BUTLER

May 31, 2013

VIA ELECTRONICALLY

Hon. James Allison, Chairman
c/o Sharla Dillon
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243-0505

RE: Joint Petition of Tennessee-American Water Company, the City of Whitwell, Tennessee, and the Town of Powells Crossroads, Tennessee, for Approval of a Purchase Agreement and a Water Franchise Agreement and for the Issuance of a Certificate of Convenience and Necessity, TRA Docket No. 12-00157

Dear Chairman Allison:

Enclosed for filing please find the *Post-Hearing Reply Brief of Tennessee-American Water Company* in the above-captioned matter.

As required, an original of this filing, along with four (4) hard copies, will follow. Should you have any questions concerning this filing, or require additional information, please do not hesitate to let me know.

Very truly yours,

BUTLER, SNOW, O'MARA, STEVENS & CANNADA, PLLC

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Attachment
cc: Parties of Record

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BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

JOINT PETITION OF TENNESSEE-AMERICAN WATER COMPANY, THE CITY OF WHITWELL, TENNESSEE, AND THE TOWN OF POWELLS CROSSROADS, TENNESSEE, FOR APPROVAL OF A PURCHASE AGREEMENT AND A WATER FRANCHISE AGREEMENT AND FOR THE ISSUANCE OF A CERTIFICATE OF CONVENIENCE AND NECESSITY	)	**DOCKET NO. 12-00157**

POST-HEARING REPLY BRIEF OF TENNESSEE-AMERICAN WATER COMPANY

Pursuant to the Procedural Schedule established by the Tennessee Regulatory Authority ("TRA" or "Authority") in this matter, Tennessee-American Water Company ("TAWC") respectfully submits its Post-Hearing Reply Brief.[1]

I. ARGUMENTS

As demonstrated below, a thoughtful review and detailed consideration of the Post-Hearing Brief of the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate" or "CAPD") clearly reveals that most of the CAPD's arguments are simply unsupported by the evidentiary record. No matter the good faith effort or the well-

[1] To ease the administrative burden upon the Authority and to comply with the 15-page limit on the reply briefs, TAWC incorporates by reference, as if set forth fully herein, its previously submitted support and arguments in this case. To the extent TAWC does not address an item set forth in the *Consumer Advocates' Post-Hearing Brief*, it is because TAWC has concluded that the record is sufficiently clear for the Authority to resolve the item in favor of TAWC.

intentioned nature with which they are made, arguments not supported by the evidentiary record must fail.[2]

A. The Consumer Advocate's assertion that the City of Whitwell is uninformed is not supported by the evidentiary record.

In its Post-Hearing Brief, the Consumer Advocate claims that the City of Whitwell ("Whitwell") "was only informed that their rates would not change and was not informed of the impact on rates that the accounting and ratemaking requests . . . will have[.]"[3] The evidentiary record, however, simply does not support the Consumer Advocate's assertion.

First, among other things, Mayor Easterly testified that she is aware of the leaks in Whitwell's Water System (the "System"), that she is aware of TAWC's estimated capital expenditures, that she is aware of TAWC's proposed comprehensive planning study, and that she is aware of the proposed Dunlap connection.[4] In fact, Mayor Easterly testified that she understood that if TAWC's proposal for the Dunlap connection moves forward that it could have an impact on the rates of the System's customers.[5]

When asked if anyone had talked with her *or the commissioners* about how TAWC's estimated capital expenditures might affect the future rates of Whitwell's customer's, Mayor

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[2] Arguably, the *Consumer Advocate's Post-Hearing Brief* contains a host of statements that are neither legal arguments nor part of the evidentiary record. Rather than burdening the Authority with a well-grounded motion to strike, TAWC will rely, to the extent applicable, on the Authority's adherence to its previous orders in this docket and the UAPA. *See, e.g., Hearing Officer's Order Denying Consumer Advocate's Motion to Compel Discovery and Granting, in part, and Denying, in part, Consumer Advocate's Motion to Reconsider Procedural Schedule and Entering Amended Procedural Schedule*, TRA Docket No. 12-00157, p. 12 (April 30, 2013) (Hearing Officer quoting the Consumer Advocate: "The briefs are the work product of attorneys' legal analysis of applying law to facts *in the record*."), and p. 15 (Hearing Officer's Findings & Conclusions: "It also seems apparent to the Hearing Officer that the briefs that the Consumer Advocate wishes to file are not in the nature of legal briefs, exclusively, but are more akin to post-hearing briefs, in which it is appropriate to include both factual and legal arguments *on the evidence*.") (emphasis added); and Tenn. Code Ann. §4-5-314(d) ("Findings of fact shall be based exclusively upon the evidence of record in the adjudicative proceeding[.]").

[3] *Consumer Advocate's Post-Hearing Brief*, TRA Docket No. 12-00157, p. 14 (May 24, 2013).

[4] *Hearing Transcript Vol. I*, p. 80, LL 6 - 20 (May 6, 2013) (Testimony of Whitwell Mayor Cindy Easterly) (hereinafter "*Tr. Vol. I*").

[5] *Id.* at 82 – 83.

Easterly responded that they had not talked *with her*.[6] It is noteworthy, however, that she did not say that they had not talked to the other commissioners. The reason for her response is simple; the primary discussions occurred before her election to the commission.[7] Hence, though Mayor Easterly knows more than the Consumer Advocate gives her credit for knowing, she testified that others were involved and likely had more information than she did.

