

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

NOTICE OF WORKSHOP

TO

ALL INTERESTED PERSONS

UNDOCKETED

IN RE: ACQUISITION ADJUSTMENT WORKSHOP REGARDING
RULE 25-30.0371, FLORIDA ADMINISTRATIVE CODE

ISSUED: January 8, 2010

NOTICE is hereby given that the Florida Public Service Commission will conduct a workshop, to which all persons are invited, at the following time and place:

January 27, 2010, at 9:30 A.M.
Room 148, Betty Easley Conference Center
4075 Esplanade Way
Tallahassee, FL 32399-0862

The purpose of this workshop is to discuss the Commission's policy on water and wastewater acquisition adjustments as set forth in Rule 25-30.0371, Florida Administrative Code (F.A.C.), Acquisition Adjustments.

Attached hereto is a copy of the workshop agenda, Rule 25-30.0371, F.A.C., and a list of questions for comment on the Rule which will be discussed at the workshop. Interested persons are encouraged to submit comments to the Commission, and may raise additional questions and comments at the workshop. In addition, interested persons unable to attend are encouraged to submit comments.

Deadline to submit written comments for all interested persons is January 21, 2010. Please submit comments to: Greg Shafer, Division of Regulatory Analysis, Florida Public Service Commission, 2540 Shumard Oak Blvd., Tallahassee, FL 32399-0852, or at gshafer@psc.state.fl.us. Mr. Shafer can be contacted at (850) 413-6958.

Any person requiring some accommodation at this workshop because of a physical impairment should call the Office of Commission Clerk at (850) 413-6770 at least 48 hours prior to the workshop. Any person who is hearing or speech impaired should contact the Florida Public Service Commission by using the Florida Relay Service, which can be reached at: 1-800-955-8771.

DOCUMENT NUMBER-DATE


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FPSC-COMMISSION CLERK

NOTICE OF WORKSHOP
UNDOCKETED
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Emergency Cancellation of Workshop - If a named storm or other disaster requires cancellation of the meeting, Commission staff will attempt to give timely direct notice to the parties. Notice of cancellation of the meeting will also be provided on the Commission's website (<http://www.psc.state.fl.us/>) under the Hot Topics link found on the home page. Cancellation can also be confirmed by calling the Office of the General Counsel at (850) 413-6199.

By DIRECTION of the Florida Public Service Commission, this 8th day of January,
2010.



ANN COLE
Commission Clerk

(SEAL)

ELS

Workshop Agenda

In Re: Acquisition Adjustment Rule Workshop regarding
Rule 25-30.0371, Florida Administrative Code

- Opening Remarks
- Staff Presentation on the Commission's Acquisition Adjustment Policy
- Questions & Comments by Interested Parties
- Questions & Comments by Commissioners
- Conclusion

Rule 25-30.0371, Florida Administrative Code, Acquisition Adjustments.

(1) Definition. For the purpose of this rule, an acquisition adjustment is defined as the difference between the purchase price of utility system assets to an acquiring utility and the net book value of the utility assets. A positive acquisition adjustment exists when the purchase price is greater than the net book value. A negative acquisition adjustment exists when the purchase price is less than the net book value.

(2) Positive Acquisition Adjustments. A positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Any entity that believes a full or partial positive acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipated rate reductions or rate stability over a long-term period, and anticipated cost efficiencies.

(3) Negative Acquisition Adjustments. A negative acquisition adjustment shall not be included in rate base unless there is proof of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value then the inclusion of a negative acquisition adjustment shall be calculated pursuant to paragraph (b) below.

(a) Contested. Any entity that believes a full or partial negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. Under no circumstance, however, shall the purchaser be required to record on its books more than 70 percent of a negative acquisition adjustment. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as the anticipated retirement of the acquired assets and the condition of the assets acquired.

(b) Uncontested. If the purchase price is less than 80 percent of net book value, then the amount of the difference in excess of 20 percent of net book value shall be recognized for ratemaking purposes as a negative acquisition adjustment. The negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings review unless the purchaser files for a rate increase pursuant to Section 367.081(2), 367.0814, 367.0817 or 367.0822, F.S., that will be effective during the amortization period. The negative acquisition adjustment shall be amortized over a 5-year period from the date of issuance of the order approving the transfer of assets.

(4) Amortization Period. In setting the amortization period for a Commission approved acquisition adjustment pursuant to (2) or (3)(a) above, the Commission shall consider evidence provided to the Commission such as the composite remaining life of the assets purchased and the condition of the assets purchased. Amortization of the acquisition adjustment shall begin on the date of issuance of the order approving the transfer of assets.

(5) Subsequent Modification. Any full or partial acquisition adjustment, once made by the Commission pursuant to (2) or (3)(a) above, may be subsequently modified if the extraordinary circumstances do not materialize or subsequently are eliminated or changed within five years of the date of issuance of the order approving the transfer of assets.

Specific Authority 350.127(2), 367.121(1)(f) FS. Law Implemented 367.071(5), 367.081(2)(a), 367.121(1)(a), (b) FS. History–New 8-4-02.

Questions for Comment

In Re: Acquisition Adjustment Rule Workshop regarding
Rule 25-30.0371, Florida Administrative Code

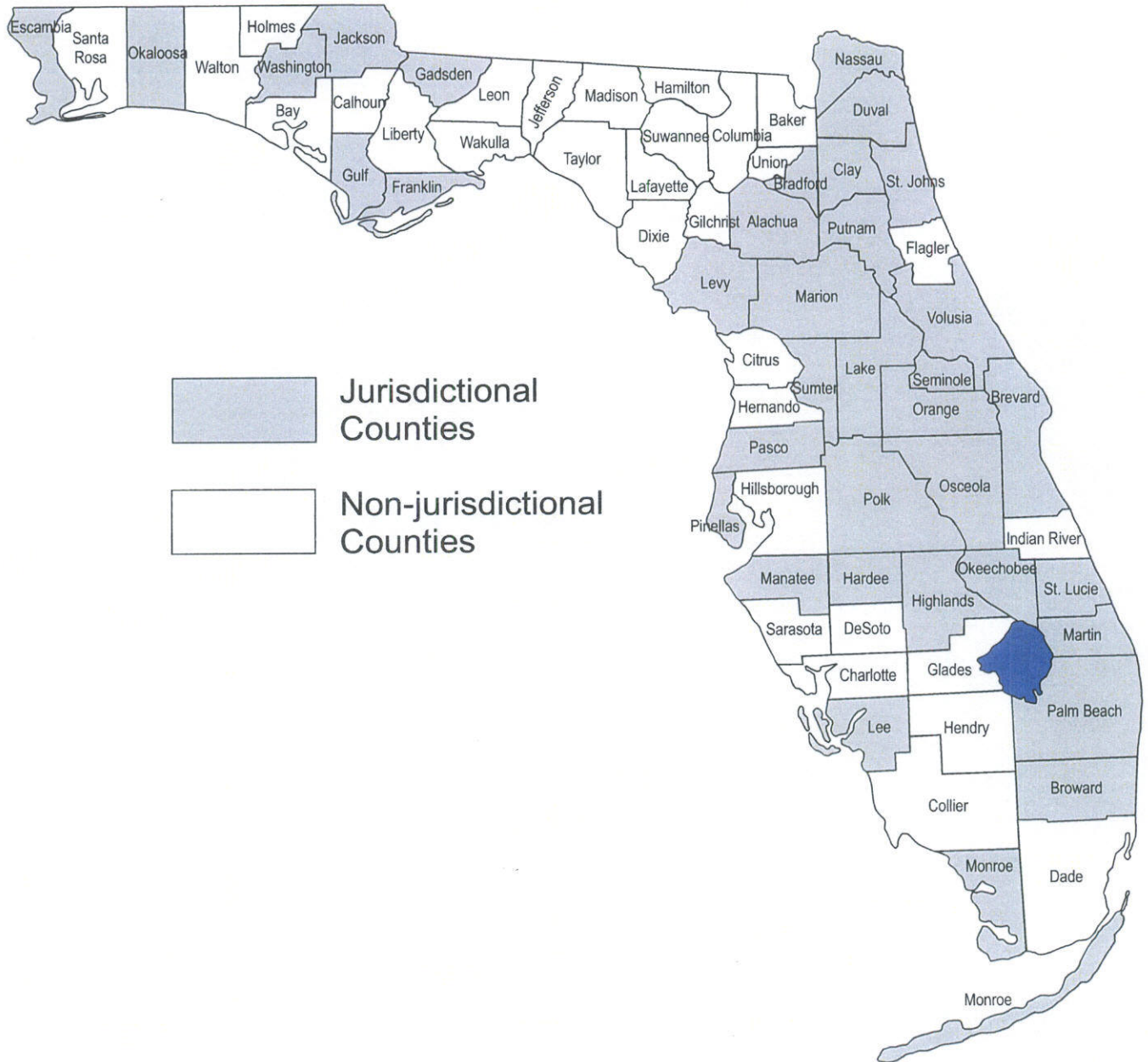
1. Approximately how many investor-owned water and wastewater systems under Commission jurisdiction are currently distressed and/or would benefit from being acquired by a larger utility?
2. How has the Commission's current acquisition adjustment rule impacted the acquisition strategy of investor-owned water and wastewater utilities in Florida?
3. Has the number of investor-owned water and wastewater systems available for acquisition been affected either positively or negatively by the Commission's current acquisition adjustment rule?
4. Please describe the current market for acquisitions: Are systems available for acquisition? Who is in the market to make acquisitions? Are larger investor-owned utilities incented to make acquisitions? Is capital readily available to fund acquisitions?
5. How has the Commission's acquisition adjustment rule impacted the customers of the acquired and acquiring utilities?
6. Please provide any additional comments regarding the Commission's current acquisition adjustment rule.

Tab No.**Description of Document**

1. FPSC Water & Wastewater Jurisdictional County Map
Jurisdictional Counties Map
Jurisdictional Counties as of October 2009
2. 2008 Water & Wastewater Utility Revenue by Class
3. February 1992 FPSC Order No. 25729 Stating Acquisition Policy
4. July 23, 2002, FPSC Notice of Adoption of Rule
5. Text of Rule 25-30.0371 Acquisition Adjustments
6. Section-by-section Explanation of Rule
7. Summary of Acquisition Adjustments 1986 - 2000
8. Analysis of Commission Approved Acquisition Adjustments
1986 - 2000
9. Summary of Transfers Since Adoption of Rule 25-30.0371
10. Refocusing on the Commission's Acquisition Policy Regarding Water
and Wastewater Utilities, February 2001
11. NAWC 50-state Survey of Acquisition Adjustment Policy
Released July 2009
12. Parties' Responses to Staff Questions
13. Staff Presentation

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36 Jurisdictional Counties



WATER AND WASTEWATER

PSC JURISDICTIONAL AND NON-JURISDICTIONAL COUNTIES

**JURISDICTIONAL
COUNTIES
(36)**

ALACHUA
BRADFORD
BREVARD
BROWARD
CLAY
DUVAL
ESCAMBIA
FRANKLIN
GADSDEN
GULF
HARDEE
HIGHLANDS
JACKSON
LAKE
LEE
LEVY
MANATEE
MARION
MARTIN
MONROE
NASSAU
OKALOOSA
OKEECHOBEE
ORANGE
OSCEOLA
PALM BEACH
PASCO
PINELLAS
POLK
PUTNAM
SEMINOLE
ST. JOHNS
ST. LUCIE
SUMTER
VOLUSIA
WASHINGTON

**NON-JURISDICTIONAL
COUNTIES
(31)**

BAKER
BAY
CALHOUN
CHARLOTTE
CITRUS
COLLIER
COLUMBIA
DADE
DESOTO
DIXIE
FLAGLER
GILCHRIST
GLADES
HAMILTON
HENDRY
HERNANDO
HILLSBOROUGH
HOLMES
INDIAN RIVER
JEFFERSON
LAFAYETTE
LEON
LIBERTY
MADISON
SANTA ROSA
SARASOTA
SUWANEE
TAYLOR
UNION
WAKULLA
WALTON

**FLORIDA PUBLIC SERVICE COMMISSION
DIVISION OF ECONOMIC REGULATION
JURISDICTIONAL COUNTIES AS OF October 2009**

<u>COUNTY</u>	<u>JURISDICTIONAL DATE</u>	<u>ORDER NUMBER</u>	<u>ISSUED</u>
1. Alachua	06/30/92	92-0964	09/09/92
2. Bradford	07/06/92	92-0959	09/09/92
3. Brevard	07/19/61	3198	07/13/61
	07/02/70	4911	07/02/70
4. Broward	09/25/59	2814	10/02/59
5. Clay	05/08/67	4196	05/19/67
6. Duval	07/15/68	4392	07/18/68
	04/01/74	6091	04/04/74
7. Escambia	12/03/91	25593	01/13/92
8. Franklin	08/20/64	3692	09/25/64
9. Gadsden	03/16/93	93-0783	05/24/93
10. Gulf	09/09/86	16721	10/14/86
11. Hardee	10/22/09	09-0820	12/14/09
12. Highlands	09/07/82	11256	10/25/82
13. Jackson	06/08/71	5139	06/11/71
14. Lake	06/13/72	5472	06/30/72
15. Lee	02/18/70	4836	03/02/70
16. Levy	01/04/83	11600	02/10/83
17. Manatee	10/10/95	95-1393	11/09/95
18. Marion	05/05/81	10028	05/26/81
19. Martin	09/09/75	6919	09/24/75
	09/23/80	9684	12/01/80
20. Monroe	12/10/74	6429	01/03/75
	07/27/84	13916	10/10/02
21. Nassau	09/17/01	02-0555	04/23/02
	07/15/02	02-1411	12/31/84
22. Okaloosa	10/20/92	92-1409	12/03/92
23. Okeechobee	05/13/04	04-0593	06/15/04
24. Orange	05/01/61	3174	05/23/61
25. Osceola	10/12/59	2820	10/20/59
26. Palm Beach	07/13/59	2797	07/28/59
27. Pasco	07/11/72	5488	07/19/72
28. Pinellas	08/13/65	3857	08/18/65
29. Polk	05/14/96	96-0896	07/11/96
30. Putnam	06/28/66	4056	08/12/66
31. Seminole	08/11/59	2809	09/16/59
	09/23/75	6939	10/02/75
32. St. Johns	07/25/85	14760	08/23/85
	09/26/89	22330	12/20/89
	01/16/09	09-0092	02/12/09
33. St. Lucie	09/22/64	3695	10/13/64
	10/01/92	92-0704	07/22/92
34. Sumter	01/13/87	17207	02/18/87
35. Volusia	09/03/59	2808	09/16/59
36. Washington	10/16/86	17653	06/03/87

JURISDICTION RESCINDED

1. Bay	09/07/04	04-1065	10/29/04
2. Charlotte	07/28/64	3693	09/25/64
	07/01/80	11496	01/10/83
	09/27/94	94-1451	11/28/94
	09/25/07	07-0984	12/10/07
3. Collier	02/27/96	96-0582	05/03/96
4. Columbia	05/11/07	07-0667	08/20/07
5. Citrus	07/27/99	99-1899	09/24/99
6. Desoto	03/05/97	97-0603	05/27/97
7. Flagler	08/05/96	96-1391	11/20/96
8. Hernando	08/04/69	4730	08/21/69
	04/05/94	94-0719	06/09/94
9. Santa Rosa	01/10/61	3101	01/24/61
	07/20/84	14037	01/25/85
10. Walton	08/25/65	3859	09/01/65
	06/30/85	--	--

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2008 WATER & WASTEWATER REVENUE BY CLASS

