia Suburban) and the Regulated Companies filed a Joint Application for Approval of Acquisition of the stock of AquaSource Utility, Inc. and an Emergency Petition for Variance or Waiver of Rules 25-30.030(4)(c), (5), (6), and (7), and 25-30.037(3)(i), (j), and (k), Florida Administrative Code.

According to the application, on July 29, 2002, Aqua Acquisition Corporation (Acquisition Corp.), DQE, Inc., and AquaSource entered into a Purchase Agreement which will ultimately result in Philadelphia Suburban acquiring the stock of AquaSource and the resulting controlling interest in its five Florida utility subsidiaries. The application states that the stock of AquaSource is currently owned by DQE, Inc. Philadelphia Suburban intends to purchase this stock, with the result that it will become the corporate parent of AquaSource Utility, Inc. and the corporate grandparent of the five Florida AquaSource utility subsidiaries.

By Order No. PSC-02-1627-PAA-WS, issued November 25, 2002, in this docket, the Commission granted the joint petition for variance or waiver of Rules 25-30.030(4)(c), (5), (6), and (7), and 25-30.037(3)(i), (j), and (k), Florida Administrative Code. This recommendation addresses the transfer of majority organizational control of AquaSource from DQE to Philadelphia Suburban. The Commission has jurisdiction pursuant to Section 367.071, Florida Statutes.

**DISCUSSION OF ISSUES**

**ISSUE 1:** Should the transfer of majority organizational control of AquaSource Utility, Inc. from DQE, Inc. to Philadelphia Suburban Corporation be approved?

**RECOMMENDATION:** Yes. The transfer of majority organizational control of AquaSource Utility, Inc. from DQE, Inc. to Philadelphia Suburban Corporation should be approved. The approved rates and charges of the Regulated Companies should be continued until authorized to change by the Commission in a subsequent proceeding. [BRADY, HARRIS]

**STAFF ANALYSIS:** As discussed in the case background, on October 7, 2002, Philadelphia Suburban along with the Regulated Companies filed a joint application for approval of acquisition of the stock of AquaSource and the resulting transfer of controlling interest in Arredondo Utility Company, Inc., Crystal River Utilities, Inc., Jasmine Lakes Utilities Corporation, Lake Suzy Utilities, Inc., and Ocala Oaks Utilities, Inc. The Purchase Agreement was executed on July 29, 2002, with provisions for the closing to be contingent upon Commission approval pursuant to Section 367.071(1), Florida Statutes. The closing, which is contingent upon multi-state regulatory approvals, is intended to occur in the second half of 2003.

The application as filed and amended is in compliance with the governing statute, Section 367.071, Florida Statutes, other pertinent statutes and provisions of the Florida Administrative Code, and Commission Order No. PSC-02-1627-PAA-WS. It contained the correct filing fee prescribed for such filings by Rule 25-30.020, Florida Administrative Code.

**Noticing.** The application contains proof of compliance with the noticing provisions set forth in Rule 25-30.030, Florida Administrative Code, and the variance approved by Order No. PSC-02-1627-PAA-WS which simplified the noticing format by not requiring a full legal description for all the Regulated Companies. Three letters from customers were timely received but none of the customers specifically requested a hearing. Legal staff sent a follow-up letter responding to the concerns in the letters and asking for a response by December 16, 2002, if the customers wished to pursue an objection to the application and request a hearing. No response to any of the follow-up letters has been received.

Therefore, there are no pending objections to the application. However, staff would note that two of the customer letters indicated problems with meter readings. Therefore, staff forwarded a copy of the letters to the applicable utility subsidiary requesting that it look into the matter and report its findings to the customers and staff. Staff will monitor and follow-up as necessary to ensure the customers' concerns are resolved.

**Financing.** Rule 25-30.037(3)(e) and (g), Florida Administrative Code, require the application to contain a statement describing the financing of the purchase, a list of entities providing funding to the buyer, and an explanation of the manner and amount of such funding. On July 29, 2002, Philadelphia Suburban, Acquisition Corporation, DQE, and AquaSource entered into a Purchase Agreement in which Philadelphia Suburban will acquire all of the issued and outstanding shares of common stock and 90 of the 100 outstanding shares of preferred stock of AquaSource; all of the issued and outstanding shares of common stock of AquaSource Development Company (a Texas corporation which does not conduct business in Florida); and all of the issued and outstanding shares of common stock of The Reynolds Group (an Indiana water utility holding company also not conducting business in Florida). In addition, Acquisition Corporation will purchase certain non-regulated assets, consisting largely of contract operating agreements with various water and wastewater service providers. As such, AquaSource's five regulated Florida subsidiaries will remain first tier subsidiaries of AquaSource and will become second tier subsidiaries of Philadelphia Suburban.

The Purchase Agreement provides for a target cash purchase price of approximately \$205,000,000. The final purchase price may be increased by up to \$10,000,000 or decreased by up to \$25,000,000 as various purchase price adjustments are applied. Such adjustments will relate to the achievement of certain operating performance criteria, involving revenue, rate base and project customer connections as detailed in the Purchase Agreement. Philadelphia Suburban and Acquisition Corporation intend to fund the purchase with cash from a combination of short-term debt, long-term debt, common stock and/or securities convertible into common stock. The ultimate funding decision will be driven by financial market conditions existing at the time the acquisition is consummated. According to its 2001 Annual Report, Philadelphia Suburban's goal is to maintain an equity ratio adequate to support its current Standard and Poors corporate credit rating of "A+" and

it senior secured debt rating of "AA-." As of December 31, 2001, Philadelphia Suburban's long-term debt was \$531,455,000, at an average interest rate of 6.96%, and its stock equity was \$473,833,000.