Second, Mayor Easterly testified that numerous meetings and discussions occurred between TAWC and *representatives* of Whitwell, including Whitwell's *attorney(s)*.[8] So, despite the Consumer Advocate's pure speculation to the contrary, according to the evidentiary record, there were more individuals involved in the negotiations on behalf of Whitwell than just the mayor. While it is certainly not novel for a city to have its mayor as its leading spoke-person in a hearing of this type, it is perfectly normal for Mayor Easterly not to be intimately familiar with each and every substantive detail of the acquisition that were delegated to others better suited to such roles. For example, though Deron Allen is President of TAWC, and thus intimately familiar with the operations of the company, there are certain aspects of the company's operations delegated to others for a host of reasons.[9]

Third, in explaining the parties' rationale for mutually settling on the preferred approach for determining the purchase price, Mr. Bickerton clearly testified that certain representatives of Whitwell were well aware of the accounting and ratemaking treatment sought by TAWC.[10] Moreover, Mr. Bickerton further testified as follows:

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[6] *Id.* at 81, LL 1 – 14 (emphasis added).
[7] *Id.*
[8] *Pre-Filed Direct Testimony of Mayor Cindy Easterly*, TRA Docket No. 12-00157, p. 3, LL 66-68 (April 22, 2013) (adopting the Pre-Filed Direct Testimony of Mayor Steve Hudson) (emphasis added). *See also Pre-Filed Direct Testimony of Crossroads Mayor Ralph Chapin*, TRA Docket No. 12-00157, p. 2, LL 53-55 (Dec. 27, 2012) (emphasis added).
[9] *Tr. Vol. I* at 11 – 56 (Testimony of TAWC Witness Deron Allen).
[10] *Id.* at 95 – 96 (Testimony of Bickerton).

> During the work session we explained to the commissioners - - and I should add that the city manager and city recorder were also in attendance at that meeting as well. We did explain to them our plan for capital investment . . . We did - - also explained to them that, you know, in all likelihood there would be a rate impact at some point.[11]

Therefore, the Consumer Advocate is just plain wrong in loosely claiming that "the only mention of rates is that they would remain the same at closing."[12] This simply is not true.

Next, in responding to cross-examination from the Consumer Advocate, Mr. Bickerton talked about a single meeting – the June work session.[13] Given the substantial amount of time that Mr. Bickerton was subject to cross-examination, the Consumer Advocate could easily have explored the nature and content of the other meetings and discussions between TAWC and Whitwell. But, the Consumer Advocate chose not to do so. It certainly does not follow, as the Consumer Advocate asks the Authority to accept, that this was the only meeting in which the parties discussed substantive issues related to the acquisition. Again, the evidentiary record just does not support this limited construction of the events.

Fifth, the Consumer Advocate contends that "[t]here is no evidence in the record to indicate that Whitwell's commissioners or its citizens have an understanding of what 'rate base' is, must less understand how it could impact rates."[14] Suffice it to say, the evidentiary record clearly reveals that Whitwell had representatives participate in the negotiations on its behalf.[15]

Next, ignoring the whole of the record, the Consumer Advocate maintains that "Whitwell confirmed there was no discussion of the purchase price."[16] While this may look good on paper, it simply does not reflect the evidentiary record. Taking the above quote in context, the

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[11] *Id.* at 100 – 101.
[12] *Consumer Advocate's Post-Hearing Brief* at 15.
[13] *Tr. Vol. I* at 100, L 15.
[14] *Consumer Advocate's Post-Hearing Brief* at 15.
[15] Additionally, *Hearing Exhibit No. 11*, introduced by the CAPD, provides as follows: "For purposes of this transaction rate base equals utility plant in service less accumulated depreciation less unamortized contributions in aid of construction."
[16] *Id.* at 15.

Consumer Advocate asked Mayor Easterly to review *Hearing Exhibit No. 10* and to determine whether *Hearing Exhibit No. 10* noted any discussions of the purchase price at the three readings of the Ordinance authorizing the Asset Purchase Agreement ("Purchase Agreement") before Whitwell's Board of Commissioners.[17] To single out this quote without context is, at the least, misleading. As noted earlier herein, and as supported by the evidentiary record, there were many meetings and discussions between Whitwell and TAWC related to the acquisition.

Seventh, the Purchase Agreement clearly makes certain accounting and ratemaking approvals conditions precedent to closing.[18] Also, the *Joint Petition* evidences that Whitwell and TAWC were represented by separate counsel.

Finally, while the Consumer Advocate may have approached the acquisition, and the accompanying negotiations, differently than Whitwell, that in and of itself does not render Whitwell's approach uninformed. According to the evidentiary record, the Consumer Advocate's claim that Whitwell is uninformed is simply not true.

B. The Consumer Advocate's "notice" argument is without merit.

The Consumer Advocate maintains that "there is no evidence to suggest discussions and disclosures made during the negotiations were adequate notice for ratepayers in setting rates."[19] Again, though it conducted extensive cross-examination at the hearing, the Consumer Advocate chose not to ask either how many meetings and discussions occurred between TAWC and Whitwell or the nature and content of those additional meetings and discussions. It certainly does not follow from the Consumer Advocate's failure to ask such questions that no such meetings or discussions took place.

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[17] *Tr. Vol. I* at 84, LL 1 – 7.
[18] *See Joint Petition, Exhibit A*, pp. 12 – 13.
[19] *Consumer Advocate's Post-Hearing Brief* at 15.

For instance, Mayor Easterly testified that there were a number of other meetings in addition to the June work session and the formal voting meetings (i.e. the three readings).[20] Additionally, Mr. Bickerton, speaking of a formal presentation made by TAWC in August, after the June work session, testified that various information related to the acquisition was made available to anyone at that meeting.[21] He also testified that such information was available at the three meetings in which the formal readings occurred.[22]

In support of its position, it appears that the Consumer Advocate is attempting to somehow re-cast the *Joint Petition* as a "petition for revision of rates," and, as such, claim that the *Joint Petition*, as submitted, compromises the ratepayers' due process with respect to "rate-setting."[23] Yet again, the Consumer Advocate's position is simply not supported by the evidentiary record. Should the TRA approve the *Joint Petition*, the evidentiary record clearly reflects that TAWC has committed to apply Whitwell's current rates.[24] Further, it is also clear that any subsequent increase in the rates for customers served by the System will have to undergo the scrutiny of the TRA and comply with the statutory notice requirements applicable to rate cases.[25]

The evidentiary record reveals that the discussions and negotiations between TAWC and Whitwell began in early 2011 with Mayor Hudson and the City Manager, Charles Tucker, and continued for an extended period of time,[26] which provided a fair amount of time for anyone that wished to engage in discourse on the potential sale — for or against — or gain more information to do so. Despite the Consumer Advocate's contention here, TAWC notes that the Authority is

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[20] *Tr. Vol. I* at 89, LL 13 – 18. *See also Pre-Filed Direct Testimony of Mayor Easterly* at 3, LL 66 – 68.
[21] *Tr. Vol. I* at 94, LL 21 – 25. *See also Hearing Exhibit No. 11.*
[22] *Id.* at 95, LL 1 – 4.
[23] *Consumer Advocate's Post Hearing Brief* at 3 and 10.
[24] *Hearing Transcript. Vol. II*, TRA Docket No. 12-00157, p. 217, LL 17-19 (May 7, 2013) (Testimony of Bickerton) (hereinafter "*Tr. Vol. II*").
[25] *See, e.g., Tr. Vol. I* at 81, LL 15 – 21 (Testimony of Mayor Easterly).
[26] *Id.* at 93, LL 13 – 18.

not here confronted with an allegation by a customer, a Whitwell commissioner or the Consumer Advocate that Whitwell officials did not follow the law in pursuing, negotiating and approving the acquisition.