COMPANY NAME	CLASS	TOTAL WATER CUSTOMERS	TOTAL WASTEWATER CUSTOMERS	GROSS REVENUE
Aqua Utilities Florida, Inc.	A	18,336	7,910	\$10,055,461
Aloha Utilities, Inc.	A	3,067	2,790	\$9,952,114
Sanlando Utilities Corporation	A	12,125	9,259	\$6,501,005
North Sumter Utility Company, L.L.C.	A	15,967	15,885	\$6,410,060
North Fort Myers Utility, Inc.	A	1,845	1,807	\$4,740,690
Lake Utility Services, Inc.	A	9,399	3,102	\$4,061,569
Alafaya Utilities, Inc.	A	1,663	7,523	\$3,791,018
Utilities, Inc. of Florida	A	6,662	2,920	\$3,063,686
Peoples Water Service Company of Florida, Inc.	A	11,858	0	\$3,048,381
Lindrick Service Corporation	A	3,039	2,506	\$2,778,925
Mad Hatter Utility, Inc.	A	3,389	2,861	\$2,043,024
Mid-County Services, Inc.	A	0	5,800	\$1,924,996
Indiantown Company, Inc.	A	1,838	1,744	\$1,901,864
Marion Utilities, Inc.	A	6,099	117	\$1,568,139
Water Management Services, Inc.	A	1,818	0	\$1,374,799
K W Resort Utilities Corp.	A	0	1,888	\$1,320,295
O&S Water Company, Inc.	A	3,006	0	\$1,300,107
Ni Florida, LLC	B	0	2,735	\$1,689,087
Southlake Utilities, Inc.	B	2,398	2,195	\$1,586,189
Wedgefield Utilities, Inc.	B	0	0	\$1,421,661
Royal Utility Company	B	1,926	1,520	\$1,101,457
Rainbow Springs Utilities, L.C.	B	2,432	1,479	\$1,074,250
Forest Utilities, Inc.	B	0	4,048	\$1,044,345
Sunshine Utilities of Central Florida, Inc.	B	3,560	0	\$978,543
Plantation Bay Utility Co.	B	1,498	1,389	\$926,423
Cypress Lakes Utilities, Inc.	B	0	1,230	\$867,118
Parkland Utilities, Inc.	B	805	787	\$815,345
Utilities, Inc. of Eagle Ridge	B	0	2,535	\$809,923
Utilities, Inc. of Pennbrooke	B	0	1,251	\$809,600
Tierra Verde Utilities, Inc.	B	0	2,412	\$789,841
Miles Grant Water and Sewer Company	B	1,137	1,037	\$777,118
Utilities, Inc. of Longwood	B	0	1,723	\$770,736
Venture Associates Utilities Corp.	B	1,059	0	\$699,545
Gold Coast Utility Corp.	B	187	171	\$616,214
Highlands Utilities Corporation	B	0	258	\$602,761
Windstream Utilities Company	B	1,299	0	\$568,927
Placid Lakes Utilities, Inc.	B	1,970	0	\$530,068
Lighthouse Utilities Company, Inc.	B	1,350	0	\$528,519
Utilities, Inc. of Hutchinson Island	B	1,400	1,400	\$527,313
Labrador Utilities, Inc.	B	797	767	\$521,345
Continental Utility, Inc.	B	945	944	\$503,655
Grenelefe Resort Utility, Inc.	B	1,227	1,227	\$498,386
Park Water Company	B	810	0	\$480,649
Key Haven Utility Corporation	B	0	0	\$455,278
Service Management Systems, Inc.	B	367	286	\$379,622
Sun Communities Finance, LLC d/b/a Water Oak Utility	B	0	0	\$372,933
Highlands Ridge Utilities, LLC	B	643	617	\$360,569
Harbor Hills Utilities, L.P.	B	0	0	\$360,195
Hunter's Ridge Utility Co. of Lee County	B	0	468	\$354,611
Tradewinds Utilities, Inc.	B	519	292	\$346,108
Commercial Utilities, Division of Grace and Company, Inc.	B	0	39	\$236,860
East Central Florida Services, Inc.	B	83	0	\$233,785
Residential Water Systems, Inc.	B	710	0	\$230,680
Environmental Protection Systems of Pine Island, Inc.	B	0	462	\$228,901
Ferncrest Utilities, Inc.	B	0	0	\$0
CWS Communities LP d/b/a Palm Valley Utilities	C	797	796	\$400,067
CC Utility Systems, L.L.C. d/b/a Coral Cay Water & Sewer Company	C	681	676	\$339,080
Four Lakes Golf Club, Ltd.	C	850	850	\$330,613
Useppa Island Utility, Inc.	C	156	145	\$322,225
Tymber Creek Utilities, Incorporated	C	449	420	\$317,698
River Ranch Water Management, L.L.C.	C	1,218	732	\$294,845
Paradise Lakes Utility, L.L.C.	C	454	452	\$248,421
Country Club Utilities, Inc.	C	399	399	\$230,037
Orchid Springs Development Corporation	C	510	494	\$201,775
North Peninsula Utilities Corporation	C	0	563	\$199,842

2008 WATER & WASTEWATER REVENUE BY CLASS

COMPANY NAME	CLASS	TOTAL WATER CUSTOMERS	TOTAL WASTEWATER CUSTOMERS	GROSS REVENUE
Mink Associates II, LLC d/b/a Crystal Lake Club Utilities	C	524	519	\$186,990
Sebring Ridge Utilities, Inc.	C	0	535	\$174,325
County-Wide Utility Co., Inc.	C	0	0	\$170,969
CHC VII, Ltd.	C	888	887	\$170,271
BE Utility Systems, L.L.C. d/b/a Buccaneer Water Service	C	969	0	\$168,638
C.F.A.T. H2O, Inc.	C	221	220	\$163,793
Four Points Utility Corporation	C	256	256	\$159,437
Holiday Utility Company, Inc.	C	454	0	\$150,202
Colonial Manor Utility Company	C	708	0	\$148,580
Pasco Utilities, Inc.	C	698	0	\$148,408
Sun Communities Acquisitions, LLC d/b/a Buttonwood Bay Utilities	C	0	0	\$147,378
S. V. Utilities, Ltd.	C	728	728	\$139,504
Lake Placid Utilities, Inc.	C	0	0	\$134,312
Crooked Lake Park Sewerage Company	C	0	0	\$131,365
Mountain Lake Corporation	C	166	0	\$124,893
ESAD Enterprises, Inc. d/b/a Beaches Sewer System	C	0	0	\$122,189
Lake Yale Treatment Associates, Inc.	C	0	0	\$112,672
Francis I Utility, L.L.C.	C	0	0	\$112,353
Keith & Clara Starkey d/b/a Heather Hills Estates	C	354	354	\$112,342
Fairmount Utilities, the 2nd, Inc.	C	0	0	\$109,639
Orangewood Lakes Services, Inc.	C	233	190	\$106,758
L. P. Utilities Corporation	C	0	0	\$102,907
Virginia City Utility Company a Division of Community Utilities of Florida, Inc.	C	315	0	\$101,513
L W V Utilities, Inc.	C	0	0	\$94,482
Crestridge Utility Corporation	C	614	0	\$93,674
Hidden Valley SPE LLC d/b/a Orange Lake	C	0	242	\$90,956
Utility Corporation of Florida, Inc.	C	0	0	\$89,485
Damon Utilities, Inc.	C	279	102	\$89,357
HV Utility Systems, L.L.C.	C	0	537	\$88,837
W.P. Utilities, Inc.	C	0	0	\$88,814
Neighborhood Utilities, Inc.	C	0	0	\$86,556
Keen Sales, Rentals and Utilities, Inc.	C	212	0	\$85,984
Innerarity Island Development Corporation	C	200	183	\$84,703
Sun Communities Operating Limited Partnership	C	383	377	\$83,986
FIMC Hideaway, Inc.	C	0	0	\$83,295
Dixie Groves Utility Company a Division of Community Utilities of Florida, Inc.	C	341	0	\$82,806
Pine Ridge Management Corporation	C	140	141	\$80,651
Plantation Landings, Ltd.	C	419	417	\$78,489
Silver Fox Utility Company LLC d/b/a Timberwood Utilities	C	160	158	\$75,392
Sunny Shores Water Co., Inc.	C	263	0	\$73,511
Holiday Gardens Utilities, Inc.	C	454	0	\$70,907
BFF Corp	C	0	109	\$70,902
Shangri-La by the Lake Utilities, Inc.	C	0	0	\$70,038
Sunnse Utilities, LLC	C	0	0	\$69,771
C. S. Water Company, Inc.	C	0	0	\$67,130
Oak Springs, LLC	C	315	0	\$65,671
Anglers Cove West, Ltd.	C	340	340	\$64,892
St. James Island Utility Company	C	0	0	\$58,224
East Marion Sanitary Systems, Inc.	C	89	83	\$56,345
Pine Island Cove Homeowners Association, Inc.	C	0	318	\$51,162
Kincaid Hills Water Company	C	0	0	\$50,661
Mobile Manor Water Company, Inc.	C	314	0	\$50,531
The Vantage Development Corporation	C	0	0	\$50,463
Zachary Taylor Camping and Lodge, Inc.	C	0	219	\$49,042
Pinecrest Ranches, Inc.	C	0	0	\$48,523
Northgate Properties, Inc.	C	0	0	\$46,937
Raintree Utilities, Inc.	C	0	0	\$45,575
Silver Lake Utilities, Inc.	C	58	0	\$42,601
Colony Park Utilities, Inc.	C	0	300	\$42,222
W.B.B. Utilities, Inc.	C	76	0	\$41,962
St. John's River Club Utility Company, LLC	C	82	82	\$38,160
S & L Utilities, Inc.	C	0	0	\$37,145
Tevalo, Inc. d/b/a McLeod Gardens Water Company	C	0	0	\$31,155
Brendenwood Water System, Inc.	C	57	0	\$29,388
Century Estates Utilities, Inc.	C	0	0	\$27,697
Holmes Utilities, Inc.	C	66	0	\$26,429
Regency Utilities, Inc.	C	0	0	\$24,554
CWS Communities LP	C	271	0	\$23,691

2008 WATER & WASTEWATER REVENUE BY CLASS

COMPANY NAME	CLASS	TOTAL WATER CUSTOMERS	TOTAL WASTEWATER CUSTOMERS	GROSS REVENUE
Hidden Cove, Ltd.	C	122	122	\$22,999
C & H Utilities, Inc.	C	51	93	\$20,727
Allen Lafortune and Otis Fonder	C	0	0	\$20,398
Bayshore Utilities, Inc.	C	191	0	\$19,694
Alturas Utilities, L.L.C.	C	0	0	\$19,488
Par Utilities, Inc.	C	0	0	\$17,085
Pine Harbour Water Utilities, LLC	C	60	0	\$15,678
Joyland Water System	C	0	0	\$14,968
Orange Blossom Utilities, Inc.	C	0	0	\$14,876
Kemple Water Company	C	135	0	\$14,206
San Sebastian Water, LLC	C	0	0	\$12,637
Orangeland Water Supply	C	0	0	\$7,515
B & C Water Resources, L.L.C.	C	8	0	\$7,321
Century - Fairfield Village, Ltd.	C	295	295	\$3,685
MSKP Town and Country Utility, LLC d/b/a Town & Country Utility	C	3	0	\$2,159
Farmton Water Resources LLC	C	4	0	\$1,011
Central Sumter Utility Company, L.L.C.	C	0	0	\$0
Colina Bay Water Company, LLC	C	0	0	\$0
D & E Water Resources, L.L.C.	C	0	0	\$0
Grove Utilities, Inc.	C	0	0	\$0
Lanjger Enterprises of America, Inc.	C	0	0	\$0
St. Johns Landing of Putnam County Utilities Services, Inc. d/b/a St. Johns Landing Utilities Services	C	0	0	\$0
TBBT Utility LLC	C	0	0	\$0
West Lakeland Wastewater, Inc.	C	0	0	\$0
		103,973	68,812	\$100,035,937

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation of Acquisition) DOCKET NO. 891309-WS
Adjustment Policy) 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)(c), 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

DOCUMENT NUMBER-DATE

01624 FEB 17 1992

FPSC-RECORDS/REPORTING

ORDER NO. 25729
DOCKET NO. 891309-WS
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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

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(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

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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.

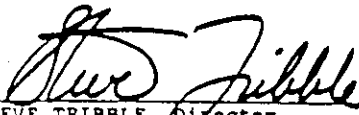
It is, therefore

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.

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


STEVE TRIBBLE, Director,
Division of Records and Reporting

(S E A L)

MJP

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.

4

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Proposed Rule 25-30.0371,
F.A.C., Acquisition Adjustment.

DOCKET NO. 001502-WS
ORDER NO. PSC-02-0997-FOF-WS
ISSUED: July 23, 2002

The following Commissioners participated in the disposition of this matter:

LILA A. JABER, Chairman
J. TERRY DEASON
BRAULIO L. BAEZ
MICHAEL A. PALECKI
RUDOLPH "RUDY" BRADLEY

NOTICE OF ADOPTION OF RULE

NOTICE is hereby given that the Florida Public Service Commission, pursuant to Section 120.54, Florida Statutes, has adopted Rule 25-30.0371, Florida Administrative Code, relating to acquisition adjustments for water and wastewater utilities, without changes. The rule was filed with the Department of State on July 15, 2002 and will be effective on August 4, 2002. A copy of the rule as filed with the Department is attached to this Notice.

Since approximately 1983, we have had a policy on acquisition adjustments for water and wastewater utilities that, absent extraordinary circumstances, the purchase of a utility system at a premium or discount shall not affect rate base. An acquisition adjustment is a regulatory convention by which the books of the utility are adjusted to reflect changes in the original cost rate base valuation resulting from purchase prices that differ from original cost rate base valuations. Whether or not an acquisition adjustment is included in rate base is a decision made by the Commission. A positive acquisition adjustment may be recorded when the purchase price of the transaction is above the original cost rate base valuation. If approved, the acquiring utility will then be permitted to earn a rate of return on the amount of the purchase price. A negative acquisition adjustment may be recorded when the purchase price of the utility is below the original cost rate base valuation. If approved, the negative acquisition adjustment reduces the rate base valuation to an amount less than the original cost rate base valuation.

DOCUMENT NUMBER-DATE

07670 JUL 23 02

FPSC-COMMISSION CLERK

We found that our acquisition adjustment policy has produced the intended result of creating incentives for larger utilities to acquire small, troubled utilities in In re: Investigation of Acquisition Adjustment Policy, Order No. 25729, issued February 17, 1992, at pages 1-2:

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.

We continue to believe that this policy is appropriate and that there are benefits derived from it.

Chapter 120, Florida Statutes, the Administrative Procedure Act, provides that "[e]ach agency statement defined as a rule by s. 120.52 shall be adopted by the rulemaking procedure provided by this section as soon as feasible and practicable." § 120.54(1)(a), Fla. Stat. (2000). Accordingly, pursuant to this statute, a notice of proposed rule development was published in the November 12, 1999, edition of the Florida Administrative Weekly. A staff workshop was held on December 2, 1999, and a Commission workshop was held on February 7, 2001. At our December 4, 2001, agenda conference, we deferred a decision on the proposed rule in order for staff to conduct an informal workshop in an attempt to resolve the differences between parties. Staff conducted informal workshops on January 31 and February 26, 2002. The parties' differences were partially resolved, but an agreement was not reached on all provisions of the rule. On May 21, 2002, after hearing from the parties, we approved a rule that codifies our existing policy with some exceptions. We are modifying our existing policy to provide an incentive for a purchasing utility to refrain from filing a rate case for a five-year period subsequent to the purchase. In addition, the rule also provides an incentive for a utility to obtain the lowest price possible when negotiating a purchase price lower than book value. We believe that codification of this rule will reduce costs in future proceedings by diminishing some of the controversy over acquisition adjustments and expediting transfer or rate case proceedings.

Rule 25-30.0371 provides that a positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Some of the factors that we will consider in making a determination whether there are extraordinary circumstances justifying a positive adjustment are listed in the rule and include anticipated improvements in quality of service, anticipated compliance with regulatory mandates, anticipated rate reductions, and anticipated cost efficiencies. These factors are listed by way of example, and other evidence may be offered.

As to negative acquisition adjustments, the rule provides that such an adjustment shall not be included in rate base unless there is proof of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value, then it requires the inclusion of a negative acquisition adjustment calculated pursuant

to paragraph (3)(b). Paragraph (3)(a) provides that the entity that believes that a negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. This paragraph also provides an incentive to the purchasing utility company to try and negotiate the best price possible when purchasing below net book value. It provides that only 70 percent of the acquisition adjustment can be booked if extraordinary circumstances are proven. In addition, this paragraph lists examples of the evidence we will consider in determining whether there are extraordinary circumstances justifying a negative adjustment. It includes evidence such as the anticipated retirement of the acquired assets and the condition of the assets acquired, and other evidence may be offered. In addition, the existence of evidence of any one factor alone does not mean that an adjustment will be approved.

