March 4, 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

Aqua Utilities Florida, Inc. ("AUF") offers the following clarifications to its post-workshop comments submitted on February 26, 2010 in the undocketed matter referenced above. More specifically, after reflecting on its post-workshop comments, AUF wishes to make clear its position on the appropriate amortization period for the negative acquisition adjustment addressed in AUF’s Option No. 1 if the Commission decides that changes to Rule 25-30.0371 are necessary.

AUF’s suggested Option No. 1 would only operate where the negotiated purchase price is more than 50% below the net book value of the utility being acquired. Under those unique facts, this option would provide for a sharing of the calculated negative acquisition adjustment amount (i.e., the difference between the purchase price and 80% of net book value). AUF’s post-workshop comments made it clear that 50% of the calculated negative acquisition amount would be immediately recognized on the utility’s books for ratemaking and earning surveillance purposes. However, those comments were silent regarding how that amount would be amortized.

To clarify, AUF respectfully submits that the amount of the shared negative acquisition adjustment should be amortized over the composite remaining life of the assets purchased, which would be consistent with the amortization treatment set forth in subsection (4) of current rule. This suggested amortization is further clarified in subsections (3)(c) and (4) of Revised Option No. 1 (attached). In order to supply further clarification, and for illustrative purposes only, AUF provides the following example:
• **Example:** If the purchase price is less than 50% of net book value, and the calculated amount of the negative acquisition adjustment (the difference between the purchase price and 80% of net book value) is $400,000, then the acquiring utility would immediately recognize half of that amount (i.e., $200,000) as a negative acquisition adjustment for ratemaking and earnings review purposes. Assuming that the remaining life of the purchased assets was 25 years, the negative acquisition adjustment would be reflected on the purchasing utility’s books for 25 years, until fully amortized. Under this example, the appropriate annual amortization amount would be $8,000. Customers would benefit from this recorded negative acquisition amount because the unamortized portion of that amount would be reflected in rates established in future rate cases for 25 years into the future.

AUF appreciates the opportunity to provide this clarification.

Sincerely,

HOLLAND & KNIGHT LLP

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D. Bruce May, Jr.

DBM:kjg
Enclosure

cc: Kimberly A. Joyce
    William T. Rendell
    Cindy Miller
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) or (c) below, depending on the amount of the purchase price.

(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—Purchase Price Less than 80 Percent But More than 50 Percent of Net Book Value. If the purchase price is less than 80 percent but more than 50 percent of net book value, then the amount of the difference between (i) the purchase price, and (ii) in excess of 20 80 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.

(c) Uncontested—Purchase Price Equal to or Less than 50 Percent of Net Book Value. If the purchase price is equal to or less than 50 percent of net book value, then the difference between (i) the purchase price and (ii) 80 percent of net book value, shall be recognized for ratemaking purposes as a negative acquisition adjustment as follows: 50 percent of the negative acquisition adjustment shall be immediately recorded on the books for ratemaking and earnings review purposes and amortized pursuant to (4) below. The remaining 50 percent of the negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings.
REVISED OPTION No. 1

(4) Amortization Period. In setting the amortization period for a Commission approved acquisition adjustment pursuant to (2), (3)(a), or (3)(c) 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.
February 26, 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 post-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
    Cindy Miller
AQUA UTILITIES FLORIDA, INC.'S
POST-WORKSHOP COMMENTS

Aqua Utilities Florida, Inc. ("AUF") appreciates the opportunity to provide post-workshop comments in the above-referenced matter. The Commission's current policy on acquisition adjustments for water and wastewater utilities is clearly articulated in Order No. PSC-02-0997-FOF-WS1 (the "Final Order") and codified in Florida Administrative Code Rule 25-30.0371 (the "Rule"). That policy is based on extensive rulemaking proceedings that took place over a period of several years and which culminated in the adoption of the Rule. The Rule is the product of thoughtful and thorough analysis that carefully balanced the interests of all stakeholders, including customers and utilities. Thus, before embarking on a path that could alter the existing Rule, AUF respectfully suggests that the Commission first consider the fundamental principals on which the existing Rule is based, and the consequences (both intended and unintended) of displacing those principals with something new and untested. In addition, the Commission should carefully consider whether it has the requisite statutory authority to alter its long-standing acquisition adjustment policy. If, at the conclusion of that analysis, the Commission is inclined to propose a change to the Rule, AUF would respectfully suggest that such change be narrowly crafted to address specific concerns so as to leave the Rule's fundamental purpose and structure of the Rule intact. AUF's more detailed comments and proposals are set forth below.

The Existing Rule was Developed Through Extensive Rulemaking Proceedings that Carefully Balanced the Interests of all Stakeholders.

Prior to issuing the Final Order and adopting the Rule, the Commission conducted a series of informal and formal rulemaking proceedings during which it carefully considered numerous comments from all stakeholders, including the Office of Public Counsel ("OPC") 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. As AUF representatives stated at the January 27th workshop, the information gathered in that rulemaking proceeding is relevant today and should be part of any consideration regarding potential changes to the Commission's existing acquisition adjustment policies.²

The Fundamental Purpose of the Rule is to Encourage Well Run Utilities to Acquire Smaller Systems.