Finally, pursuant to Tenn. Code Ann. §§ 65-4-107 and 65-4-201, the Authority publicly noticed the hearing in this docket on April 22, 2013. Moreover, at the outset of the May 6, 2013, hearing, the Authority provided the opportunity for public comments.

C. The well-known deficiencies in Whitwell's audited financial statements were considered during the arms-length negotiations process.

The Consumer Advocate argues that "[t]he best way to ensure buyers are motivated to negotiate the lower price is by permitting normal market effects to occur and maintain the integrity of the negotiation process."[27] There is nothing in Mr. Novak's testimony regarding the buyer's motivation, market effects or the integrity, or lack thereof, of the negotiations process. Again, while the Consumer Advocate may have acted differently if it were either the buyer (TAWC) or the seller (Whitwell), such is not relevant here.

Rather than speculating wildly about TAWC's and Whitwell's negotiating process,[28] perhaps it would have better served the Consumer Advocate to have asked specific questions at the hearing about the negotiations process. As is its right, this, the Consumer Advocate chose not to do or not to do sufficiently. The unique opportunity presented in the Joint Petition should not be jeopardized due to the manner in which the CAPD chose to handle this proceeding.

Notwithstanding the assertions of the Consumer Advocate, the evidentiary record reflects that TAWC was well aware of the deficiencies during the evaluation and negotiation processes.[29] Moreover, the record clearly reveals that TAWC evaluated and considered the audited financial

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[27] *Consumer Advocate's Post-Hearing Brief* at 9.
[28] *Id.* at 8 - 9, 17 – 18, 20 – 21, 24 and 27.
[29] *Tr. Vol. I* at 119, L 4 and p. 123, L 2 (Testimony of Bickerton).

statements, including the deficiencies.[30] No matter how many times the CAPD states that TAWC did not appropriately weigh the financial statements, it does not make the claim accurate. In fact, the Consumer Advocate's expert witness, Mr. Novak, presented no testimony to support the CAPD's unsubstantiated assertions.[31]

In support of its contentions with respect to TAWC's shortcomings in adequately valuing the System, the Consumer Advocate asserts that "[a] valuation of assets requires more than just considering original cost."[32] TAWC agrees. The assets are just one component of the transaction and process. Other material factors are involved as well, and, as set forth in the evidentiary record, were considered by TAWC, such as, but not limited to, Whitwell retaining some assets, water quality regulatory compliance, retaining Whitwell employees, adopting Whitwell's current rates, construction in progress, property taxes, increased customer base, proposed removal of the tap fee, customer benefits and capital improvements, just to name a few.[33] Moreover, in addition to reviewing Whitwell's financial statements, records and reports provided by it and its accountants, TAWC, among other things, took full advantage of its ability

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[30] *Id.* at 127, LL 9 – 11 (Testimony of Bickerton).

[31] *See Pre-Filed Testimony of William H. Novak*, TRA Docket No. 12-00157 (April 12, 2013).

[32] *Consumer Advocate's Post-Hearing Brief* at 17. Contrary to the CAPD's arguments, it is axiomatic that every water system is, by its very non-permanent nature, declining at some level each and every day. Hence, every system, no matter how well managed, needs some work. As Mr. Bickerton testified, however, this does not mean that the working and operable assets are not valuable. Although Mayor Easterly testified that infrastructure upgrades and improvements are necessary, this does not mean that the System is, as Mr. Novak concludes, "dilapidated." *Tr. Vol. II* at 244, L 13. Rather, it signifies that like all water systems the System is declining at some level every day and that Whitwell has concluded that it would strain the City of Whitwell going forward to properly maintain the System. *See Pre-Filed Direct Testimony of Mayor Easterly*, Exhibit 1at 2, L 36 ("Whitwell has done an admirable job of managing the System to date[.]"). The foregoing is supported by certain of the hearing exhibits offered by the Consumer Advocate. *See, e.g., Hearing Exhibit Nos. 12 (May 4, 2012 Sanitary Survey) and 13 (April 29, 2011 Sanitary Survey)*, TRA Docket No. 12-00157 ("With this score, the system will remain among Tennessee's APPROVED public water supplies."). *See also, e.g., Consumer Advocate's Post-Hearing Brief* at 33 ("Whitwell does have excessive water loss, but it has shown it is capable of making the repairs necessary to reduce water loss.").

[33] Without any citation to the evidentiary record whatsoever, which appears to be the rule rather than the exception with much of the *Consumer Advocate's Post-Hearing Brief*, the Consumer Advocate asserts that TAWC "exclude[d] any considerations that would reduce such value." *Consumer Advocate Post-Hearing Brief* at 20. *See also, cf., id.* at 26 ("TAWC did not incorporate into the purchase price the condition of the system."). These unsubstantiated assertions simply are not accurate and certainly are not supported by the whole of the evidentiary record. In fact, the Consumer Advocate's expert witness, Mr. Novak, presented no testimony to support the CAPD's unsubstantiated contentions. *See Pre-Filed Testimony of William H. Novak.*

to *actually inspect* the above-ground assets — i.e. plants, tanks, intake structures, booster stations, hydrants, pumps — during the negotiations and valuation processes.[34] A review of the evidentiary record will show that TAWC's testimony that it inspected the System is undisputed.[35] After conducting these inspections, along with other analyzes, including title searches,[36] Mr. Bickerton concluded as follows:

> "So we felt comfortable with the assets that were recorded on their financial statements as being a sound basis for the determination of the base of the purchase price."[37]

Employing his vast experience with acquisitions, this is why Mr. Bickerton rejected several overtures from the Consumer Advocate to characterize the System as a high risk investment.[38] Having inspected the above-ground portion of the System,[39] subsequent to the acquisition TAWC would, consistent with its pre-acquisition and post-acquisition study efforts, begin to move beyond inspection into flow testing, mapping and modeling and other similar planning activities.[40]

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[34] *Tr. Vol. I* at 128, LL 1 – 6 and *Tr. Vol. I* at 122, LL 2 – 5 (Testimony of Bickerton). *See also, e.g., Tr. Vol. I* at 20, LL 20 – 22 (Question from CAPD: "[B]ut have you done any preliminary assessments as to where some of the water losses are? A: We have within reason. . . . We can't really go over and start to dig up streets[.]") (Testimony of Deron Allen).

[35] *Id.* at 122, LL 15 – 16 (Testimony of Bickerton). Further, the record evidences that TAWC had substantial experience in evaluating the System. *Id.* at 93, LL 1 – 12.

[36] *Id.* at 128, L 5.

[37] *Tr. Vol. I* at 122, LL 6 – 9.

[38] *Id.* at 121, LL 21 – 25 and p. 122, LL 1 – 10. *See also Tr. Vol. I* at 134, LL 21 – 23.

[39] The remainder of the System was considered via other means. *See, e.g., Hearing Exhibit No.* 7, TRA Docket No. 12-00157. This exhibit is **CONFIDENTIAL** and was marked **CONFIDENTIAL** and filed **UNDER SEAL**. *See also, e.g., Tr. Vol. I* at 21, LL 3 - 5 (interviews of the System's operators) (Testimony of Allen).

[40] *See, e.g., Hearing Exhibit No.* 7 at 14 – 15. Ignoring the evidentiary record, the CAPD maintains that no inspection has occurred. *See Consumer Advocate's Post-Hearing Brief* at 8 and 25. Mr. Bickerton never testified that he only toured the assets. Mr. Bickerton testified that he "inspected" the assets. *Tr. Vol. I* at 128 ("[W]e did *inspect* the facilities."); and *id.* at 122, L 3 ("We can *examine* tanks, booster stations, treatment plants, intake structures, pumps.") (emphasis added). Mr. Allen may not have inspected and examined the facilities, but Mr. Bickerton did.

undermine the same just by saying that it was not done the way the Consumer Advocate would have done it. Moreover, during cross-examination, the Consumer Advocate did not inquire much, if at all, as to any specific "gives and takes" during the negotiation process. Because the Consumer Advocate chose not to ask sufficient questions in this regard does not make the manner in which the parties negotiated, nor the results reached, improper.[41] In sum, the Consumer Advocate's thinly veiled attempt to establish itself in the position of having perfect knowledge of the various compromises that were necessarily part and parcel of the negotiation process must fail. Anything less renders both the hearing and the evidentiary record meaningless.[42]

D. The 10-year old valuation of the West Valley Water System is simply not relevant and should not be given any weight.

Among other things, TAWC maintained in its Post-Hearing Brief that the 2003 valuation of the West Valley Water System ("West Valley") is outdated and should not be relied upon by the Authority in this proceeding, particularly when coupled with the fact that the portion of the

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[41] Although the Consumer Advocate surprisingly asserts in its Post-Hearing Brief (p. 18) that TAWC did not use historic original costs in the Suck Creek acquisition, TAWC is prohibited from responding as it desires to the related statements and characterizations by the Consumer Advocate with respect to the Suck Creek acquisition, as such response may lead to exceeding the scope of the evidentiary record in this proceeding. Suffice it to say, TAWC stands by Mr. Bickerton's Pre-Filed Rebuttal Testimony that TAWC used historic original costs to record the Suck Creek acquisition. *See Pre-Filed Rebuttal Testimony of Mr. Bickerton*, TRA Docket No. 12-00157, p. 3, LL 65 - 68 (April 19, 2013). *See also TAWC's May 24, 2007, Responses to TRA Staff's Data Requests*, TRA Docket No. 03-00388 (Response to Q1); and *TAWC's July 25, 2003, Responses to TRA Staff's First Data Requests*, TRA Docket No. 03-00388 (Response to Q4, Exhibit 4A and Exhibit 4B, p. 6, Note 1, Item G). Finally, it is noteworthy that when cross-examining Mr. Bickerton with respect to Suck Creek, the CAPD did not ask a single question on whether TAWC applied historical original cost in the Suck Creek acquisition. *See Tr. Vol. II* at 201 – 202.

[42] In its Post-Hearing Brief, the Consumer Advocate states (pp. 10 – 11) that "TAWC has forecasted its O&M expenses and taxes, and its forecasted utility operating income is expected to allow it to over earn beyond its authorized rate of return by at least $200,000." As Mr. Bickerton testified, return on equity is the preferred methodology for determining whether a project is accretive. *Tr. Vol. II* at 196, LL 23 – 25, and p. 197, L 1. Although TAWC does not agree with the methodology employed by the CAPD here, it nonetheless notes that the application of said methodology is flawed. For instance, the CAPD employed a 2-year average of rate base for year one. Further, the CAPD only used Whitwell's rate base components for its year one average rate-base calculation even though the forecast assumes that the acquisition was approved and thus both Whitwell's and TAWC's combined rate base should have been captured. Lastly, the CAPD makes no provision for working capital and deferred tax adjustments. *See, e.g., Hearing Exhibit No. 20*, TRA Docket No. 12-00157.

(Whitwell) System that constituted West Valley as it existed in 2003 is much different today.[43] TAWC will not re-assert the same arguments here.