Paragraph (3)(b) outlines our treatment when the purchase price is less than 80 percent of net book value. It requires that the amount that exceeds 20 percent of net book value will be recognized for ratemaking purposes as a negative acquisition adjustment as an incentive for the utility not to file for a rate increase. The paragraph also establishes an amortization period for the acquisition adjustment of five years. If the utility does not file for a rate increase that will be effective during the amortization period, then the negative acquisition adjustment is not booked or recognized for any review of earnings. If the utility does file for a rate increase that will be effective during the amortization period, the unamortized negative acquisition adjustment is booked and used to test the earnings level and the need for a rate increase. The 20 percent that was not booked as a negative acquisition adjustment would not be recognized.

Subsection (4) requires us to establish an amortization period for any approved positive or negative acquisition adjustment except for one booked under (3)(b) above. Factors that we will take into consideration when establishing the amortization period are listed in the rule.

Subsection (5) of the rule authorizes subsequent modification of a positive or negative acquisition adjustment, except for one made pursuant to paragraph (3)(b), if the circumstances that initially justified it do not materialize, or if they are

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eliminated or changed within five years. We believe that five years is a reasonable time in which to evaluate the circumstances justifying an adjustment. We took this action in a docket involving Chesapeake Utility Corporation. We approved a positive acquisition adjustment for Central Florida Gas Company to reflect expected savings from the company's acquisition by Chesapeake in Order No. 18716, issued January 26, 1988, in Docket No. 870118-GU. In a subsequent rate review, we found that the predicted savings never materialized and removed the acquisition adjustment from rate base. Order No. 23166, issued July 10, 1990, in Docket No. 891179-GU.

The rule we adopt implements section 367.071(5), Florida Statutes, which authorizes the Commission to establish the rate base for a utility when it approves a sale, assignment, or transfer, and section 367.081(2)(a), Florida Statutes, requiring the Commission to fix rates and to consider the cost of providing service including a fair return on the investment of the utility in property used and useful in the public service. In addition, sections 367.121(1)(a) and (b), Florida Statutes, provide the Commission with the power to prescribe fair and reasonable rates and charges, and to prescribe a uniform system and classification of accounts for all utilities.

This docket is closed upon issuance of this notice.

By ORDER of the Florida Public Service Commission, this 23rd day of June, 2002.

BLANCA S. BAYÓ, Director
Division of the Commission Clerk
and Administrative Services

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records and Hearing
Services

(S E A L)

CTM

25-30.0371 Acquisition Adjustments.

(1) Definition. For the purpose of this rule, an acquisition adjustment is defined as the difference between the purchase price of utility system assets to an acquiring utility and the net book value of the utility assets. A positive acquisition adjustment exists when the purchase price is greater than the net book value. A negative acquisition adjustment exists when the purchase price is less than the net book value.

(2) Positive Acquisition Adjustments. A positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Any entity that believes a full or partial positive acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipated rate reductions or rate stability over a long-term period, and anticipated cost efficiencies.

(3) Negative Acquisition Adjustments. A negative acquisition adjustment shall not be included in rate base unless there is proof

of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value then the inclusion of a negative acquisition adjustment shall be calculated pursuant to paragraph (b) below.

(a) Contested. Any entity that believes a full or partial negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. Under no circumstance, however, shall the purchaser be required to record on its books more than 70 percent of a negative acquisition adjustment. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as the anticipated retirement of the acquired assets and the condition of the assets acquired.

(b) Uncontested. If the purchase price is less than 80 percent of net book value, then the amount of the difference in excess of 20 percent of net book value shall be recognized for ratemaking purposes as a negative acquisition adjustment. The negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings review unless the purchaser files for a rate increase pursuant to section 367.081(2).

367.0814, 367.0817 or 367.0822, F.S., that will be effective during the amortization period. The negative acquisition adjustment shall be amortized over a 5-year period from the date of issuance of the order approving the transfer of assets.

(4) Amortization Period. In setting the amortization period for a Commission approved acquisition adjustment pursuant to (2) or (3)(a) above, the Commission shall consider evidence provided to the Commission such as the composite remaining life of the assets purchased and the condition of the assets purchased. Amortization of the acquisition adjustment shall begin on the date of issuance of the order approving the transfer of assets.

(5) Subsequent Modification. Any full or partial acquisition adjustment, once made by the Commission pursuant to (2) or (3)(a) above, may be subsequently modified if the extraordinary circumstances do not materialize or subsequently are eliminated or changed within five years of the date of issuance of the order approving the transfer of assets.

Specific Authority: 350.127(2), 367.121(1)(f), FS.

Law Implemented: 367.071(5), 367.081(2)(a), 367.121(1)(a)(b), FS.

History: New 08/04/02.

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25-30.0371 Acquisition Adjustments.

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(2) Positive Acquisition Adjustments. A positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Any entity that believes a full or partial positive acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipated rate reductions or rate stability over a long-term period, and anticipated cost efficiencies.

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(a) Contested. Any entity that believes a full or partial negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. Under no circumstance, however, shall the purchaser be required to record on its books more than 70 percent of a negative acquisition adjustment. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as the anticipated retirement of the acquired assets and the condition of the assets acquired.

(b) Uncontested. If the purchase price is less than 80 percent of net book value, then the amount of the difference in excess of 20 percent of net book value shall be recognized for ratemaking purposes as a negative acquisition adjustment. The negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings review unless the purchaser files for a rate increase pursuant to Section 367.081(2), 367.0814, 367.0817 or 367.0822, F.S., that will be effective during the amortization period. The negative acquisition adjustment shall be amortized over a 5-year period from the date of issuance of the order approving the transfer of assets.

(4) Amortization Period. In setting the amortization period for a Commission approved acquisition adjustment pursuant to (2) or (3)(a) above, the Commission shall consider evidence provided to the Commission such as the composite remaining life of the assets purchased and the condition of the assets purchased. Amortization of the acquisition adjustment shall begin on the date of issuance of the order approving the transfer of assets.

(5) Subsequent Modification. Any full or partial acquisition adjustment, once made by the Commission pursuant to (2) or (3)(a) above, may be subsequently modified if the extraordinary circumstances do not materialize or subsequently are eliminated or changed within five years of the date of issuance of the order approving the transfer of assets.

Specific Authority 350.127(2), 367.121(1)(f) FS. Law Implemented 367.071(5), 367.081(2)(a), 367.121(1)(a), (b) FS. History—New 8-4-02.

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25-30.0371 Acquisition Adjustments

RULE TEXT	EXPLANATION
<p>(1) Definition. For the purpose of this rule, an acquisition adjustment is defined as the difference between the purchase price of utility system assets to an acquiring utility and the net book value of the utility assets. A positive acquisition adjustment exists when the purchase price is greater than the net book value. A negative acquisition adjustment exists when the purchase price is less than the net book value.</p>	<p>Subsection (1) defines "acquisition adjustment" as "the difference between the purchase price of utility system assets to an acquiring utility and the net book value of the utility assets" and describes when a positive or negative acquisition adjustment exists.</p>
<p>(2) Positive Acquisition Adjustments. A positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Any entity that believes a full or partial positive acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipated rate reductions or rate stability over a long-term period, and anticipated cost efficiencies.</p>	<p>Subsection (2) provides that a positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. This subsection also provides that the entity that believes such an adjustment should be made has the burden to prove the existence of extraordinary circumstances. This is consistent with the Commission's decision in <u>In re Wedgefield Utilities</u>, Order No. PSC-98-1092-FOF-WS, issued August 12, 1998, in Docket No. 960235-WS. In addition, the subsection lists certain factors the Commission will consider to determine whether there are extraordinary circumstances justifying a positive adjustment.</p> <p>For a positive acquisition adjustment (where the purchase price is greater than the net book value of the utility's assets), subsection (2) of the rule provides that the Commission will consider anticipated improvements in quality of service, anticipated compliance with regulatory mandates, anticipated rate reductions, and anticipated cost efficiencies. These factors are listed by way of example, and other evidence may be offered.</p>

(3) Negative Acquisition Adjustments. A negative acquisition adjustment shall not be included in rate base unless there is proof of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value then the inclusion of a negative acquisition adjustment shall be calculated pursuant to paragraph (b) below.

Subsection (3) provides that a negative acquisition adjustment shall not be included in rate base unless there is proof of extraordinary circumstances or where the purchase price is less than 80 percent of net book value. If the purchase price is less than 80 percent of net book value, then it requires the inclusion of a negative acquisition adjustment calculated pursuant to paragraph (3)(b). Example 1 gives an example of how subsection (3) works when the purchase price is greater than 80 percent of net book value.

(a) Contested. Any entity that believes a full or partial negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. Under no circumstance, however, shall the purchaser be required to record on its books more than 70 percent of a negative acquisition adjustment. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as the anticipated retirement of the acquired assets and the condition of the assets acquired.

Paragraph (3)(a) provides that the entity that believes that a negative acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. This is consistent with the Commission's decision in Order No. PSC-98-1092-FOF-WS. This paragraph also provides an incentive to the purchasing utility company to try and negotiate the best price possible when purchasing below net book value. It provides that only 70 percent of the acquisition adjustment can be booked if an entity proves extraordinary circumstances. Example 2 illustrates the application of paragraph (3)(a). In addition, this paragraph lists certain factors the Commission will consider to determine whether there are extraordinary circumstances justifying a negative adjustment. These factors include the anticipated retirement of the acquired assets and the condition of the assets acquired. These factors are listed by way of an example, and other evidence may be offered.

<p>(b) Uncontested. If the purchase price is less than 80 percent of net book value, then the amount of the difference in excess of 20 percent of net book value shall be recognized for ratemaking purposes as a negative acquisition adjustment. The negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings review unless the purchaser files for a rate increase pursuant to Section 367.081(2), 367.0814, 367.0817 or 367.0822, F.S., that will be effective during the amortization period. The negative acquisition adjustment shall be amortized over a 5-year period from the date of issuance of the order approving the transfer of assets.</p>	<p>Paragraph (3)(b) outlines the Commission treatment when the purchase price is less than 80 percent of net book value. This paragraph requires that the amount that exceeds 20 percent of net book value be recognized for ratemaking purposes as a negative acquisition adjustment as an incentive for the utility not to file for a rate increase. The paragraph establishes an amortization period for the acquisition adjustment of five years. If the utility does not file for a rate increase that will be effective during the amortization period, then the negative acquisition adjustment is not booked or recognized for any review of earnings. If the utility does file for a rate increase that will be effective during the amortization period, the unamortized negative acquisition adjustment is booked and used to test the earnings level and the need for a rate increase. The 20 percent that was not booked as a negative acquisition adjustment would not be recognized. Example 3 illustrates the application of paragraph (3)(b).</p>
<p>(4) Amortization Period. In setting the amortization period for a Commission approved acquisition adjustment pursuant to (2) or (3)(a) above, the Commission shall consider evidence provided to the Commission such as the composite remaining life of the assets purchased and the condition of the assets purchased. Amortization of the acquisition adjustment shall begin on the date of issuance of the order approving the transfer of assets.</p>	<p>Subsection (4) requires the Commission to establish an amortization period for any approved positive or negative acquisition adjustment except for one booked under (3)(b) above. It also lists some factors that the Commission will take into consideration when establishing the amortization period.</p>

(5) Subsequent Modification. Any full or partial acquisition adjustment, once made by the Commission pursuant to (2) or (3)(a) above, may be subsequently modified if the extraordinary circumstances do not materialize or subsequently are eliminated or changed within five years of the date of issuance of the order approving the transfer of assets.

Subsection (5) of the rule authorizes the Commission to subsequently modify a positive or negative acquisition adjustment, except for one made pursuant to paragraph (3)(b), if the circumstances that initially justified it do not materialize, or if they are eliminated or changed within five years. Five years is believed to be a reasonable time in which to evaluate the circumstances justifying an adjustment. The Commission took this action in a docket involving Chesapeake Utility Corporation. The Commission approved a positive acquisition adjustment for Central Florida Gas Company to reflect expected savings from the company's acquisition by Chesapeake in Order No. 18716, issued January 26, 1988, in Docket No. 870118-GU. In a subsequent rate review, the Commission found that the predicted savings never materialized and removed the acquisition adjustment from rate base. Order No. 23166, issued July 10, 1990, in Docket No. 891179-GU.

Example 1

Treatment of Negative Acquisition Adjustment in the Instance of a Rate Case Filing Under the Proposed Acquisition Adjustment Rule

[Subsection (3)] - Purchase Price more than 80 percent of NBV

1.	Net Book Value:	\$100,000
2.	Purchase Price:	\$ 80,100
3.	Negative Acquisition Adj. (Line 1 - Line 2):	\$ 19,900
4.	Amount of Negative Acq. Adj. That is (Partially or In Total) Recognized for Ratemaking Purposes	\$ 0

5. Rate Base Example:

	Net Book Value	Beginning of Year 1	Beginning of Year 2	Beginning of Year 3	Beginning of Year 4
Utility Plant in Service	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000
Accumulated Depreciation	(50,000)	(50,000)	(55,100)	(60,200)	(65,300)
Contributions In Aid of Construction	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)
Accumulated Amortization of CIAC	15,000	15,000	16,650	18,300	19,950
Negative Acquisition Adjustment		0	0	0	0
Accum. Amortization of Acq. Adj.		0	0	0	0
Rate Base	\$100,000	\$100,000	\$96,550	\$93,100	\$89,650

Example 2

Treatment of a Contested Negative Acquisition Adjustment Under the Proposed Acquisition Adjustment Rule

[Paragraph (3)(a)]

- | | | |
|----|---|------------|
| 1. | Net Book Value: | \$ 100,000 |
| 2. | Purchase Price: | \$ 30,000 |
| 3. | Negative Acquisition Adj. (Line 1 - Line 2): | \$ 70,000 |
| 4. | Amount of Negative Acq. Adj. <u>NOT</u> Recognized in Rate Base Pursuant to Proposed Rule (Line 3 x 30%): | \$ 21,000 |
| 5. | Maximum Negative Acq. Adj. That Can Be Approved By The Commission (Line 3 x 70%): | \$ 49,000 |
| 6. | Amortization Period Pursuant to Subsection (4) (Remaining life): | 25 years |
| 7. | Rate Base Example: | |

Paragraph (3)(a)	Net Book Value	Beginning of Year 1	Beginning of Year 2	Beginning of Year 3	Beginning of Year 4
Utility Plant in Service	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000
Accumulated Depreciation	(50,000)	(50,000)	(55,100)	(60,200)	(65,300)
Contributions In Aid of Construction	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)
Accumulated Amortization of CIAC	15,000	15,000	16,650	18,300	19,950
Negative Acquisition Adjustment	(49,000)	(49,000)	(49,000)	(49,000)	(49,000)
Accum. Amortization of Acq. Adj.		1,960	3,920	5,880	7,840
Rate Base	\$51,000	\$52,960	\$51,470	\$49,980	\$48,490

Example 3

Treatment of Negative Acquisition Adjustment in the Instance of a Rate Case Filing Under the Proposed Acquisition Adjustment Rule

[Paragraph (3)(b)]

- | | | |
|----|---|-----------|
| 1. | Net Book Value: | \$100,000 |
| 2. | Purchase Price: | \$ 30,000 |
| 3. | Negative Acquisition Adj. (Line 1 - Line 2): | \$ 70,000 |
| 4. | Amount of Negative Acq. Adj. <u>NOT</u> Recognized for Ratemaking Purposes (Line 1 x 20%): | \$ 20,000 |
| 5. | Amount of Negative Acq. Adj. That is (Partially or In Total) Recognized for Ratemaking Purposes (Line 3 - Line 4) | \$ 50,000 |
| 6. | Rate Base Example: | |

	Net Book Value	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5
Utility Plant in Service	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000
Accumulated Depreciation	(50,000)	(55,100)	(60,200)	(65,300)	(70,400)	(75,500)
Contributions In Aid of Construction	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)
Accum. Amortization of CIAC	15,000	16,650	18,300	19,950	21,600	23,250
Negative Acquisition Adjustment		(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Accum. Amortization of Acq. Adj.		10,000	20,000	30,000	\$40,000	\$50,000
Rate Base	\$100,000	\$56,550	\$63,100	\$69,650	\$76,200	\$82,750

7

Summary of PSC Acquisition Decisions 1986 – 2000

	Number	Average \$ Value	Low \$ Value	High \$ Value
Positive Adjustments Approved	4	100,022	13,105	266,324
Negative Adjustments Approved	4	(247,857)	(17,753)	(497,831)
Positive Adjustments Not Approved	62	697,204	10	13,703,359
Negative Adjustments Not Approved	43	(108,661)	(56)	(1,700,391)

8

Commission Approved Acquisition Adjustments 1986 - 2000

COMMISSION APPROVED POSITIVE ACQUISITION ADJUSTMENTS 1986 - 2000

UTILITY	ORDER NUMBER	PURCHASE PRICE	NET BOOK VALUE	ACQUISITION ADJUSTMENT	REVENUE IMPACT (a)
South Waterfront Park (1)	15925	\$0	(\$13,105)	\$13,105	\$1,966
Jax Sub – SUN (2)	23111	\$844,482	\$726,148	\$118,334	\$17,750
Jax Sub – Atlantic (3)	92-0895	\$1,337,911	\$1,071,488	\$266,423	\$39,963
Jax Sub –PonteVedra (4)	95-0502	\$1,790,000	\$1,567,395	\$222,605	\$33,391

- (1) Adjustment to bring rate base to \$0.
- (2) Large utility buying financially troubled smaller utility.
- (3) Lower rates for customers, better management.
- (4) Positive acquisition adjustment allowed based on several bids.