The Commission has made it very clear that the Rule is designed to encourage acquisitions by well run utilities while providing customers with better water and wastewater service 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*

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."
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. Indeed, discussions at the January 27th workshop showed that smaller systems continue to struggle in today's fragile economy and, in the case of developer-owned systems, general disinterest in utility operations continues to present risks to customers, the industry, and regulators.

The Commission's Current Acquisition Policy was Designed to Benefit Customers.

The Commission's existing acquisition adjustment policy was specifically designed with ratepayers in mind. The Final Order explains that the Rule is structured 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, cost-saving 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 Rule Is Consistent With The Florida Legislature's Directives.**

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.").
Concerns Expressed At the January 27th Workshop can be Addressed Under the Existing Rule.

Most of the comments at the January 27th workshop recognized that the Rule was a good policy and advanced legitimate interests by encouraging the acquisition of small utilities by larger well-run utilities, and by diminishing controversies in acquisition proceedings thus reducing legal and administrative costs to customers and companies. However, some limited concerns were expressed that rigid application of the Rule in certain unique circumstances could produce anomalous results. More specifically, some commissioners' expressed the concern that the Rule could award a "windfall" to an acquiring utility that was able to negotiate a purchase price that was approximately 80% below net book value of the acquired utility, and that the Rule "tied their hands" from addressing this anomaly.

As indicated above, AUF believes that the existing Rule has worked well and served its intended purposes of encouraging well-run utilities to purchase smaller systems and reducing costs. If, however, the Commission believes that it does not have the flexibility under the existing Rule to address the anomalous situation described above, AUF respectfully suggests that the Commission consider the following options. These options are narrow in scope and address only the concerns expressed at the January 27th workshop without eviscerating the basic structure of the Rule and unnecessarily raising the specter of lack of statutory authority.

OPTION No. 1

Option No. 1, which is attached as Exhibit "1", is designed to address specific concerns expressed at the January 27th workshop where the negotiated purchase price is more than 50% below the net book value of the utility being acquired. If that unique fact
pattern were to occur, this option would provide for a sharing of the calculated negative acquisition amount (i.e., the difference between the purchase price and 80 percent of net book value). This "sharing" approach would be structurally similar to the comments made by Commissioner Skop at the January 27th workshop as well as the post workshop comments dated April 2, 2001, which OPC distributed at the January 27th workshop.\footnote{Indeed, OPC's 2001 comments state that the concept of sharing of negative acquisition adjustments presents a "win-win" proposition, and provides other benefits to both the utility and customers by making subsequent cases less contentious and less costly. See OPC 2001 Comments, pp. 3-4.} Under this option, at the time the Commission approves the transfer, 50% of the calculated negative acquisition amount would be immediately recognized on the utility's books for ratemaking and earnings surveillance purposes.

**OPTION No. 2**

Option No. 2, which is attached as Exhibit "2", is also designed to address the anomalous situation where the negotiated purchase price is more than 50% below the net book value of the acquired utility. If that unique fact pattern were to arise, this option would extend the amortization period from five years to seven years. By extending the amortization period, a greater portion of the negative acquisition amount would be recognized in rates thus further deterring the acquiring utility from coming in for a rate case. Importantly, in the previous rulemaking proceedings, all of the stakeholders, including OPC, discussed the length of time over which the negative acquisition adjustment should be amortized. In its comments, OPC stated that extending the amortization period to a term of "six to ten years" would be an improvement to the Commission's policy and would provide greater rate stability to customers. See OPC's 2001 Comments, pp. 4-5. While a limited extension of the amortization period may be appropriate, AUF believes that extending the amortization period to ten years, or more,
would eviscerate any incentive for a well-run utility to acquire smaller systems, and thus countermand the basic policy and statutory authority upon which the Rule is based. See Final Order at 2. For that reason, AUF has suggested that the amortization period could be extended to seven years.

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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 26th day of February, 2010.

[Signature]

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Attorneys for Aqua Utilities Florida, Inc.
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) or (c) below, depending on the amount of the purchase price.

(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 - Purchase Price Less than 80 Percent But More than 50 Percent of Net Book Value. If the purchase price is less than 80 percent but more than 50 percent of net book value, then the amount of the difference between (i) the purchase price, and (ii) 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.

(c) Uncontested - Purchase Price Equal to or Less than 50 Percent of Net Book Value. If the purchase price is equal to or less than 50 percent of net book value, then the difference between (i) the purchase price and (ii) 80 percent of net book value, shall be recognized for ratemaking purposes as a negative acquisition adjustment as follows: 50 percent of the negative acquisition adjustment shall be immediately recorded on the books for ratemaking and earnings review purposes. The remaining 50 percent of the negative acquisition adjustment shall not be recorded on the books for ratemaking purposes or used for any earnings.

(4) Amortization Period. In setting the amortization period for a Commission approved
OPTION No. 1

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.
OPTION No. 2

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) or (c) below, depending on the amount of the purchase price.

(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: – Purchase Price Less than 80 Percent But More than 50 Percent of Net Book Value. If the purchase price is less than 80 percent but more than 50 percent of net book value, then the amount of the difference between (i) the purchase price, and (ii) in excess of 20 80 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.

(c) Uncontested-Purchase Price Equal to or Less than 50 Percent of Net Book Value. If the purchase price is equal to or less than 50 percent of net book value, then the difference between (i) the purchase price and (ii) 80 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
OPTION No. 2

367.0822, F.S., that will be effective during the amortization period. The negative acquisition adjustment shall be amortized over a 7-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.