The Consumer Advocate asks the Authority to rely upon a decade-old valuation absent the accompanying supporting documentation. *Hearing Exhibit No. 14* does not contain several items of supporting documentation relied upon by the engineer in conducting the valuation.[44] The evidentiary record will reflect that during the discovery phase of this proceeding, the Consumer Advocate asked TAWC to produce "supporting documentation" in a number of instances. So, the Consumer Advocate certainly understands the importance of underlying documentation.[45]

In fact, it is somewhat ironic that the Consumer Advocate is asking the Authority to rely upon such incomplete information — a valuation without supporting documentation — because the CAPD has successfully made an argument very similar to that being made now by TAWC. In *Tennessee Consumer Advocate v. Tennessee Regulatory Authority*, 1997 Tenn. App. LEXIS 148 *10,[46] the Consumer Advocate contended, in part, that the Tennessee Public Service Commission, predecessor agency to the Authority, violated its due process rights by denying the CAPD the ability to question, cross-examine, impeach and contradict an independent consultant's report provided to and relied upon by the Commission. Similarly, if the Authority accepts, and we do not think that it will, the Consumer Advocate's invitation to rely upon this

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[43] *TAWC's Post-Hearing Brief*, TRA Docket No. 12-00157, pp. 20 - 23 (May 24, 2013). *See also Tr. Vol. I* at 139, LL 18 – 22 and p. 140, LL 21 – 24 (Mr. Bickerton testifying that there have been improvements to that portion of the (Whitwell) System that was previously West Valley.); and *Tr. Vol. I* at 140, LL 16 – 18 ("This was done ten years ago. I mean, I think if you did an appraisal of these same assets, you're not going to get the same answer today."). Even the CAPD acknowledged that changes have been made. *Consumer Advocate's Post-Hearing Brief* at 33 ("Whitwell does have excessive water loss, but it has shown it is capable of making the repairs necessary to reduce water loss.").

[44] *See Hearing Exhibit No. 14*, TRA Docket No. 12-00157, p. 1 of 12 and p. 2 of 12 (The engineer who performed the valuation acknowledging therein that there is substantial supporting documentation).

[45] *See, e.g., Pre-Filed Testimony of William H. Novak* at 3, LL 4 -5 ("In addition, I have reviewed the Company's workpapers supporting the proposed acquisition.").

[46] A copy of this case was submitted with *TAWC's Post-Hearing Brief.*

valuation, absent very material supporting documentation, such an action would appear to also run afoul of basic principles of fairness, as TAWC's right to, among other things, contradict the valuation would be abrogated without access to the supporting documentation.[47]

For the foregoing reason, coupled with the arguments set forth in TAWC's Post-Hearing Brief, the Authority should give no weight whatsoever to either the incomplete compilation of the 2003 valuation or its underlying methodology, as neither can be adequately subjected to the Authority's normal and required scrutiny.

E. TAWC's request for deferred accounting of its due diligence costs are reasonable and within the authority of the TRA.

Consistent with its Post-Hearing Brief, TAWC submits that it is well within the TRA's expressed and implied authorities to allow TAWC to recover its acquisition costs by use of a regulatory asset as requested in detail in the *Joint Petition.*[48]

In its Post-Hearing brief, the Consumer Advocate cites a handful of TRA cases for the proposition that the TRA should only grant requests for deferred accounting in certain enumerated, limited circumstances.[49] While, the Consumer Advocate is correct that requests to the TRA for deferred accounting have been few and far between, the matters cited by the Consumer Advocate fall short of establishing black-letter law for how the TRA should determine future requests, such as the one contained in the *Joint Petition.* The matters previously heard by the TRA deal with unique, narrow fact patterns—none of them involving acquisitions.[50] Thus, there does not appear to be any statute, case law, or TRA precedent prohibiting the TRA from granting TAWC's request.

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[47] *See, e.g., Tr. Vol. II* at 230, LL 13 – 15 ("I don't believe that that appraisal was appropriate in the way it calculates value.") (Testimony of Bickerton).
[48] *TAWC's Post-Hearing Brief*, TRA Docket No. 12-00157, pp. 7-9.
[49] *See Consumer Advocate's Post-Hearing Brief* at 37-39.
[50] *See id.*

On the other hand, other states have recognized and granted utilities' requests to treat acquisition costs as a deferred regulatory asset.[51] For example, in a 2007 docket, the Florida Public Service Commission weighed a similar request for deferred accounting.[52] The Florida matter involved the acquisition of one investor-owned gas utility by another.[53] As part of the transaction, the surviving company sought to recover the acquisition costs associated with purchasing its competitor through deferred accounting—specifically the use of a regulatory asset.[54] The Commission granted the company's request after finding that the costs were properly classified as a regulatory asset.[55] The Commission further noted that its decision was consistent with its past approach of recording gains and losses for plant sales.[56] Moreover, the Commission reasoned that "gains or losses on disposition of property devoted to, or formerly devoted to, public service should be recognized above the line and that those gains or losses, if prudent, should be amortized...."[57] Finally, the Commission noted that its decision did not limit its ability to review the amounts for reasonableness in future rate proceedings.[58]

The requests made by the Florida utility and TAWC are strikingly similar. Much like the Florida utility, TAWC only seeks to treat its acquisition costs as a regulatory asset that it may seek to recover for in a future rate case before the TRA.[59] This request would not immediately

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[51] *See e.g. In re: Petition for approval of acquisition adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc.*, 2007 FLA. PUC LEXIS 579; *Citizens Utilities Company and DuPage Utility Company: Joint Petition for Approval of Acquisition of Outstanding Capital Stock of DuPage Utility Company by Citizens Utilities Company of Illinois, and for other related authority and relief*, 1991 Ill. PUC LEXIS 39.5

[52] *See In re: Petition for approval of acquisition adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc.*, 2007 FLA. PUC LEXIS 579 * 25-29.

[53] *See id.* at * 1.

[54] *See id.* at * 2.

[55] *See id.* at *34.

[56] *See id.* at * 27.

[57] *See id.* at * 27-28.

[58] *See id.*at * 28.

[59] *See Pre-Filed Rebuttal Testimony of Bickerton* at 2.

impact the rates for either the Whitwell System or TAWC's existing system.[60] Accordingly, in light of the similarities between the matters, TAWC submits that the TRA should employ the same reasoning of the Florida Commission and grant TAWC's request.