COMMISSION APPROVED NEGATIVE ACQUISITION ADJUSTMENTS 1986 - 2000

UTILITY	ORDER NUMBER	PURCHASE PRICE	NET BOOK VALUE	ACQUISITION ADJUSTMENT	REVENUE IMPACT (a)
Laniger (1)	22962	\$256,022	\$416,727	(\$160,705)	(\$24,106)
CGD (2)	93-0011	\$175,361	\$490,498	(\$315,137)	(\$47,271)
Jasmine Lakes (3)	93-1675	\$606,826	\$624,579	(\$17,753)	(\$2,663)
Sun Communities Finance (4)	97-0034	\$224,695	\$722,526	(\$497,831)	(\$74,675)

- (1) Settlement between OPC and utility.
- (2) 3 party nontaxable exchange between related parties.
- (3) Settlement between OPC and utility.
- (4) Recognized to offset “lost CIAC” per Order 18255.

(a) Assumed revenue impact of 15% (10% ROR, 2% taxes, and 3% depreciation) of acquisition adjustment.

9

Summary of Transfers Since Adoption of Rule 25-30.0371 Acquisition Adjustments

Negative Acquisition Adjustment Per Rule 25-30.0371, F.A.C.

Docket No.	Transfer From/To	Rate Base	Purchase Price	Neg Acq Adj
080167-WS	Breeze Hill/Aqua	\$98,000	\$95,000	\$0 ^[1]
070739-WS	Fairways/Aqua	632,252	450,000	55,802
040591-WS	Fl Water/Aqua	15,741,914	13,038,951	0 ^[2]
030407-WS	Springside/Par	59,777	35,255	12,567
020484-WS	Labrador/Labrador	1,151,387	800,000	351,387
020256-WS	AP/Sunshine	19,685	1	19,684

Positive Acquisition Adjustment Denied or Not Requested

Docket No.	Transfer From/To	Rate Base	Purchase Price	Pos Acq Adj
090232-WS	Wedgfield Utilities Inc./ Pluris Wedgfield	\$6,300,000	\$7,300,000	\$1,000,000
080183-WU	Tamiami Vill/Ni Florida	66,842	745,000	678,158
080268-WS	Par/FIMC Hideaway	51,330	80,000	28,670
070740-SU	Hudson/Ni Florida	2,417,932	5,600,000	3,182,068
041461-WU	Floralino/Colonial Manor	47,208	303,000	256
041096-WS	Buffalo Bluff/St. John Rr	51,970	100,000	48,030
040179-WS	Columbia/Utilities, Inc	1,531,055	1,900,000	368,945
040160-WU	Keen/Alturas	29,874	45,000	15,126
040159-WU	Keen/Sunrise	52,609	90,000	37,391
031042-WS	Hunter Creek/MSN	102,932	229,000	126,068
030991-WU	Suwannee/Consolidated	0	15,000	15,000
030656-WU	Dixie Groves/Dixie	29,186	115,000	85,814
030655-WU	Virginia/Virginia	31,276	140,000	108,724
030471-WS	Breeze Hill/Breeze Hill	113,809	200,000	86,191
030340-WU	Community/Sunshine	0	10,000	10,000
030236-WS	Pennbrook/Utilities, Inc	1,260,563	1,800,000	539,437
030102-WS	Woodlands/L.P.	380,609	409,959	29,350
020945-SU	Creola/Francis I	62,328	325,000	262,672

[1] Purchase price (\$95,000) was more than 80% of rate base (\$78,400).

[2] Purchase price (\$13,038,951) was more than 80% of rate base (\$12,593,531).

Rate Base Not Established or Purchase Price Equals Rate Base

Docket No.	Transfer From/To	Reason
080269-WU	Pine Harbour/Pine	System inherited by new owner
060698-SU	Del Tura/NFMU	Plant to be dismantled, appears PP > RB
060169-SU	Laurel Oaks/Forest	Plant to be dismantled, appears PP > RB
050902-WS	Lake Haven/Gold Coast	Rate Base set in prior rate case, appears
050323-SU	Hérons Glen/NFMU	Plant to be dismantled, appears PP > RB
050062-WS	Mink/Silver Fox	Utility acquired with MHP, PP = RB
041394-WS	CWS/Mink	Utility acquired with MHP, PP = RB
030891-WS	IHC/Columbia	Utility acquired with resort, PP = RB
030747-SU	Hacienda/HV	Utility acquired with MHP, PP = RB
020892-WS	Buttonwood Bay/Sun	Utility acquired with MHP, PP = RB
020382-WS	New River Rch/River Rch	Acquisition adjustment addressed in SARC

10

FLORIDA PUBLIC SERVICE COMMISSION

REFOCUSING ON THE COMMISSION'S
ACQUISITION POLICY REGARDING WATER AND
WASTEWATER UTILITIES

PREPARED BY:

Division of Policy Analysis & Intergovernmental Liaison

FEBRUARY 2001

Introduction

The Commission's policy on acquisition adjustments, in short, is that absent extraordinary circumstances, there won't be one. Often in water and wastewater cases, this policy is questioned for, we believe, two main reasons. First, if a change in the composition of the industry is something the Commission would like to pursue, it may want to encourage certain acquisitions by granting positive acquisition adjustments or not granting negative acquisition adjustments. Second, sometimes there are glaring "deals" where a utility is purchased for a negligible sum while rate base is large; not necessarily where the purchase price is below but close to rate base, but where there is an extreme difference between the two, and allowing a return on rate base rather than purchase price does not seem "fair". The Commission's acquisition policy, as determined through past decisions as well as a discussion of opposing views questioning this policy, is explained in greater detail within this paper.

The composition of the water and wastewater industry in Florida is an amalgam of differing sized municipal, county, investor and cooperatively owned systems. A majority of these systems are small "Mom and Pop" utilities. Since enactment of the Safe Drinking Water Act, utilities have had to meet increasingly stringent environmental and water quality standards in an already high capital arena.

As a direct result of these rising costs, a large segment of the industry comprised of utilities serving less than 500 connections are in jeopardy of being unable to continue operations without environmental or water quality problems. This also raises concerns over the affordability of water service. The Commission has long recognized the technical, managerial and financial problems inherent in most small utility operations which work against their ability to be viable and to sustain safe, efficient and cost effective long term operation.

Because Florida is now plagued by the past proliferation of small utilities, concerns exist about their long term viability. Consolidation of these smaller systems is one way in which the Commission could address the issues of environmental and water quality compliance as well as financial viability. Further, from a regulatory standpoint, issues such as conservation, reuse, overall service quality and affordability are generally easier to address with larger utilities.

The controversy regarding acquisition adjustments is spotlighted in cases where there is a wide discrepancy between rate base and purchase price. Due to the concerns these "deals" raise, the Commission may want to consider competing regulatory goals in evaluating this issue. This will be discussed in the section regarding arguments against current Commission policy.

Types of Acquisitions

The following scenarios show the various ways in which FPSC regulated utility assets change ownership.

- Transfers to governmental authorities.
- Transfers to non-jurisdiction entities such as a homeowners association, non-profit entity, etc.
- Transfer of a larger system to another large system.
- Transfers of small systems to large systems.
- Interconnection to regional facilities with the acquired utility remaining jurisdictional
- Interconnection to regional facilities with the acquired utility becoming non-jurisdictional

Current Acquisition Policy

Current Commission policy with regard to acquisition adjustments was formalized in a generic proceeding by two orders, PAA Order No. 23376, issued 8/21/90 and Final Order No. 25729, issued 2/17/92. The Commission stated the following:

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.

Also in Order No. 25729, the Commission goes on to elaborate why it believes its practice is appropriate and what incentives it believes are included within this practice:

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 better quality of service at a reasonable rate.

The following table details transfer/acquisition activity since 1997 and shows activity to be fairly constant.

SUMMARY OF TRANSFERS SINCE 1997				
Year	Transfers	Transfers of small utilities resulting in certificate cancellations	Sale to Governmental Entities resulting in certificate cancellations	Total
1997	13	1	5	19
1998	4	2	11	17
1999	5	0	10	15
2000	8	5	7	20

Commission policy is well established and acquisitions continually occur. However, controversy still exists on a case by case basis surrounding the issue of acquisition adjustments.

Acquisition Adjustments

An acquisition adjustment is a regulatory convention by which the books of the utility are

adjusted to reflect changes in the historical rate base valuation resulting from purchase prices that differ from original cost rate base valuations. The need to develop this separate accounting treatment is largely a consequence of certain abuses in the utility industry during the acquisition and merger period of the 1920's and 30's. The decision to include an acquisition adjustment in rate base must be made by the Commission and must be consistent with current policy based upon the existence of extraordinary circumstances.

Since 1988, the Commission has found extraordinary circumstances resulting in three negative and three positive acquisition adjustments. The Commission policy of not recognizing acquisition adjustments, either positive or negative, in the absence of a showing of extraordinary circumstances does constitute an incentive for acquisition of small systems when they can be purchased at a discount to established rate base value.

Positive acquisition adjustments

A positive acquisition adjustment results when the purchase price exceeds the net book value of the acquired property. For example, if the original cost rate base valuation is \$100, but an acquiring utility paid \$120 for the assets, a positive acquisition adjustment, if approved, would inflate the original cost rate base valuation to \$120. The acquiring utility would then be permitted to earn a rate of return on the

investment of \$120. It has been argued that in certain situations such an adjustment provides incentive for the acquisition of troubled or run down utilities by larger and more able utilities.

The criteria for evaluating a positive acquisition adjustment are enumerated in Commission Orders Nos. 8206 and 9455:

- Did the purchaser pay more than the original cost?
- Was the transaction at arms length?
- Did the purchased assets remain in use?
- Does the purchased system provide a needed expansion of the old system?
- Was the purchase price below replacement cost?
- Was the sale approved by the proper authority?
- Did the purchase benefit the customers?

A determination of whether the purchase benefits the customers is typically the most analyzed of the above criteria. Additionally, if the inclusion of a positive acquisition adjustment can be related to cost reductions, a double recovery of the utility's investment will not occur.

Opponents of a positive acquisition adjustment believe there are no circumstances where a positive acquisition adjustment would be appropriate. The basis of the argument is that any positive acquisition adjustment leads to increased rate base, based solely on a change in

ownership.

Negative Acquisition Adjustment

A negative acquisition adjustment is recorded when the purchase price of the transaction is below the original cost rate base valuation. If approved, the negative acquisition adjustment reduces the rate base valuation to the level of the purchase price. In the previous example, assume a purchase price of \$80. An approved negative acquisition adjustment would reduce rate base to the \$80 purchase price. The rationale in this instance is to not permit an acquiring utility to earn a return on a value greater than its actual investment. However, if the purchasing utility were to negotiate a price much lower than rate base and be required to earn a return only on the purchase price, this could act as a disincentive to negotiate a lower price or conclude the purchase.

In evaluating negative adjustments, the Commission considers the physical condition of the acquired facilities and whether the purchase was prudent.

Arguments Against Current Commission Policy

Opponents of the current policy argue that no incentive should be necessary for larger utilities to purchase smaller systems. They argue that if the regulatory process is properly functioning, the opportunity to earn a reasonable return on its capital investment and recover all prudently incurred operating expenses should be

sufficient incentive for any utility.

While rate of return regulation may be appropriate for larger utilities, it is apparent that this method of regulation contributes to the cash flow problems for Class C utilities. We have reviewed all Class C utilities which filed 1999 Annual Reports and have developed the following table detailing achieved rates of return. It should be noted that the calculated rates of return are based upon data as filed by the utilities subjected to only a desk audit.

CLASS C WATER AND WASTEWATER UTILITIES' 1999 ACHIEVED RATES OF RETURN				
UTILITY	TOTAL	UNDER 10%	NEGATIV E	PERCENT UNDER 10% OR NEGATIV E
WATER	113	26	57	73%
WASTEWAT ER	81	16	51	83%

This analysis shows that a majority of these regulated utilities have failed to achieve adequate rates of return and cash flow under rate base regulation. While reducing rate base to purchase price may appear fair and reasonable by allowing a return solely on the owner's investment, this practice could reduce a utility's ability to fund its operations and thereby jeopardize its long term viability.

Consequently, ratepayers may end up paying higher rates in later years to overcome neglect or the inability to fund improvements resulting from lower rates in the short term. A utility's future cash needs must be met if it is to remain viable.

The present acquisition policy is especially questioned in the case of deals where a utility is purchased at a price well below the rate base level and no acquisition adjustment is made. This scenario was recently highlighted in Docket No. 970409-SU, regarding the purchase of the Tropical Isles system by Florida Water Service Corporation. In this case, the utility was purchased for \$5.00 with rate base being in excess of \$270,000. This docket provided a vivid example of the reaction to future rates being based upon rate base and not the actual \$5.00 investment of the new owners.

One view is that purchasing utilities should not be allowed to earn a return on so-called "phantom" investment when purchase price is below rate base of the acquired utility. A negative acquisition adjustment is appropriate in such cases, absent a showing by the acquiring utility that it should not be made.

Beyond the need for an acquisition incentive, there is an additional important reason for not including a negative acquisition adjustment in rate base. If regulatory policy is to have long term rather than short term objectives, regulators should therefore treat utilities as

going concerns and evaluate rates on a cash need's basis. Utilities are often sold at a discount because the owner is unable to continue operating it at existing rate levels. This is an example where regulators should also consider the ability of the new owner to provide long term service in compliance with regulatory standards. Where large differences exist between rate base and purchase price, the Commission should explore the reasons for the differences on a case by case basis and consider the possibility of approving a partial acquisition adjustment if warranted by extraordinary circumstances.

Another concern regarding excluding negative acquisition adjustments involves cases in which the system is in disrepair and the acquiring utility must incur major capital outlays for improvements. The concern is that if the rate base remains at full original cost and the purchaser makes significant improvements, the customers may in effect be paying for the same plants twice -- once for the original rate base amount and again for the improvements to restore the facilities.

It is countered that the former utility owner was unable to maintain the system due to low rates paid by customers causing a deterioration of the system. Therefore, any improvements should be considered deferred maintenance expense never included in previous rates. The basis of the argument is that customers have paid too little for too long, benefiting from low rates which were in part responsible for the neglect and

condition of the utility system. The new owner has assumed the existing problems of the utility and an inevitable increase in rates will be needed to correct problems to the ultimate benefit of the customers. Viewing the improvements as deferred maintenance, not included in the previous rates, presents the double payment issue as a problem of timing as opposed to rate level. In any event, it may be that the Commission, in order to fulfill its obligation to fairness, should in some way recognize the reasons for such disparities and address them in a manner that is fair to both customers and utility owners.