**Proof of Ownership, Tariffs, Certificates.** Rule 25-30.037(3) (i), (j), and (k), Florida Administrative Code, requires evidence that the utility owns or has continued use of the land upon which the utility treatment facilities are located, tariff sheets reflecting the change in ownership, and the return of utility certificates for modification. Order No. PSC-02-1627-PAA-WS granted AquaSource's petition for variance from this rule since no changes are taking place at the Regulated Companies level.

**Annual Reports and Regulatory Assessment Fees (RAFs).** Staff has verified that the Regulated Companies are current on annual reports and RAfs through 2001 and that there are no outstanding fees, penalties, or refunds due.

**Environmental Compliance.** Pursuant to Rule 25-30.037(3) (h), Florida Administrative Code, the application contains a statement that, after reasonable investigation, the utility systems operated by the Regulated Companies appear to be in satisfactory condition and in compliance with all applicable standards set by the Florida Department of Environmental Protection (DEP). Staff also contacted all the applicable DEP offices. While compliance work and upgrades are being performed at several locations, DEP is satisfied with the Regulated Companies' response and anticipates no enforcement action.

**Public Interest.** Pursuant to Rule 25-30.037(3) (f), Florida Administrative Code, the application contains a statement describing how the transfer is in the public interest, including a summary of the buyer's experience in water or wastewater utility operations, a showing of the buyer's financial ability to provide service, and a statement that the buyer will fulfill the commitments, obligations and representations of the seller with regard to utility matters.

Philadelphia Suburban is a Pennsylvania based corporation. According to the application, Philadelphia Suburban is the second largest investor-owned water utility holding company in the United States, serving approximately two million consumers in six states. Philadelphia Suburban's largest subsidiary, Pennsylvania Suburban

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and wastewater service to the public throughout Pennsylvania. Substantial additional water and wastewater operations are conducted through other subsidiaries in Illinois, Maine, New Jersey, North Carolina, and Ohio.

According to the application, ownership and control of the Regulated Companies by Philadelphia Suburban is intended to produce a stronger water and wastewater utility system by adding strategic focus, financial and human resources, and the necessary size and scope to address the challenges facing the water and wastewater utility industry in a more cost-effective manner. The application further states that Philadelphia Suburban is committed to providing adequate, efficient, safe and reliable water and wastewater service and believes performance bears this out. As an example, the application indicates that PSW has the lowest customer complaint ratio of any investor-owned water company in Pennsylvania and has never violated a primary maximum contaminant level standard.

According to the application, it is presently anticipated that local management will remain substantially in place and staffing levels will not be materially disturbed. Philadelphia Suburban also affirmed that the Regulated Companies are expected to continue to operate in much the same manner as they currently do and will continue to be fully subject to all applicable laws, rules, and policies governing the regulation of Florida public utilities.

With regard to financial ability, the application provided a copy of Philadelphia Suburban's 2001 Annual Report which indicates sizable financial resources. According to the Annual Report, Philadelphia Suburban's 2001 operating revenues were \$307,280,000 with operating income available to common stock of \$60,005,000, and total assets of \$1,560,339,000 on a customer base of 602,510 customers or approximately 2,000,000 total consumers. According to the application, Philadelphia Suburban's size, access to capital, and its recognized strengths in system planning, capital budgeting and construction management, uniquely positions it to be able to provide high quality water and wastewater service. And, because of its outstanding credit quality, Philadelphia Suburban believes it will be able to access the capital markets on favorable terms.

As the second largest investor-owned water and wastewater utility system in the country, Philadelphia Suburban also enjoys substantial economies of scale and scope through the mass purchasing of certain goods (e.g., chemicals and equipment) and the

provision of centralized service (e.g., the system-wide administration of employee pension and benefit plans). The proposed transaction presents an opportunity to further expand these economies and to extend the resulting benefits to customers of the Regulated Companies through consolidation and elimination of duplicative function in such areas as accounting and record keeping, financial and regulatory reporting, customer billing and accounting, and customer service.

Finally, the application indicates Philadelphia Suburban is totally committed to providing its customers with the highest quality service at the lowest reasonable price. Philadelphia Suburban has worked in partnership with State and local officials to address the problems faced by smaller systems that may lack the financial and/or technical resources needed to comply with evolving water quality and wastewater collection and disposal standards. Since the proposed acquisition offers expanded opportunities to the Regulated Companies' employees for career advancement and professional growth, the applicant believes customers will benefit by Philadelphia Suburban's ability to recruit, develop and maintain a skilled workforce.

**Rate Base.** It has been Commission practice not to establish rate base for transfers of majority organizational control because a stock transfer has no regulatory impact on rate base. Similarly, it has also been Commission practice that an acquisition adjustment for stock transfers is not made. Therefore, staff's recommendation does not include issues regarding the establishment of rate bases at the time of transfer or acquisition adjustments.

**Rates and Charges.** Rule 25-9.044(1), Florida Administrative Code, requires that the rates and charges for a new owner be continued until authorized to change by the Commission. Therefore, staff recommends that the rates and charges approved for Regulated Companies be continued until authorized to change by the Commission in a subsequent proceeding. According to the application, the proposed acquisition is intended to have no immediate effect on the rates charged or service provided by the Regulated Companies.

**Conclusion.** Based on all the above, staff recommends that the transfer of majority organizational control of AquaSource Utility, Inc. from DQE, Inc. to Philadelphia Suburban Corporation is in the public interest and should be approved. The approved rates and

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charges of the Regulated Companies should be continued until authorized to change by the Commission in a subsequent proceeding.

**ISSUE 2:** Should the docket be closed?

**RECOMMENDATION:** Yes. There are no issues remaining and the docket should be closed upon the issuance of the Final Order. (HARRIS)

**STAFF ANALYSIS:** There are no issues remaining and the docket should be closed upon the issuance of the Final Order.