In addition, in its Post-Hearing Brief, the Consumer Advocate, often times without citing any legal authority, argues that permitting the utility to recover expenses generally violates the prohibition against retroactive ratemaking and allows single-issue ratemaking.[61] Despite the Consumer Advocate's lengthy discussion detailing how states critically review deferred accounting requests, TAWC has found that several states grant these requests without considering them as retroactive ratemaking.[62]

For example, in a 2007 matter involving a request to defer certain costs related to environmental remediation, the Connecticut Department of Public Utility Control viewed the request as appropriate.[63] In the Department's view, the request was consistent with its past practice of allowing the cost of due diligence related to environmental cleanup to be recoverable in deferred accounting—to be addressed at the next rate case.[64] In another matter, the Texas Public Utilities Commission allowed deferred accounting to prevent the detrimental effects of regulatory lag on investors.[65] Finally, the Michigan Public Service Commission has permitted an electric utility to amortize extraordinary storm-related expenses.[66] The Commission found that retroactive ratemaking did not occur because the previous rates were not changed to correct

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[60] Id.
[61] *See Consumer Advocate's Post-Hearing Brief* at 40-42.
[62] *See e.g. Citizens Utilities Company and DuPage Utility Company: Joint Petition for Approval of Acquisition of Outstanding Capital Stock of DuPage Utility Company by Citizens Utilities Company of Illinois, and for other related authority and relief*, 1991 Ill. PUC LEXIS 395; *AG v. Mich. PSC*, 686 N.W. 2d 804 (MI. 2004); *Application of Yankee Gas Services Company for an accounting ruling to defer manufactured gas plant environmental remediation/investigation costs*, 2005 Conn. PUC LEXIS 157; *Office of Public Utilities Counsel v. Public Utilities Commission*, 808 S.W.2d 497 (Tex. App. 1990).
[63] *See Application of Yankee Gas Services Company for an accounting ruling to defer manufactured gas plant environmental remediation/investigation costs*, 2005 Conn. PUC LEXIS 157 *7.
[64] *Id.* at * 6.
[65] *Office of Public Utilities Counsel v. Public Utilities Commission*, 808 S.W.2d 497, 500 (Tex. App. 1990).
[66] *AG v. Mich. PSC*, 686 N.W. 2d 804, (MI. 2004).

further deficiencies caused by the storms.[67] These examples illustrate the willingness of utility commissions from other states to grant requests for deferred accounting without considering the act to be retroactive ratemaking.

Therefore, contrary to the arguments made by the Consumer Advocate, the Authority has more than sufficient grounds to grant the accounting requests without concern of violating the doctrine of retroactive ratemaking.

IV. CONCLUSION

As evidenced at the hearing, circumstances have converged to present a unique opportunity for investment, growth, safety, reliability, conservation and efficiencies for the benefit of the customers of the System, the customers of TAWC, Whitwell, the Town of Powells Crossroads and TAWC. The record supports moving forward to capture these opportunities as set forth in the Joint Petition.

Respectfully submitted this 31st day of May, 2013.

BUTLER, SNOW, O'MARA, STEVENS & CANNADA, PLLC

By: _____

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[67] *Id.*

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served electronically to the following this 31st day of May, 2013.

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ButlerSnow 16528352v1

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2005 Conn. PUC LEXIS 157

Connecticut Department of Public Utility Control
May 25, 2005
DOCKET NO. 04-12-17

Reporter: 2005 Conn. PUC LEXIS 157

APPLICATION OF YANKEE GAS SERVICES COMPANY FOR AN ACCOUNTING RULING TO DEFER MANUFACTURED GAS PLANT ENVIRONMENTAL REMEDIATION/INVESTIGATION COSTS

Core Terms

environmental remediation, deferred, environmental consultant, sites, invoices

Panel: [*1] By the following Commissioners: Linda J. Kelly; Jack R. Goldberg; John W. Betkoski, III

Opinion

DECISION

I. INTRODUCTION

A. BACKGROUND

By petition received on January 19, 2005, Yankee Gas Service Company (Yankee or Company) requests a declaratory ruling from the Department of Public Utility Control (Department) regarding Yankee's right to defer approximately $ 1,046,000 of environmental remediation costs for engaging outside counsel and environmental consultants. These costs are necessary to pursue recovery of incurred and anticipated remediation costs against UGI Corporation (UGI) of Pennsylvania.

B. CONDUCT OF THE PROCEEDING

By Notice of Hearing dated February 7, 2005, the Department announced, pursuant to Conn. Gen. § 4-176, that a public hearing on the above-cited docket would be held on February 23, 2005 at its offices, Ten Franklin Square, New Britain, Connecticut. By Notice of Rescheduled hearing dated February 22, 2005, the hearing was rescheduled to March 8, 2005. The March 8, 2005 hearing was held and continued to March 21, 2005. The March 21, 2005 hearing was held and continued to March 23, 2005. The March 23, 2005 hearing was cancelled and the Department [*2] closed the hearing on April 6, 2005. The Department issued a draft Decision in this matter on May 4, 2005. All Parties were provided the opportunity to submit written exceptions to and present oral arguments on the draft Decision.

C. PARTIES TO THE PROCEEDING

The Department recognized the following as parties to the proceeding: Yankee Gas Services Company, P. O. Box 270, Hartford, Connecticut 06141-0270 and the Office of Consumer Counsel (OCC), Ten Franklin Square, New Britain, Connecticut 06051.

II. PROPOSAL OF YANKEE

The Company requests that the Department issue a declaratory ruling authorizing the creation of a regulatory asset to defer approximately $ 1,046,000 for the cost of engaging outside counsel and environmental consultants incurred and expected to incur to pursue recovery of remediation costs against UGI. Petition, p. 1; Yankee Brief, March 28, 2005.

A. RATIONALE FOR REQUEST

In 2004, Yankee commenced efforts to pursue recovery of environmental remediation costs from UGI. On August 5, 2004, Yankee sent a demand letter to UGI setting forth its claim for contribution for environmental investigation/remediation costs for 13 Connecticut manufactured gas plant **[*3]** (MGP) sites that Yankee has begun or will remediate in the future. The 13 MGP sites are previously owned, operated, controlled and/or leased by or for the benefit of UGI. UGI has not readily agreed to reimburse Yankee for environmental remediation costs although communication between the Company and UGI has been on-going. As a result, Yankee has incurred and anticipates incurring additional costs for outside legal and environmental consultants. The Company testified that these costs are necessary to pursue environmental remediation recovery from UGI. Any proceeds received from UGI will be applied to offset deferred balances of environmental remediation costs, thereby reducing or eliminating future costs to customers. Petition, pp. 1 and 2.