B. Acquisition Practices of Other States

New York, Pennsylvania and California have all implemented acquisition policies with the stated goals of consolidating the industry, thereby achieving the additional goals of safe, adequate, reasonably priced service for the long term. A review of the other states' policies and programs will highlight additional incentives for acquisitions.

New York

In 1994 the New York Department of Public Service (NYDPS) adopted a policy statement to encourage acquisitions of smaller troubled systems by larger systems. It included in its policy a number of options to provide incentives for such acquisitions. Acquisition adjustments were among a list of possible incentive

mechanisms. The NYDPS stated its intention to foster acquisitions and mergers if such transactions would address the following goals:

1. Improve the ability of small water companies to provide service;
2. Improve customer service;
3. Make it easier to comply with current and future regulations;
4. Avoid drastic rate increases;
5. Bring the rates of merged systems into parity;
6. Improve and consolidate management and operation; and
7. Promote conservation (NYDPS, 1994).¹

The NYDPS also provides for acquisition incentives if there is clear customer benefit. A water company must demonstrate long run viability and be able to provide safe and adequate service. Acquisition incentives will be considered based on the following factors:

1. Whether the acquiring company has the ability to adequately manage, serve customers, comply with regulations and

¹ New York Department of Public Service Statement on Policy of Acquisition Incentive Mechanisms for Small Water Companies, August 8, 1994.

finance capital improvements.

2. Whether the impact on customers resulting from the acquisition is as beneficial or more beneficial than realistic alternatives.
3. Whether the terms of the acquisition will permit future beneficial solutions, such as municipalization.
4. Whether customer benefits are expected to be commensurate with the incentives for the acquisition or merger.
5. Whether meaningful customer participation has been obtained through effective public involvement.²

The NYDPS also expressed its willingness to consider additional incentives where proposals are made to consolidate several water systems at once.

The actual incentives to be considered were identified by category and are:

1. Rate Base

- a. Where purchase price is less than the rate base of the utility being acquired, we will consider allowing rates to reflect the full

² Ibid.

rate base of the acquired company.

- b. Where the purchase price is greater than the rate base, [the NYDPS] will consider allowing the rates to the purchase price premium. Such an adjustment could be justified by improved service, realized cost efficiencies and economies of scale.
- c. Where capital expenditures are required for service improvement or compliance reasons, we will consider allowing projected improvement costs to be reflected in rates immediately, subject to later review.
- d. When the acquired company has little or no rate base, we will consider allowing a proxy rate base equivalent to the rate base per customer of the acquiring company.

2. Depreciation

Where circumstances warrant, accelerated depreciation or depreciation on projected improvement costs subject to later reconciliation may be permitted.

3. Amortization

Amortization may be considered as a means of recovering the reasonable costs of acquisition and/or the recovery of a purchase premium. The term of the amortization should consider adverse customer impact.

In addition, the following incentives may be considered in special cases for good cause shown:

4. Operating Ratio

This mechanism may be used [for rate setting] in cases where rate base mechanisms may be less effective.

5. Rate of Return

When accompanied by appropriate justification, it may be beneficial to allow a premium on the overall rate of return as an acquisition incentive.

6. Delayed Recovery

Where acquisition costs or improvement costs, or the effects of rate equalization may cause adverse customer rate impact, a phase-in recovery or delayed recovery may be appropriate rather than lose the opportunity for consolidation.

7. Lease/Buy-out

When the overall benefit of an acquisition is uncertain and a trial takeover of management, operation, and ownership appear to be beneficial, we may consider leased company operation with an option to buy as a way to provide incentive.³

A recent contact with the New York Commission revealed that since the acquisition incentive program was implemented in 1994, it has not resulted in an increase in acquisitions. While acquisitions have occurred, they have not involved small or troubled utilities. However, utilities are encouraged to discuss with the Commission what they would need to buy certain utilities. Aquasource, which also operates within Florida, has purchased several utilities and it is believed a key incentive for the purchases was the provision of automatic rate increases after an initial rate freeze. Upon purchasing a utility, rates are frozen for four years after which rates may be increased by a factor based upon the cost of the GDP for each of the next seven years. This initially protects customers from rate increases and provides the utility with known increases without litigation or additional regulatory expense.

Pennsylvania

³ Ibid.

Pennsylvania has also adopted a policy of encouraging industry consolidation and acquisitions if the proposed transaction meets the following thresholds:

1. The acquisition is in the public interest;
2. The acquisition will not effect the viability of the acquirer;
3. The acquired system has less than 3,300 connections, is not currently viable, is in violation of statutory and regulatory standards, and has failed to timely comply with any order of the DEP or PUC;
4. The acquired system's customers will receive improved service in a reasonable time frame;
5. The purchase price is fair and reasonable and conducted through arms' length negotiations;
6. Single tariff pricing should be implemented to the extent reasonable. Phased in implementation of rates may be appropriate if necessary to address affordability.⁴

⁴ National Association of Water Companies Source Book of Regulatory Techniques for Water Utilities, June, 1997, p 1.1-11.

The specific incentive mechanisms to be considered include:

1. Rate of Return Premiums

Additional rate of return basis points may be awarded for certain acquisitions or improvement costs based on sufficient support filed by the utility in a rate proceeding;

2. Acquisition Adjustment

When acquisition costs exceed depreciated original cost, a reasonable excess may be included in rate base and amortized over 10 years;

3. Deferral of Acquisition Improvement Costs

In cases where improvement costs are too great to be absorbed by rate payers at one time, rate recovery may be in phases.

4. Plant Improvement Surcharge

Extraordinary improvement costs may be temporarily offset by surcharging the customers of the acquired system. If those improvements benefit only the customers of the acquired system, the improvement costs may be allocated to those customers on a greater than

average (but less than 100%) basis to the new customers for a reasonable period of time.⁵

The Pennsylvania program is directed at the reduction of small troubled utilities. A recent contact with the Pennsylvania Commission shows that acquisitions are a common occurrence. However, in most cases the transactions do not meet the criteria to utilize acquisition incentives. However, the state is willing to work with utilities to accomplish its goal of industry consolidation and it is believed this environment is conducive to acquisitions. Additionally, a major factor helping small utilities and acquisition activity is the Pennsylvania Infrastructure Investment Authority (PENNVEST) which provides low cost loans and grants for water and wastewater improvements.

California

The California Public Utilities Commission (CPUC) began workshops in 1997 to investigate the dynamics of acquisitions and mergers of water utilities in its state. One of the issues before the Commission was the use of original cost to establish rate base versus replacement cost new less depreciation (RCNLD) in acquisition cases. Before the CPUC could conclude its investigation, the California legislature enacted HB 1268 permitting "fair market value" (as determined by actual purchase price) rate base valuation if less than RCNLD.

⁵ Ibid., p12.

California Public Utilities Code Section 2718-2720 is the Public Water System Investment and Consolidation Act of 1997. The legislature found:

1. Public water systems face replacement and upgrade costs due to the Safe Drinking Water Act and state regulations and requirements;
2. Increasing amounts of capital necessary to fund public water system investment;
3. Scale economies are achievable;
4. Providing incentives to achieve economies will provide benefits to rate payers.⁶

In order to encourage investment and consolidation in public water systems, Section 2720 provides:

1. The Commission (CPUC) shall use "fair market value" when establishing rate base for distribution systems of public water systems acquired by a water corporation;
2. If "fair market value" is greater than RCNLD, the Commission may include the difference in the rate base for rate

⁶ Ibid, 1999 Update 1, pp 1.2-9, 1.2-10.

purposes if additional amounts are fair and reasonable. Fairness and reasonableness determinations may consider whether the acquisition will improve reliability, compliance, efficiencies, and economies of scale that would not otherwise be available and the impact to consumers will be fair and reasonable.

A recent contact with the California Commission reveals there has been activity regarding acquisitions and mergers of larger utilities with minimal activity regarding small utilities. It was indicated that the large utilities have business plans to expand to become more efficient and avoid being acquired by larger utilities. Also, California based utilities have acquired out of state utilities. The impact of allowing fair market value has had more of an impact on purchase price rather than the number of acquisitions. While this policy may act as a stimulus, it does make or break acquisitions. Aquasoure had initially shown interest in acquiring several utilities, but has since decided to not enter the California market. The California staff states they had opposition to their offering up to 7 times book value for utilities and seeking utilities throughout the state with no clear plan for central or regional operation.

The level and number of incentives offered for acquisitions is dependent upon defining the Commission's goals regarding industry

consolidation and determining how aggressively it wishes to pursue that goal. A review of other state's programs provides a shopping list of available incentives to facilitate consolidation of the industry.

C. Florida's Acquisition Policy for Other Industries

While this paper deals exclusively with the water and wastewater industry, a brief discussion of acquisition treatment by the other industries is provided for informational purposes.

In the gas industry, the Commission looks at acquisition adjustments on a case by case basis. In each case, the acquisition is thoroughly and individually reviewed on its merits as to whether or not it will provide benefit to the body of rate payers. In Docket No. 870118-GU, Central Florida Gas Company was purchased by Chesapeake Utilities, Inc., and requested that it be allowed to amortize a positive acquisition adjustment. The acquisition resulted in a revenue requirement reduction. Central Florida indicated there would be additional savings associated with the use of Chesapeake's gas purchasing agent, engineering department, and rate and accounting staff for the preparation of rate cases. In Order No. 18716, the Commission approved the amortization based on projected savings due to Central Florida's acquisition by Chesapeake. However, Central Florida was put on notice that the projected savings would be analyzed in future rate cases to determine if the projected savings actually

occurred or had eroded. In Docket No. 891179-GU, Central Florida failed to demonstrate that the projected savings related to the acquisition had occurred. It was noted that Central Florida had actually experienced a total increase in its revenue requirements since its acquisition by Chesapeake. Therefore, in Order No. 23166, the Commission disallowed the acquisition adjustment.

City Gas Company was purchased by NUI Corporation and had requested that it be allowed to amortize a positive acquisition adjustment. In evaluating the request, the Commission referred to the policy established in Order No. 23376 (Docket No. 891309-WS). In Order No. 24013, the Commission found that there was insufficient evidence in the record to support the finding that City Gas customers had benefitted as a result of the acquisition by NUI. Therefore, the Commission found that City Gas had not demonstrated any extraordinary circumstances to justify the inclusion of the acquisition adjustment.

In the telecommunications industry, Section 364.33, Florida Statutes, provides that Commission approval is required for the acquisition, transfer, or assignment of majority stock ownership of a telecommunications company operating a telecommunication facility in Florida. The acquisition, transfer, or assignment of majority stock ownership of the company is approved by the Commission based upon an analysis of the public's interest in efficient, reliable telecommunications.

Generally speaking, most telecommunications companies are acquired at a premium and companies tend not to request an acquisition adjustment.

Until recently in the electric industry, it was rare that you would find acquisitions or mergers of power companies. However, the commission currently has two open dockets pertaining to acquisitions in this industry. Docket No. 00-0824 is a review of Florida Power Corporation's earnings including the effects of its acquisition by Carolina Power & Light. Also, Docket No. 00-1148 is a review of Florida Power & Light Company's (FPL's) proposed merger with Entergy Corporation, the formation of a Florida regional transmission Company, GridFlorida, and the effect of these activities on FPL's retail rates. In instances of acquisitions involving larger utilities, synergy is generated through economies of scale, especially in administrative functions where some duplication can be eliminated.

Certain transactions give rise to intangible assets that are not separately identifiable such as patents, copyrights, and trademarks. Intangible assets that cannot be separately identified relate to the company as a whole. Intangible assets are factors in the production or distribution of goods or services that generate revenue. They are similar to property, plant, and equipment. However, they lack physical characteristics. They frequently exist because of the unique combination of separate assets and personnel of the company, and their

synergism explains why the value of an company as a whole-- measured in terms of its anticipated earning capacity--may be greater than the sum of the values of the individual parts of the company. This is commonly called goodwill. Goodwill is the capability of an company to produce earnings in excess of normal.

This unique earning capability results from intangible advantages working for the company in conjunction with the separately identifiable tangible and intangible assets. The value of the enterprise as a whole may exceed the value of the sum of the individual assets, less the liabilities, of the company. Such situations result from the existence of intangible qualities, such as an outstanding reputation, superior managerial capability, and/or the ability to operate at an above-normal level of efficiency.

Where Do We Go From Here

In Order No. 25729, issued on February 17, 1992, the PSC concluded an investigation regarding acquisition adjustments and confirmed its existing policy. In that Order, the Commission enumerated the benefits to customers of new ownership as follows:

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 general disinterest in utility operations in the case of developer owned systems.

The Commission may want to consider an overall goal of helping ensure the sustained provision of safe, environmentally sound and reasonably priced water and wastewater service to Floridians. While infusion of funds through rate

increases, grants or low interest loans may provide a short term fix for many utilities, many utilities will continue to have long term problems based predominately upon their small scale of operation. Therefore, consolidation of the industry by larger utilities acquiring smaller utilities, resulting in the above stated benefits, may be a reasonable option to eliminating problems faced by small utilities and assuring the long term provision of better quality water and wastewater service. However, the Commission should assure that each acquisition is in the public interest and evaluate each case based upon resulting customer benefits. Additionally, the Commission must closely investigate all cases where a wide difference exists between purchase price and rate base. It is important to understand the reasons for these differences and evaluate customer benefits in determining if and at what level an acquisition adjustment might be granted.

If the Commission were to pursue a goal of consolidating the industry thereby eliminating small non-viable utilities, a key factor is if the acquiring entity is regulated by this Commission. The Commission is not involved in negotiating or establishing the purchase price of a utility. If the Commission chooses to provide incentives for small system acquisitions, such incentives could only be based upon its continued regulatory authority. The acquiring utility is concerned how continued regulatory treatment of the acquired assets and customers will impact its profit. Conversely, a non-

regulated entity such as a city, county, cooperative or exempt homeowners association is concerned mainly with purchase price and its ability to expand its customer base and provide ongoing service to its citizens or members. While it is desirable for governmental entities to acquire utilities based upon their ability to fund operations and their vested interest in providing service to their citizens, the Commission cannot offer incentives for these purchases. However, since these type acquisitions are fairly common, it appears motivation and incentive already exist.

From the standpoint of the Commission, an acquisition policy which provides incentives for consolidation is most beneficial with the scenario of a larger utility acquiring a smaller utility. However, at issue is the economic rationale for acquisition of a small, poorly maintained utility with limited customer growth potential and whether additional incentives may be needed to promote these transfers.

The key to any policy which would lead to consolidation of the industry and reduction in the number of small utilities is an understanding that the problems faced by small utilities and their customers may be a statewide problem that extends beyond this Commission's jurisdiction. Any action, including acquisition incentives, designed to promote an environment conducive to acquisitions by this Commission would impact only a portion of the state's utilities. Therefore, we can help to provide a solution to only part of

the problem. Based upon our experience in certifying new utilities when a county gives jurisdiction to the Commission, we are well aware that non-jurisdictional counties are likewise inundated with small utilities.

We believe if consolidation of the industry is pursued it may be best addressed if considered as a state goal expressed by the legislature. This state policy would then serve as a backdrop to implement measures to stimulate acquisitions. Mergers or acquisitions cannot be mandated. Acquisitions are business decisions which for investor-owned utilities are generally prudent only with the expectation of future profit.

Utilities rely on this Commission's policy to bargain for and purchase utilities. It is important that this policy be clearly stated so all players know the rules of the game and are able to anticipate the Commission's reaction. The policy should also be flexible to entertain ways to finalize transactions and avoid same issue hearings. Litigation costs associated with transfers would be better spent in making improvements to the acquired systems.

Within its jurisdiction, the Commission could do several things to stimulate acquisitions. Regarding acquisition of large systems by other large systems and the acquisition of small utilities by larger utilities, we believe the present policy of not acknowledging either positive or negative acquisition adjustments absent extraordinary circumstances is still

appropriate. However, if a goal of reducing the number of small utilities is pursued, additional incentive options could be considered.

For the acquisition of small utilities, we believe the umbrella policy could be to facilitate a reduction in the number of small utilities for the long term benefit of the ratepayers. While higher rates are inevitable, the goal of providing safe, reliable long term service in compliance with regulatory standards benefits ratepayers. To accomplish this goal, the key question is why would an entity want to acquire a small utility in need of substantial upgrades? Further, we must recognize that these upgrades must be done by either the present or new owner with the cost borne by the ratepayers. Therefore, a two prong attack is needed to help upgrade existing small utilities making them more attractive for acquisition and/or providing incentives for larger utilities to acquire either well run or troubled small utilities.

Since small utilities may be a statewide problem, a state program such as PENNVEST in Pennsylvania, which provides low interest loans and grants for infrastructure improvements would help. This funding would be in addition to the state revolving fund. For example, we have seen many instances of small utilities seeking to retire their water or wastewater plants and tie their systems into regional systems. In several cases, these transactions have not happened due to the unwillingness of the regional system to assume dilapidated collection or distribution

systems. Access to these funds can help make utilities willing to make improvements more attractive for acquisition. Additionally, a rate increase may be needed to cover the costs of improvements and position the utility to service its acquired debt. An acquiring utility would rather not alienate its new customers with an immediate rate increase. Obviously, they would rather assume recently increased rates by the prior owner.

For small utilities with little rate base, traditional rate of return rate setting fails to provide adequate cash flow to service debt or put profit back into the utility. The operating ratio alternative currently available for Florida's small utilities can provide needed additional revenues for these utilities. To date, the Commission has approved rates based upon the operating ratio for three utilities. One of these utilities is no longer jurisdictional due to the loss of Citrus county and another was just approved in 2000. While these cases cannot reveal the impact of the operating ratio, the third case, Lake Osborne may show the positive impact of using the operating ratio. In 1996, Lake Osborne received a rate increase based upon the operating ratio. In 1997, the utility was acquired by Crystal River Utilities. Even though Lake Osborne was a small utility with rate base of only \$1,842, the ability of the new owner to continue charging the rates based upon the operating ratio may have provided the incentive to close the transfer. This is another way a small utility can make itself more attractive for

acquisition.

Small utilities where the present owners lack the desire and ability to make improvements present a different scenario. In these cases, improvements can only be made by the new owner with the cost ultimately borne by the ratepayers. In many instances, the present owners are looking to cut their losses and sell at bargain prices. Absent extraordinary circumstances, a negative acquisition adjustment would go against the goal of consolidation. Additionally, contentious recovery of costs to upgrade the acquired system is also an acquisition disincentive. Depending upon the size of the acquiring utility and the magnitude of improvements to the acquired system, implementation of a surcharge to customers of the acquired system could be made available. A surcharge would earmark only the customers of specific systems.

Additionally, when a utility acquires a system which has little or no rate base, the Commission could consider allowing a proxy rate base equivalent to the rate base per customer of the acquiring company. This would increase cash flow over otherwise break even rates providing an incentive to acquire the system.

In summary a package of the following measures would serve to provide needed incentives if the Commission were to pursue a goal of industry consolidation.

- Work with other agencies and the legislature

for funding to establish additional funding for infrastructure replacement and improvement.

- Educate our utilities to make them aware of funding options.
- Codify, through rule, the Commission's current policy of acknowledging neither a positive nor negative acquisition adjustment, absent extraordinary circumstances.
- Recognize that additional incentives are needed for the acquisition of small utilities and that immediate rate increases may be needed to achieve the long term goal of providing safe, reliable service in compliance with regulatory standards.
- Educate customers of the costs to provide quality service and the price tag of needed improvements to their specific systems. Educate them that in order to receive quality service they will bear the cost of regulatory compliance which is to their long term benefit.
- Expand applicability and promote setting rates on the operating ratio method. Utilities with sufficient cash flow are more viable entities and are better targets for acquisition.
- When the acquired company has little or no

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Acquisition Adjustments

Allowance of an acquisition adjustment provides for the difference between depreciated original cost and a purchase price. Pennsylvania explicitly allows acquisition adjustments for small and/or troubled systems, subject to certain conditions, and other states will allow such adjustments for these types of systems. Such policies should be recognized as a "Best Practice" for the water industry, but should be extended to include acquisitions that involve entities that may not be small or non viable. Texas and California are examples of states where this can occur. A basic "best practices" principle could be stated as follows:

"If and to the extent a business combination produces identifiable savings, service improvements or other benefits to customers, shareholders should have the opportunity to recover and earn a return on the investment required to produce those benefits."

In this concept, the difference between depreciated original cost and a fair market purchase price represents the investment necessary to produce benefits and would be treated similarly to other investments the utility makes to provide cost effective, reliable service. Methods to achieve this goal could include acquisition adjustments to ratebase or the ability of the utility to retain quantified savings resulting from the combination equivalent to a return of and on the investment necessary to produce the savings.

The following PDF is a 50-state survey regarding the practice of individual commissions when it comes to rate recognition of acquisition adjustments.

- [50-State Survey of Acquisition Adjustment pdf](#)

ACQUISITION ADJUSTMENT

STATE	
Alabama	<p>The Commission regulates the rates of eight small water companies. There is no specific statutory authority dealing with water company acquisition adjustments. However, in <i>Re Mobile Gas Service Corporation</i>, 2003 WL 23101066 (Ala. P.S.C. Oct. 9, 2003), the Commission relied on prior precedent to find that a positive acquisition adjustment would be allowed in rate base where the following principal criteria are satisfied: (1) the purchase price was the result of arm's length negotiations; (2) the acquisition would produce operational efficiencies; and (3) the acquisition would promote the integration of facilities.</p>
Alaska	<p><i>In the Matter of Alaska Power Co. Application</i>, No. U-01-98, Order No. 1 (R.C.A. Feb. 25, 2002) ("The Commission has interpreted this statute [AS 42.05.441(b)] to permit recovery of an acquisition adjustment if the utility demonstrate that the acquisition will provide clear, tangible benefits to ratepayers in an amount at least equal to the acquisition adjustment. However, the Commission has interpreted this rule narrowly and has refused to permit acquisition adjustments in many cases.").</p>
Arizona	<p><i>In the Matter of the Joint Application of Citizens Utilities Company, et. al. Decision No. 63584</i> (A.C.C. Apr. 24, 2001) ("Arizona-American is cautioned that the Commission will require Arizona-American to demonstrate that clear quantifiable and substantial net benefits to ratepayers have resulted from the acquisition of Citizens' systems that would not have been realized had the transaction not occurred before the Commission will consider recovery of any acquisition adjustment in a future rate proceeding.").</p>
Arkansas	<p>Ark. Code Ann. § 23-4-111 (2008)(Commission will use net book value unless adjustment warranted after consideration of factors such as the reasonableness of original cost and whether customers will receive known and measurable benefits at least equal to the incremental amount sought to be recovered.)</p>

California	<p>Cal. Pub. Util. Code § 2720 (2008)(Commission will use fair market value to establish the rate base value of a distribution system of a public water system acquired by a water corporation. If fair market value exceeds reproduction cost, difference may be included in rate base if commission determines additional amount is fair and reasonable.).</p> <p><i>Application of Citizens Utilities Co. of California (U-87-W), a California Corp., and California-American Water Company, a California Corp., Decision 01-09-057 (Cal. P.U.C. Sept. 20, 2001)</i> (approving alternative sharing program, compliant with § 2720, whereby realized synergies go first to acquiring company to amortize acquisition premium, and second to customers and company in a 90%/10% split).</p>
Colorado	<p>No general policy has been established for dealing with water company acquisition adjustments. Commission staff was unable to recall any requests for acquisition adjustments by water companies. In other sectors, acquisition adjustments are considered on a case-by-case basis.</p>
Connecticut	<p>Conn. Gen. Stat. § 16-262o, § 16-262s (2008) (all reasonable costs of the acquisition of troubled or economically non-viable water systems may be recovered in rates).</p>
Delaware	<p><i>Re Tidewater Water Supply Co., Inc., 2000 WL 33121630 (Del. P.S.C. Nov. 21, 2000)</i> (Commission has an “established practice of not allowing rate base recognition of premiums over net book value paid by an acquirer of a utility,” barring exceptional circumstances).</p>
District of Columbia	<p><i>PRIVATE WATER SYSTEMS NOT REGULATED</i></p>
Florida	<p>Fla. Admin. Code 25-30.0371 (2008) (positive acquisition adjustment not allowed in rate base absent extraordinary circumstances; negative acquisition adjustments recognized under certain circumstances).</p>
Georgia	<p><i>PRIVATE WATER SYSTEMS NOT REGULATED</i></p>

<p>Hawaii</p>	<p>The Commission has consistently disallowed the recovery of any acquisition adjustments from customers, but evaluates requests on a case-by-case basis.</p> <p><i>In the Matter of the Application of Citizens Communications Company, Kauai Electric Div. and Kauai Island Utility Co-op, Docket No. 02-0060, Order No. 19658 (Haw. P.U.C. Sept. 17, 2002)</i> (approving stipulation which included the following condition: "Applicants acknowledge the commission's policy to not allow recovery from utility customers of goodwill or acquisition premium amounts arising from utility merger and acquisition transactions. In accordance with this policy, [acquiring company] will not seek rate recovery of any goodwill amortization, acquisition premium costs or goodwill impairment changes . . . in future rate proceedings.").</p>
<p>Idaho</p>	<p><i>Re United Water Idaho Inc., 187 P.U.R.4th 312 (1998)</i> (approving an acquisition adjustment to the rate base "based on its findings that the acquisition benefits customers as well as its conclusion that the purchase price was fair and reasonable and arrived at through arms-length negotiation.").</p> <p><i>Re Resort Water Co., Inc., 2005 WL 673648 (Idaho P.U.C. Mar. 15, 2005)</i> ("It has been a consistent policy of the Commission that rate base not include the purchase price of a water system unless it could be reasonably shown that the customers have not previously paid for the water system assets . . . the amount to be included in rate base as an acquisition adjustment must be determined on a case-by-case basis").</p>
<p>Illinois</p>	<p><i>Re Consumers Illinois Water Co., 2003 WL 21108549 (Ill. C.C. Mar. 18, 2003)</i> (traditional practice of Commission is to require that acquisition adjustment be recorded below the line; however, under unique circumstances, ICC will include it in rate base).</p>

<p>Indiana</p>	<p><i>City of Ft. Wayne v. Util. Center, Inc., d/b/a/ Aquasource</i>, 840 N.E.2d 836 (Ind. Ct. App. 2006) (affirming Commission finding that, based on new owner's efforts to remedy problems at troubled utility and arms-length transaction, a return on the acquisition adjustment should be allowed).</p> <p><i>Re Indiana-American Water Co., Inc.</i> 238 P.U.R. 4th 428 (2004) (“[G]ranteeing a return on an acquisition adjustment but no return of an acquisition adjustment is consistent with past practice of this Commission.” The acquisition was found to have “resulted in cost savings in excess of the cost of capital investment needed to make those savings possible. . .”).</p> <p><i>Re Lincoln Util., Inc.</i>, 2006 WL 452338 (Ind. U.R.C. Jan. 25, 2006) (order authorizing water company to earn a return on acquisition adjustment).</p> <p><i>Re Indiana-American Water Co., Inc.</i> 2002 WL 32091039 (Ind. U.R.C. Nov. 6, 2002) (“It is the established policy of this Commission to allow an acquisition adjustment in rates in only two events, namely: 1. As a result of the acquisition, are there significant and demonstrable benefits flowing to the ratepayers, e.g. better service and/or lower rates? 2. Does the acquisition result in correction or salvage of an entity identified by this Commission as a ‘troubled’ utility?”).</p>
<p>Iowa</p>	<p><i>Office of Consumer Advocate v. Iowa Util. Bd.</i>, 454 N.W.2d 883, 113 P.U.R.4th 479 (Iowa 1990) (“According to prior board precedent, the acquisition amount may be included in the rate base if actual benefits to customers are established by the utility.”).</p>
<p>Kansas</p>	<p>The State Corporation Commission regulates a few very small water companies. There is no specific authority dealing with water company acquisition adjustments. However, in the gas and electric sectors, the Commission limits recover of an acquisition premium to an amount that reflects the realistic level of savings that the Commission believes can be achieved by the merged company. See <i>In the Matter of the Application of Kansas City Power & Light Co. for approval of its acquisition of all classes of the capital stock of Kansas Gas and Electric</i>, Docket Nos. 172, 745-U; 174, 155-D (Kan. S.C.C. Nov. 14, 1991).</p>
<p>Kentucky</p>	<p><i>Re Kentucky-American Water Co.</i>, 2005 WL 578209 (Ky. P.S.C. Feb. 28, 2005) (“[T]he net original cost of plant devoted to utility use is the fair value for rate-making purposes, unless the utility can prove, with conclusive evidence, that the overall operations and financial condition of the utility have benefited from acquisitions at prices in excess of net book value. Any utility seeking recovery of an acquisition adjustment must justify its purchase decision based on economic and quality of service criteria.”)(internal quotations omitted).</p>

Louisiana	No information available.
Maine	As a general matter, acquisition adjustments are not allowed, but requests will be evaluated on a case-by-case basis. Commission staff was unable to recall any requests for acquisition adjustments by water companies in the past decade. <i>Re Terms and Conditions of Edmund J. Quirion, 1995 WL 785875 (Me. P.U.C. Nov. 14, 1995)</i> (“We note that this Commission’s general policy has been to use the original cost minus depreciation as the proper method of determining the value of utility property. However, there may be circumstances under which acquisition cost might be considered.”).
Maryland	As a general matter, if sufficient customer benefits are shown the Commission may allow an acquisition adjustment and amortize it over several years. Commission staff noted requests for acquisition adjustments by water companies are rare. <i>Re Greenridge Utilities, Inc., 1997 WL 998596 (Md. P.S.C. June 4, 1997)</i> (“The decision to allow inclusion of the acquisition adjustment in the Company’s rate base is predicated upon consideration of whether such inclusion provide a benefit to the ratepayers.”).
Massachusetts	<i>Guidelines and Standards for Acquisitions and Mergers, D.P.U. 93-167-A at 6-7, 18-19 (1994)</i> (Companies may use savings that result from mergers and acquisitions to offset acquisition premiums and related transaction costs, based on a balancing of the benefits arising from the merger with the costs associated with the merger). Commission staff noted that a showing of savings must be made at the time of the acquisition, and not be based on generalized statements about potential merger benefits. While the policy has been focused on gas and electric company merger and acquisition activity, the precedents in <i>Guidelines and Standards for Acquisitions and Mergers</i> could potentially be applied to water companies.
Michigan	<i>PRIVATE WATER SYSTEMS NOT REGULATED</i>
Minnesota	<i>PRIVATE WATER SYSTEMS NOT REGULATED</i>
Mississippi	<i>State of Miss. v. Miss. Pub. Serv. Comm’n, 435 So.2d 608 (Miss. 1983)</i> (“...public utilities’ amortization of acquisition adjustment is a proper component of cost of service and should be included as a proper operating expense

when proven by the utility to be beneficial.”).

Missouri

Mo. Rev. Stat. § 393.146(11) (2008)

“If the commission orders the acquisition of a small water or sewer corporation, the commission shall authorize the acquiring capable public utility to utilize the commission’s small company rate case procedure for establishing the rates to be applicable to the system being acquired. Such rates may be designed to recover the costs of operating the acquired system and to recover one hundred percent of the revenues necessary to provide a net after-tax return on the ratemaking rate base value of the small water or sewer corporation’s facilities acquired by the capable public utility, and the ratemaking rate base value of any improvements made to the facilities by the acquiring capable public utility, subsequent to the acquisition, at a rate of return equivalent to one hundred basis points above the rate of return authorized for the acquiring capable public utility in its last general rate proceeding.

Re Alliance Gas Energy Corp., 2008 WL 320768 (Mo. P.S.C. Feb. 5, 2008) (observing that “there are strong precedents against allowing acquisition premiums to be reflected in rates when the assets are purchased at more than book value. For example, the Commission has stated that it will not require a company to write down its rate base when the assets are sold at less than book value.”).

Re UtiliCorp United Inc., 2004 WL 431561 (Mo. P.S.C. Feb. 26, 2004) (“Missouri has traditionally applied the net original cost standard when considering the ratemaking treatment of acquisition adjustments. That means that the purchasing utility has not been allowed to recover an acquisition premium from its ratepayers. But it also means that ratepayers do not receive lower rates through a decreased rate base when the utility receives a negative acquisition adjustment.”).