The costs which the Company requests to defer include actual expenditures since December 2003 of $ 381,275 plus forecasted costs through 2005 of $ 664,725. [1] Yankee admits that they cannot estimate with certainty the total amount of these costs going forward, although they are expected to be significant. Petition, p. 2. As of February 28, 2005, Yankee has been allocated a total of $ 381,275 or 90% of the total outside legal and environmental consultant **[*4]** invoices related to UGI. The Connecticut Light and Power Company (CL&P) has been allocated $ 42,364 or 10%. Of the 13 UGI MGP sites, Yankee and CL&P own 11.5 sites or 88.5% and 1.5 sites or 11.5%, respectively. Yankee testified that the 90% allocation of costs to date was based on rounding. Late Filed Exhibit No. 2 and Tr. 03/22/05, p. 86.

The Company states that the costs associated with the Petition are of an extraordinary magnitude in light of Yankee's results from operations. Additionally, the Company states that these costs are not included in current rates and charges. The Company therefore believes that the requested costs meet the criteria for inclusion in Account 186 of the Uniform System of Accounts (USofA). [2] The Company also believes **[*5]** that the costs are different from those previously approved by the Department as environmental remediation expenses in that these particular costs are associated with the UGI contribution effort and are not related to traditional physical remediation work. The Company has indicated that these costs are not included in present rates and requests that the Department authorize deferred accounting for such costs. The determination as to future recovery would be addressed in the Company's next rate proceeding.

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[1] This was calculated by taking the Company's original $ 750,000 projection and subtracting the difference between actual expenditures as of December 31, 2004 of $ 296,000 and actual expenditures of $ 381,275 as of February 28, 2005. ($ 750,000 - ($ 381,275 - $ 296,000)).

[2] Criteria for booking costs in Account 186 of the USofA include "unusual or extraordinary expenses, not included in other accounts, which are in the process of amortization, and items the final disposition of which is uncertain."

III. DEPARTMENT ANALYSIS

Yankee engages environmental consultants to perform traditional physical remediation, and uses in -house personnel to supervise and monitor excavation and disposal. In accordance with past practice and the settlement recently approved by the Department in **[*6]** the December 8, 2004 final Decision in Docket No. 04-06-01, Application of Yankee Gas Services Company for a Rate Increase (Settlement) , deferral of such costs is accepted practice. However, Yankee believes that the costs at issue in this proceeding, which are incurred for purposes of gaining contribution toward Yankee's environmental responsibilities, are of a different nature. Instead of funding traditional physical remediation, the costs for which Yankee seeks Department approval are for: (1) developing and refining models used to determine UGI's estimated liability; and (2) reviewing gas generation records, tar disposal records, operational records and similar information.

While the costs at issue in this proceeding are different from traditional physical remediation expenses, the Department has directed Yankee to exercise due diligence in its recovery of environmental remediation costs from other liable entities. [3] The Department stated that ratepayers will be responsible only for their share of environmental clean-up costs. It is therefore consistent for the Department to allow the ***cost*** of that ***due diligence*** to be recoverable as an environmental remediation expense.

[*7]

In light of the foregoing, the Department concludes that the outside legal and consulting costs at issue in this proceeding are environmental remediation expenses, and that, based on the terms of the Settlement, ***deferred accounting*** is appropriate. The recovery of these deferred expenses will be addressed in the next applicable rate case filed by the Company.

As discussed above, Yankee has been allocated 90% of the total outside legal and environmental consultant invoices related to UGI, while CL&P has been allocated 10%. The Department does not agree with the Company's rounding allocation and requires that the invoices be allocated between Yankee and CL&P based upon Yankee's actual 88.5% ownership interest in the sites.

IV. FINDINGS OF FACT

1. In 2004, Yankee commenced efforts to pursue recovery of actual and anticipated environmental remediation costs from UGI.

2. On August 5, 2004, Yankee sent a demand letter to UGI setting forth its claim for contribution for environmental investigation/remediation costs for 13 Connecticut manufactured gas plant (MGP) sites that Yankee has begun or will remediate in the future.

3. The 13 MGP sites are previously owned, operated, controlled **[*8]** and/or leased by or for the benefit of UGI.

4. UGI has not readily agreed to reimburse Yankee for environmental remediation costs and communication between the Company and UGI has been on-going.

5. Yankee has incurred and anticipates additional costs for outside legal and environmental consultants to total approximately $ 1,046,000.

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[3] Decision dated August 26, 1992, in Docket No. 92-02-19 See, Section, II.I.2.

6. The outside legal and environmental costs are necessary in order to pursue environmental remediation recovery from UGI.

7. Proceeds received from UGI will be applied to offset the deferred balances, thereby reducing or eliminating future costs to customers.

8. The costs for which the Company requests a deferral account include actual expenditures since December 2003 of $ 381,275 plus forecasted costs through 2005 of $ 664,725.

9. Yankee has been allocated 90% of the total outside legal and environmental consultant invoices related to UGI.

10. Of the 13 UGI sites, Yankee owns 11.5 sites or 88.5% and CL&P owns 1.5 sites or 11.5%.

11. The outside legal and environmental costs are not included in present rates.

V. CONCLUSION

The Department finds that Yankee's costs incurred to pursue recovery of environmental remediation costs through **[*9]** the assistance of outside counsel and environmental consultants can be appropriately deferred as environmental remediation costs, consistent with the terms of the Settlement. Therefore, the Department will allow the Company to defer the outside counsel and environmental consultant costs associated with its efforts to pursue environmental remediation recovery from UGI. Recovery of these deferred expenses will be reviewed in the Company's next respective rate cases.

VI. ORDERS

1. Yankee is required to use the actual ownership percent of 88.5% when allocating UGI MGP invoices.

2. On or before December 29, 2005, Yankee shall submit copies of the UGI MGP invoices, allocations and the total amount deferred for UGI environmental costs related to outside legal and environmental consultant costs.