<p>Montana</p>	<p>Mont. Code Ann. § 69-3-109. Ascertaining property values.</p> <p>“The commission may, in its discretion, investigate and ascertain the value of the property of each public utility actually used and useful for the convenience of the public. The commission is not bound to accept or use any particular value in determining rates. However, if any value is used, the value may not exceed the original cost of the property, except that the commission may include all or some of an acquisition adjustment for certain property purchased by a public utility in the purchasing utility’s rate base if the transfer of the property to the purchasing utility is in the public interest.”</p> <p><i>Re NorthWestern Corp., 259 P.U.R.4th 493 (2007)</i> (“It is a long held regulatory principle of this Commission that the value of plant in rate base is determined by original cost less depreciation. Original cost of utility property is determined when the asset is first dedicated to public service. The action of selling a utility, absent any compelling reason, is not sufficient to allow an adjustment in rate base to reflect acquisition costs.”).</p>
<p>Nebraska</p>	<p>No general policy has been established for dealing with water company acquisition adjustments. Commission staff was unable to recall any requests for acquisition adjustments by water companies. In other areas, the Commission sometimes allows acquisition adjustments.</p>
<p>Nevada</p>	<p>The Commission includes the original cost of the acquired system in rate base and does not recognize acquisition adjustments.</p>
<p>New Hampshire</p>	<p><i>Re Lakes Region Water Co., Inc., 2004 WL 3457746 (N.H. P.U.C. Sept. 23, 2004)</i> (after noting commission’s longstanding practice of not allowing recovery in excess of original cost, PUC ordered water company to book purchase price in excess of net book value as an acquisition adjustment so that it was not reflected in future customer rates).</p>
<p>New Jersey</p>	<p>No general policy has been established for dealing with water company acquisition adjustments but the Commission rarely grants acquisition adjustments and will require that a benefit to existing customers be shown by the requesting utility.</p> <p><i>Re Consumers New Jersey Water Company, 1995 WL 592835 (N.J.B.P.U. Sept. 20, 1995)</i>(adopting stipulation where given the “special and unique” circumstance of proven benefit of the acquisition to customers, company would be allowed an acquisition adjustment in next rate base by amortizing adjustment over a period of years and including the unamortized portion into rate base).</p>

New Mexico	<p><i>In the Matter of the Petition By New Mexico-American Water Company, Inc. to Change Its Service Rates, Case No. 2202 (N.M. P.S.C. Dec. 28, 1988)</i> (order approving stipulation that excluded the acquisition adjustment from the rate base and its amortization from the cost of service - acquired assets would be treated as if transferred at original cost.).</p> <p>Commission staff noted that general policy is to not allow an acquisition adjustment unless net benefit to customers is proven.</p>
New York	<p><i>Proceeding on Motion of the Commission to Establish a Policy to Provide Incentives for the Acquisition and Merger of Small Water Utilities, Case No. 93-W-0962 (N.Y. P.S.C. Aug. 8, 1994)</i> (established guidelines for acquisition of small water companies whereby, if certain customer benefits are shown, Commission may provide incentives such as inclusion of acquisition adjustment in rate base (if purchase price greater than acquired company rate base) or inclusion of acquired company rate base (if purchased for less than rate base)).</p> <p><i>Joint Petition of United Waterworks Inc. and South County Services Co., Inc. for Permission for United Waterworks to Acquire the Stock of South County Water Corp., Case No. 02-W-0949 (N.Y. P.S.C. May 21, 2004)</i> (citing to policy on acquisition of small water utilities, allowed acquiring company to include book value of stocks in rates instead of lower purchase price).</p> <p><i>Joint Petition of Aqua New York, Inc., f/k/a Kingsvale Water Co., Inc., and New York Water Service Corp., Case No. 06-W-0700 (N.Y. P.S.C. Dec. 20, 2006)</i> (the full amount of purchase premium treated as goodwill (not recoverable in rates) where acquisition was not of a small water utility).</p>
North Carolina	<p><i>In the Matter of Petition of Utilities, Inc., 147 N.C. App. 182, 555 S.E.2d 333 (2001)</i> (affirming Commission approach whereby it would refrain from allowing rate base treatment of an acquisition adjustment unless the purchasing utility established by the greater weight of the evidence that the purchase price was prudent and that both the existing customers of the acquiring utility and the customers of the acquired utility would be better off (or at least no worse off) with the proposed transfer, taking into consideration rate base treatment of any acquisition adjustment).</p>
North Dakota	<p style="text-align: center;">PRIVATE WATER SYSTEMS NOT REGULATED</p>
Ohio	<p>The Commission includes the original cost of the acquired system in rate base and does not allow acquisition adjustments. <i>Re Dayton Power and Light Co., 21 P.U.R.4th 376 (Oh. P.U.C. 1977)</i> (proposed acquisition adjustment should "clearly" be excluded from rate base given state's use of original cost.).</p>

Oklahoma	Acquisition adjustments are not allowed in rate base absent extraordinary circumstances, although requests are evaluated on a case-by-case basis. Commission staff did not recall any recent requests for acquisition adjustments by water companies.
Oregon	Or. Admin. R. 860-036-0716 (2008) (water utility may petition Commission for approval of acquisition adjustment in rates where benefits of acquisition outweigh the increase to customers' rates resulting from acquisition).
Pennsylvania	66 Pa. C.S.A. § 1327 (2008) (positive acquisition adjustments allowed under identified circumstances where small, troubled or non-viable water systems are acquired and improved; negative acquisition adjustments must be amortized to utility operating income unless, in the Commission's discretion, the public interest would not be served by doing so).
Rhode Island	Acquisition adjustments are generally not allowed, although they are evaluated on a case-by-case basis. Cost savings or other extraordinary circumstances may justify an acquisition adjustment. Commission staff did not recall any requests for acquisition adjustments by water companies in the past decade. <i>In re: Petition of Valley Gas Co., Bristol and Warren Gas Co. and Southern Union Company for Approval of Mergers, Docket Nos. D-00-02, D-00-03 (R.I. P.U.C. July 24, 2000)</i> (order approving a settlement agreement which contained the following term: "The Settling Parties agree that the Companies will not seek direct or indirect recovery of any acquisition premium in rates either through an amortization or rate base adjustment in future rate cases. . . .").
South Carolina	<i>Re Georgia Water & Well Serv., Inc., 233 P.U.R.4th 482 (2004)</i> ("If a regulatory agency determines that the cost wa reasonable and beneficial to the customers, an above-the-line expense could be allowed as an Amortization of Utility Acquisition Adjustments." However, "[t]he prevailing rule relating to the acquisition of utility plant previously used in a regulated business is that the plant must continue to be recorded at the depreciated original cost to the first owner devoting the property to public service.").
South Dakota	PRIVATE WATER SYSTEMS NOT REGULATED
Tennessee	The Authority does not have a general policy on acquisition adjustments. Generally speaking, the purchase of utility plant previously used in providing utility service is recorded on the acquiring company's books at original cost, net of accumulated depreciation. Exceptions would be considered only if the price above the seller's original cost was clear in the public interest and would be addressed on a case-by-case basis.

<p>Texas</p>	<p>30 Tex. Admin Code § 291.31(d) (2008)(positive acquisition adjustment allowed under identified circumstances).</p>
<p>Utah</p>	<p>Commission Staff stated that, in general, when the acquired asset is already a utility asset, the book value goes into rate base. When the acquired asset was not previously a utility asset, the purchase price goes in to the rate base. <i>Re Utah Power and Light Co.</i>, 53 P.U.R.4th 461 (Ut. P.S.C. May 23, 1983) (“The commission agrees that in the context of acquiring assets already dedicated to the providing of public service the general rule for determining the value of such acquired property for rate-making purposes is depreciated book value . . . The commission also recognizes, however, that there may be exceptions to this general rule should sufficient benefits accrue to the acquiring public utility and its ratepayers to justify deviations from net book value treatment. It should be emphasized that this exception would be an unusual circumstance and would be evaluated on a case-by-case basis.”).</p>
<p>Vermont</p>	<p>Board includes acquisition adjustments below the line; never included in rates. Board staff was unable to recall any recent requests for acquisition adjustments by water companies.</p> <p><i>Joint Petition of Young’s Cable TV Corp. and Okemo Vue, Inc.</i>, 1986 WL 361091 (Vt. P.S.B. May 26, 1986) (“the Board policy on rate-base acquisition adjustments is that permitted earnings on rate-base investment are limited to the depreciated cost of utility property when first placed into service, and that an upward rate base adjustment will not be permitted when ownership of the assets is directly or indirectly at a price in excess of their depreciated original cost.”)</p>
<p>Virginia</p>	<p><i>Re Virginia Natural Gas, Inc.</i>, 250 P.U.R.4th 421 (2006) (“An acquisition adjustment is allowed only in extraordinary circumstances and may be authorized if the applicant utility satisfies certain criteria . . . (i) the purchase price was determined in an arms-length bargaining and (ii) the purchase was an investment made prudently for the benefit of the customers and the utility.”).</p>
<p>Washington</p>	<p><i>Washington Util. and Transp. Comm’n v. PacifiCorp</i>, 2006 WL 1517095 (Wash U.T.C. Apr. 17, 2006) (“When a utility purchases a plant, it may seek an acquisition premium adjustment to reflect that the price paid for the plant may be higher than its book value. However, the cost of the premium is not included in rate base unless the Commission allows such treatment after finding the underlying plant purchase was prudent.”).</p> <p><i>In the Matter of the Application of Herman Suess Applicant, For the Sale and Transfer of Assets to Pattison Water Co.</i>, 2005 WL 2660173 (Wash. U.T.C. June 15, 2005) (Staff advised applicant that “absent a showing of commensurate benefits, acquisition adjustments are not included in rate base for inclusion in rates.”).</p>

<p>West Virginia</p>	<p>No general policy has been established for dealing with water company acquisition adjustments. Acquisition adjustments are often not allowed.</p> <p><i>Re West Virginia-American Water Co.</i>, 231 P.U.R.4th 423 (W. Va. P.S.C. Jan. 2, 2004) (ordered negative acquisition adjustment to rate base).</p> <p><i>West Virginia-American Water Co. and East Bank Water Dep't., Case No. 00-1719-W-PC (W. Va. P.S.C. Feb. 6, 2001)</i> (ordered acquiring company to record the book cost of assets, and “[a]ny amount paid in excess of the net book value of the acquired assets, as adjusted, should be recorded in [the acquisition adjustment account] and be amortized over 20 years. Any amount of asset book value in excess of the amount paid will be considered as a contribution. Lastly, any necessary rate recognition relating to this acquisition will be given the appropriate treatment in the [next rate case].”).</p>
<p>Wisconsin</p>	<p><i>Joint Application for Approvals Related to Wisconsin Power and Light Company's Sale of its Beloit Area Water Utility Assets to the City of Beloit</i>, 2003 WL 22220326 (Wis. P.U.C. Sept. 19, 2003)(after finding sufficient benefits to customers, allowed city to recover in customer rates a straight-line amortization of acquisition adjustment over 25 years and a return on the unamortized balance).</p> <p><i>Preliminary Agreement of the Village of Footville, Rock County, as an Electric Public Utility, to Sell Its Electric Public Utility Plant to Wisconsin Power and Light Company</i>, Dockets 2040-EA-100, 6680-EB-103 (Wis. P.U.C. Feb. 24, 1989)(As a general matter, a utility must provide some substantial physical or electrical benefit to the purchaser's system in order to be exempted from the ordinary rule that utility customers pay no more than net book value. Redistribution of costs or spreading costs over more customers is not a system benefit in and of itself).</p>
<p>Wyoming</p>	<p>No general policy has been established for dealing with water company acquisition adjustments. Commission staff was unable to recall any requests for acquisition adjustments by water companies. Requests would be reviewed on a case-by-case basis.</p>

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January 20, 2010

Florida Public Service Commission
Division of Regulatory Analysis
Attn: Greg Shafer
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0852

Via email: gshafer@psc.state.fl.us

Re: Acquisition Adjustment Workshop Regarding rule 25-30.0371

Dear Mr. Shafer:

This is written in response to the Commission notice as to the workshop referenced herein. The purpose of said workshop is to discuss the Commission's policy on water and wastewater acquisition adjustments as set forth in rule 25-30.0371, Florida Administrative Code.

Ni America ("Ni"), through its utility Ni Florida LLC, has acquired utilities in Florida in recent years and is actively pursuing other utilities. As such, the workshop topic has directly impacted Ni in its efforts to acquire and consolidate certain utility operations.

We respectfully submit the attached comments pertaining to Questions to Comment as presented in Attachment Three of the Notice of Workshop. We welcome the opportunity to visit with Commission Staff where appropriate.

If you have questions or comments, please contact either Rick Melcher (rmelcher@niamerica.com) or me (mashfield@niamerica.com). Ni appreciates the Commission's desire to review this existing rule.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael J. Ashfield".

Michael J. Ashfield
VP Acquisitions

Attachment

cc: Rick Melcher, Ni America
Marsha Rule, Rutledge, Ecenia & Purnell, P.A

10913 Metronome • Houston, Texas 77043
(713) 574-5952 • Fax: (713) 647-0277

Ni America's Responses to Questions for Comment

1. We are not aware of the specific number of distressed IOUs under Commission jurisdiction, but are well aware that there are distressed systems in Florida whose physical and financial condition negatively affects the quality of service to their customers. As such, the customers would benefit greatly from the acquisition of a larger or more financially sound utility company that could provide the investment necessary to improve and manage such systems. We would welcome the opportunity to meet with Commission Staff to discuss how certain systems could be packaged together so that necessary capital costs could be planned and factored into rates so that the utility could still receive its expected ROI.
2. The current Commission adjustment rule impedes certain acquisitions of older systems primarily. The reason being is that rate base has been depreciated and therefore the ROI on the depreciated rate base is not sufficient, or does not correlate, with the utility's actual market value (determined by either cash flow projections, replacement cost studies, or comparable sales). When this occurs, the acquiring utility is not as incentivized to make capital improvements to the system.
3. The number of IOUs available for acquisition has definitely been negatively affected by the Commission's current acquisition adjustment rule, as has our company's willingness to acquire distressed systems.
4. Current market for acquisitions: While there are systems available for acquisition, there is a disconnect between the two parties (Buyer/Seller) and the Commission as to market value of a utility. Mid to large sized utility companies are in the market for IOU acquisitions so that economies of scale can be achieved ultimately providing for better management and service to its customers. Larger utilities are only incentivized to acquire a system if the proposed acquisition is not dilutive to its shareholders. As to capital, it is definitely tighter today than it was just five years ago. Nonetheless, the utility business historically had been relatively stable and predictable so financial institutions remain open to invest in states with sound regulatory policy that adequately protects the financial health of the utility.
5. The customers have been negatively impacted by the Commission's acquisitions adjustment rule; the rule limits the desirability of acquiring and improving utility systems whose owners who are unwilling or unable to invest the necessary capital and resources into utility plant to better serve their customers. Those customers therefore are denied the improved facilities and service that would result from an acquisition.

6. Additional comments:

- The Commission should consider permitting the use of original cost studies for purposes of establishing rate base in some transfer situations - for instance, where the Seller of utility does not have sufficient records to support rate base - preferably before the parties "sign off" on the agreed rate base for Approval of Transfer. This process would encourage larger utilities to consider potential acquisitions of distressed utilities; additionally, this could promote open conversation between the Commission and the larger utilities as to formulating plans for desired consolidation.

- In situations where a rate case is needed and required within the first year of acquisition, but Seller does not have sufficient records for the period under its ownership, the Commission should permit use of normalized (Buyer's results projected out for a complete 12 months) income statement figures or accept projections that can later be substantiated if so desired. This process would help facilitate the acquisition of systems as a larger utility would then be able to achieve the cash flow necessary to justify taking over the operations and capital improvement needs of the utility, whether it is distressed or not.

Holland & Knight

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January 21, 2010

VIA E-MAIL

Mr. Greg Shafer
Division of Regulatory Analysis
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0852

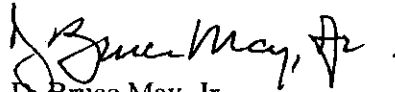
Re: *In re: Acquisition Adjustment Workshop Regarding Rule 25-30.0371, Florida
Administrative Code, Undocketed*

Dear Mr. Shafer:

Attached are Aqua Utilities Florida, Inc.'s pre-workshop comments concerning the undocketed matter referenced above.

Sincerely,

HOLLAND & KNIGHT LLP


D. Bruce May, Jr.

DBM:kjg
Enclosure

cc: Kimberly A. Joyce
William T. Rendell

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Abu Dhabi | Beijing | Caracas* | Mexico City | Tel Aviv*

* Representative Office

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Acquisition Adjustment Workshop
Regarding Rule 25-30.0371, Florida
Administrative Code

UNDOCKETED

**AQUA UTILITIES FLORIDA, INC.'S
PRE-WORKSHOP COMMENTS**

Aqua Utilities Florida, Inc. ("AUF") appreciates the opportunity to provide pre-workshop comments in the above-referenced matter. The Commission's current policy on acquisition adjustments for water and wastewater utilities is articulated in Order No. PSC-02-0997-FOF-WS¹ (the "Final Order") and codified in Florida Administrative Code Rule 25-30.0371 (the "Rule"). In addressing that policy now, AUF believes that certain principles discussed below should be taken into account.

The Commission's current policy on water and wastewater utility acquisition adjustments was developed through extensive rulemaking, and is based on a careful balancing of the interests of all stakeholders.

Prior to issuing the Final Order and adopting the Rule, the Commission conducted a series of formal and informal rulemaking workshops during which it carefully considered numerous comments from all stakeholders, including the Office of Public Counsel, customers, and the water and wastewater industry. That rulemaking process extended over a period of approximately 32 months and culminated in a thoughtful and balanced approach for determining the rate base of purchased utility systems. AUF respectfully submits that information gathered in

¹ *In re: Proposed Rule 25-30.0371, F.A.C., Acquisition Adjustments*, 02 F.P.S.C. 7:326; Docket No. 001502-WS, Order No. PSC-02-0997-FOF-WS (July 23, 2002).

that rulemaking proceeding is relevant today and should be part of any discussion regarding the Commission's existing acquisition adjustment policies.²

The Rule continues to be relevant and serve a valid public purpose today.

The Rule was designed to facilitate acquisitions while providing customers with better water and wastewater quality at reasonable rates.

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.

Final Order at 2 (citing Order No. 25729).

The policy of encouraging well-run utilities to acquire smaller systems is just as valid today as it was when the Rule was first promulgated. Public and private water and wastewater utilities continue to face financial difficulties in meeting the new water and wastewater Environmental Protection Agency ("EPA") standards. In its February 2009 study, the EPA recommends that over \$330 Billion dollars in infrastructure improvements are necessary over the next 20 years for water utilities. AUF believes that it will be increasingly difficult for smaller utilities to fund these necessary infrastructure improvements.

² AUF also would respectfully refer the Commission to the white paper it published in February, 2001, entitled, "Refocusing on the Commission's Acquisition Policy Regarding Water and Wastewater Utilities."

The Commission's current acquisition policy was designed to benefit customers.

As mentioned on the preceding page, the Commission's existing acquisition adjustment policy was specifically designed with ratepayers in mind. In addition, the Commission has made it clear that the Rule is designed to dissuade a purchasing utility from seeking a rate increase when the purchase price is significantly below the acquired utility's net book value.

Paragraph (3)(b)[of the Rule] outlines our treatment when the purchase price is less than 80 percent of net book value . It requires that the amount that exceeds 20 percent of the net book value will be recognized for ratemaking purposes as a negative acquisition adjustment as an incentive for the utility not to file for a rate increase. The paragraph also establishes an amortization period for the acquisition adjustment of five years. If the utility does not file for a rate increase that will be effective during the amortization period, then the negative acquisition adjustment is not booked to recognize for any review of earnings. If the utility does file for a rate increase that will be effective during the amortization period, the unamortized negative acquisition adjustment is booked and used to test the earnings level and the need for a rate increase. The 20 percent that was not booked has a negative acquisition adjustment would not be recognized.

Final Order at 4. The Commission summarized the Rule's customer-oriented provisions as follows:

We are modifying our existing policy to provide an incentive for a purchasing utility to refrain from filing a rate case for a five-year period subsequent to the purchase. In addition, the rule also provides an incentive for a utility to obtain the lowest price possible when negotiating a purchase price lower than book value. We believe that codification of this rule will reduce costs in future proceedings by diminishing some of the controversy over acquisition adjustments and expediting transfer or rate case proceeding.

Final Order at 3. AUF believes that the Commission's approach to acquisition adjustments carefully balances the need to encourage utilities to acquire smaller utility systems with the customer's need for reasonable rates.

The Commission's policy is consistent with directives from the Florida Legislature.

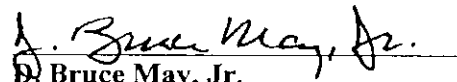
It is important to note that, prior to promulgating the Rule, the Commission considered and ultimately determined that an acquisition adjustment policy that

encouraged larger well-run utilities to acquire smaller systems was entirely consistent with the directives of the Florida Legislature. See page 11 of Staff Recommendation dated August 23, 2001 in Docket No. 001502-WS (" . . . the Legislature already directed the Commission to encourage consolidation and the acquisition of small utilities when it enacted certain policy changes following its 1989 Sunset Review of Chapter 367, Florida Statutes.").

* * *

AUF is hopeful that the Commission will find the foregoing comments constructive and useful. AUF appreciates the opportunity to participate in this process.

Respectfully submitted this 21st day of January, 2010.


D. Bruce May, Jr.

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-and-

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Attorneys for Aqua Utilities Florida, Inc.

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Acquisition Adjustment Workshop

Florida Public Service Commission
Staff Presentation
01/27/2010

1

I. Introduction and Definitions

2

Simple Explanation

An acquisition adjustment is the difference between the calculated "net book" value of a utility system and what the purchaser actually pays for it.

3

Technical Definition

An acquisition adjustment is the difference between the purchase price of utility system assets to an acquiring utility and the original cost of the utility system assets when first placed in public service less accumulated depreciation and contributions in aid of construction net of amortization.

4

Net Book Value

Net book value is an asset's original price minus depreciation and amortization.

A Company with \$100,000 of utility plant in service with a physical life of 10 years has a net book value of \$100,000 minus \$10,000 per year (depreciation).

5

Types of Acquisition Adjustments

- A Positive Acquisition Adjustment may occur when a utility purchases a system at a premium, or pays *more* than the net book value
- A Negative Acquisition Adjustment may occur when a utility purchases a system for *less* than the net book value

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II. Background

7

PSC Jurisdiction

- The PSC regulates 153 investor-owned water and wastewater utilities
- The systems are divided into A, B, and C classes:
 - Class A systems have annual revenues > \$1 million
 - Class B systems have annual revenues > \$200,000 but ≤ \$1 million
 - Class C systems have annual revenues of ≤ \$200,000
- The majority of the utilities the PSC regulates are Class C systems
- The largest company is Aqua Utilities Florida, Inc. with annual revenue of \$10,055,461
- Many systems have only a few hundred customers and annual revenues of \$50,000 or less
- The PSC has authority over a small percentage of the water and wastewater customers in Florida, most are served by government owned utilities

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- 1920s & 30s - Abusive purchasing tactics caused the regulatory framework to shift from setting rates based on purchase price to basing rates on the utilities' actual value
- 1983 - FPSC stated the policy that there will be no acquisition adjustment, either negative or positive, absent a showing of extraordinary circumstances
- 1989 - The Office of Public Counsel (OPC) filed a petition to initiate rulemaking or investigation on the PSC's acquisition adjustment policy
- 1992 - Commission approved staff's recommendation to make no change to the acquisition adjustment policy in Order No. 25729

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Wedgefield Acquisition of Econ

- In February 1996, Wedgefield Utilities, Inc filed an application to acquire Econ Utilities Corporation Docket No. 960283-WS
- Wedgefield, a subsidiary of Utilities, Inc., specializes in ownership and operation of small systems
- Wedgefield purchased Econ for \$545,000 and at that time, Econ's assets had a net book value of \$2,930,836
- In October of 1996, the Commission approved the transfer and set rate base for the utility

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Wedgefield Acquisition of Econ Utilities

- The transfer was protested by OPC and a hearing was held to determine rate base
- Customers cited poor water quality, inconsistent service, and comparatively large bills as reasons the purchase price, rather than the net book value should be used for rate base
- There was disagreement on the status of Econ's facilities and whether it qualified as a "troubled" system
- The negative acquisition adjustment was denied, but the case caused the Commission to reevaluate the acquisition adjustment policy

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Acquisition Environment

- Small water and wastewater systems experienced increased strain resulting from:
 1. Aging utility infrastructure
 2. Increasingly stringent water quality standards resulting from the Safe Drinking Water Act (1986) and Florida's Department of Environmental Protection
- As the Commission attempted to balance the need for acquisition incentives with sensitivity to rate impacts results became less predictable

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Transfers Before the Rule was Enacted in 2002

In the time period between 1986 and 2000:

- There were 113 total transfers
 - Four positive acquisition adjustments were approved
 - Four negative acquisition adjustments were approved
- The positive acquisition adjustments ranged from \$1,966 to \$266,423
- The negative acquisition adjustments ranged from \$2,663 to \$497,831

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III. Acquisition Adjustment Rule

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Rule Development

- May 1999 - At Internal Affairs the Commissioners directed staff to proceed with the rulemaking process to codify the existing policy
- May 1999 - Staff proposed a draft rule reflecting current policy and an alternative rule based on input from various parties
- May 1999 - Dec. 2001 - Staff and the parties continued to refine the alternative proposed rule through a series of workshops, negotiations, and agendas
- May 2002 - The proposed rule was approved by the Commission and a Notice of Rulemaking was released

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Transfers After the Rule Became Effective

Between 2002 and 2009 there were:

- 6 Negative acquisition adjustments
- 15 Denied or not requested positive acquisition adjustments
- 11 Transfers where rate base was equal to purchase price or rate base was not established
- The negative acquisition adjustments ranged from \$12,567 to \$351,387
- There were two negative acquisition adjustments where the purchase price was more than 80% of rate base, so no adjustment was made

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General Purpose

The acquisition adjustment rule (F.A.C. 25-30.0371) is designed to:

- Encourage the purchase of smaller, often troubled systems by larger, more established utilities
- Keep rate increases to a minimum
- Diminish some of the controversy over acquisition adjustments and expedite transfer or rate case proceedings (Order No. PSC-02-0997-FOF-WS)

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Positive Acquisition Adjustments

- The policy on positive acquisition adjustments was left virtually unchanged, but formalized: A positive acquisition adjustment shall not be included in rate base absent extraordinary circumstances.
- The company or entity that believes it should receive the adjustment has the burden to prove the existence of "extraordinary circumstances"
- Examples of extraordinary circumstances include commitment to improve quality of service and compliance with regulatory mandates, potential rate reductions, and cost efficiencies

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Negative Acquisition Adjustments

- A negative acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances *or where the purchase price is less than 80% of net book value.*
- Paragraph 3b requires that the amount that exceeds 20% of net book value be recognized for ratemaking purposes as a negative acquisition adjustment as an incentive for the utility not to file for a rate case
- The negative acquisition adjustment is amortized over a 5 year period
- If the utility does not file for a rate increase that will be effective during the amortization period, then the negative acquisition adjustment is not booked or recognized in review of earnings

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Reasons to Encourage Small System Acquisitions

- Large utilities can achieve economies of scale
- Large utilities have easier access to capital at more favorable terms
- Large utilities may be able to utilize excess capacities in existing facilities in the case of interconnections
- Incorporating smaller utilities into larger ones may be a lower cost option to expanding or rebuilding the smaller system
- Large utilities have greater technical and managerial expertise
- Large utilities can manage and protect water resources more effectively/efficiently

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IV. Example

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Scenario 1

A small retirement community has its own wastewater treatment plant. The owner can no longer afford to maintain it. The net book value is \$100,000, but the system needs upgrades and new equipment, so the owner agrees to sell it to a large water company for \$30,000.

Rate base will immediately reflect the \$30,000 purchase price plus \$20,000, 20% of net book value. The remaining difference, \$50,000, will be recognized as a negative acquisition adjustment for ratemaking purposes and will be amortized over 5 years.

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Sample Amortization Schedule

- Net Book Value = \$100,000
- Purchase Price = \$30,000
- The difference = \$70,000
- The amount of the negative acquisition adjustment not recognized for ratemaking purposes = \$20,000
- Amount of negative acquisition adjustment that is recognized for ratemaking purposes = \$50,000
- \$50,000 amortized over 5 years = \$10,000 per year

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Sample Amortization Schedule

	Net Book Value	Beginning Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5	End of Year 6
Utility Plant in Service	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000	\$190,000
Accumulated Depreciation	(50,000)	(50,000)	(55,100)	(60,200)	(65,300)	(70,400)	(75,500)
CIAC	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)
Accum. Amortization of CIAC	15,000	15,000	16,650	18,300	19,950	21,600	23,250
Negative Acq. Adj.		(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Accum. Amortization of Acq. Adj.		\$0	\$10,000	\$20,000	\$30,000	\$40,000	\$50,000
Rate Base	\$100,000	\$50,000	\$56,550	\$63,100	\$69,650	\$76,200	\$82,750

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Scenario 2

A small retirement community has its own wastewater treatment plant. The developer does not wish to be in the utility business. The net book value is \$500,000, but the developer agrees to sell the system for \$100,000.

Rate base will immediately reflect the \$100,000 purchase price plus \$100,000, 20% of net book value. The remaining difference, \$300,000, will be recognized as a negative acquisition adjustment for ratemaking purposes and will be amortized over 5 years.

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Sample Amortization Schedule

- Net Book Value = \$500,000
- Purchase Price = \$100,000
- The difference = \$400,000
- The amount of the negative acquisition adjustment not recognized for ratemaking purposes = \$100,000
- Amount of negative acquisition adjustment that is recognized for ratemaking purposes = \$300,000
- \$300,000 amortized over 5 years = \$60,000 per year

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Sample Amortization Schedule

	Net Book Value	Beginning Year 1	End of Year 1	End of Year 2	End of Year 3	End of Year 4	End of Year 5
Utility Plant in Service	\$590,000	\$590,000	\$590,000	\$590,000	\$590,000	\$590,000	\$590,000
Accumulated Depreciation	(50,000)	(50,000)	(55,100)	(60,200)	(65,300)	(70,400)	(75,500)
CIAC	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)
Accum. Amortization of CIAC	15,000	15,000	16,650	18,300	19,950	21,600	23,250
Negative Acq. Adj.		(300,000)	(300,000)	(300,000)	(300,000)	(300,000)	(300,000)
Accum. Amortization of Acq. Adj.		0	60,000	120,000	180,000	240,000	300,000
Rate Base	\$500,000	\$200,000	\$256,850	\$313,100	\$369,650	\$426,200	\$482,750

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VI. Acquisition Incentives in Other States

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Pennsylvania

- Positive acquisition adjustments are included in rate base because purchase price is thought to be a "reasonable" estimation of a utilities' value
- The utility must fulfill certain conditions relating to size, service, and rates to get the positive acquisition adjustment
- Absent "matters of substantial public interest" the difference between purchase price and the original cost of the system will be amortized over a "reasonable period of time"

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California

- In 1997 the California legislature passed the Public Water System Investment and Consolidation Act
- The Act establishes "fair market value" as the amount used when determining rate base in the event of a transfer
- Fair market value is the purchase price when the purchase is done without urgency on either the buyer or seller's part
- The Commission must find any positive acquisition adjustment to be "fair and reasonable"

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North Carolina

In 2004, Aqua America Inc. filed with the North Carolina Commission to obtain Heater Utilities, Inc. from Allele Water Services, Inc. Aqua was allowed to realize an \$18 million positive acquisition adjustment on the condition that the funds they gained from the acquisition adjustment be put into a special "Acquisition Adjustment account" and used to purchase and update other small, nonviable water and wastewater systems in North Carolina.