This Decision is adopted by the following Commissioners:

Linda J. Kelly

Jack R. Goldberg

John W. Betkoski, III

1991 Ill. PUC LEXIS 395

Illinois Commerce Commission
September 18, 1991
90-0405

Reporter: 1991 Ill. PUC LEXIS 395

Citizens Utilities Company and Dupage Utility Company: Joint *petition* for *approval* of *acquisition* of outstanding capital stock of DuPage Utility Company by Citizens Utilities Company of Illinois, and for other related authority and relief

Core Terms

surcharge, acquisition, merger, sewer, customers, proposed acquisition, sector, tariff, rate case, filing requirements, maintenance work, eighteen months, set forth, recommended, private sector, true-up, original cost, enforcement program, separate account, anticipated, confirmation, financing, below-the-line, outstanding, revisions, billing, stock

Opinion

[*1]

ORDER

By the Commission:

On November 5, 1990, Citizens Utilities Company of Illinois ("Citizens") and DuPage Utility Company ("DuPage") (collectively "Petitioners") filed a verified Joint Petition ("Joint Petition") seeking approval of Citizens' acquisition of outstanding capital stock of DuPage and subsequent merger with DuPage, and requesting certain other related relief.

In addition to Commission approval of the proposed acquisition and merger, Citizens and DuPage also seek (i) approval of the costs of Citizens' acquisition of DuPage, $ 395,000 with certain adjustments, plus acquisition-related transaction costs, as the original cost rate base for DuPage subsequent to the acquisition; (ii) authorization of DuPage's continuation for a limited period of time of its rate surcharge, originally authorized in Consolidated Dockets 85-0440 and 86-0116, until such time as costs associated with certain maintenance-related improvements ordered by the Commission in Docket 59474 and Docket 85-0205 are recovered, or new rates for DuPage are put into effect, whichever occurs first; (iii) approval of certain revisions to DuPage's existing Certificates of Public Convenience and Necessity to **[*2]** accurately reflect DuPage's current service territory, and authorization of the transfer of those Certificates to Citizens at the time of merger; (iv) waiver, or confirmation of the inapplicability, of certain of the standard filing requirements set forth in 83 Ill.Adm. Code 285, in connection with an anticipated request by DuPage for an increase in its standard rates, to a level not to exceed the currently-approved rates of Citizens, to be filed shortly after the acquisition is completed; (v) approval of DuPage's use of Citizens' currently authorized rate of return as a proxy in connection with DuPage's anticipated rate case; (vi) certification of DuPage's true-up report for the period May 1987 to June 1990 as being in compliance with the reporting requirements set forth in Consolidated Dockets 85-0440

and 86-0116; and (vii) authorization of an extension of time to permit DuPage up to eighteen months from the acquisition to complete the private sector program ordered in Docket 85-0205.

Pursuant to notice, as required by law and the rules and regulations of the Commission, this matter came on for hearing before a duly authorized Hearing Examiner at the Commission's offices in Chicago, **[*3]** Illinois, on January 25, 1991. A subsequent hearing was held on March 5, 1991. Petitioners appeared by counsel and presented the testimony of Thomas Fricke, General Manager of Citizens; Carole Clark, President of DuPage; and James Duda, Manager of Revenue Requirements of Citizens in support of the Joint Petition. Staff appeared by counsel and the following Commission Staff members were present and participated in the hearings: Walter Hoolhorst, Senior Auditor, and William Ide, Chief Water Engineer. The Village of Lisle ("Lisle") also appeared by counsel. The Meadows Homeowners Association, Inc. ("MHA") filed a Petition to Intervene on March 1, 1991 which was granted by the Hearing Examiner at the hearing on March 5, 1991. Also at the hearing on March 5, 1991, the Hearing Examiner granted Citizens' request to orally amend the Joint Petition to clarify Petitioners' request relating to continuation of DuPage's surcharge, and to modify Petitioners' request relating to the Commission's standard filing requirements so as to conform it to the filing requirements currently in effect. On April 22, 1991, the record was marked "Heard and Taken."

Initial and Reply Briefs were filed by **[*4]** Citizens, DuPage, Staff and MHA. Lisle adopted as its initial brief the Initial Brief of MHA.

A copy of the Hearing Examiner's Proposed Order was served on all parties on July 22, 1991. Exceptions to the Hearing Examiner's Proposed Order were filed by Citizens, DuPage and Staff. Replies to Exceptions were filed by MHA, Citizens and Staff. Exceptions and Replies, as filed, have been considered and certain exceptions are addressed on pages 10-14 herein.

Background

A summary of the history of DuPage and the various Dockets addressing and attempting to correct the quality of service provided by DuPage is necessary for an understanding of the relief requested by Citizens in conjunction with its acquisition of DuPage.

DuPage provides water and sewage collection service to residential and commercial customers in and near Lisle, Illinois, in DuPage County. Sewage collection service is provided to approximately 1,000 residential customers and bulk water sales to about 1,700 residential customers.

On December 18, 1974, the Commission, on its own motion, issued a Citation Order in Docket 59474 against DuPage, directing it to show cause why it should not be ordered to provide such facilities **[*5]** and take such actions as necessary to eliminate the backup of sewage into customers' homes. Numerous Orders were entered from time to time during the subsequent decade, culminating in an Order on Rehearing in Docket 59474 entered on November 20, 1984. Said Order on Rehearing exhaustively detailed the unfortunate history of this utility and highlighted a sewer system evaluation survey ("RJN Study") prepared by outside consultants and undertaken by DuPage pursuant to Commission direction. That study concluded that 67% of the total inflow originated from sources located in the customer sector (the portion of the system owned and controlled by DuPage's customers) and 33% originated from sources located in the utility sector (the portion of the system owned and controlled by DuPage). The study recommended extensive work to the customer sector and the utility sector of the sewer system. DuPage proposed that the Commission allow it to effect a sewer surcharge to pay for same within the parameters of Docket 59474. The Commission's November 20, 1984 Order ordered the implementation of the survey's recommendations but found the record insufficient to determine the most economic way of **[*6]** financing the work.

Consolidated Dockets 85-0440 and 86-0116 provided the means for financing the survey's recommendations and the means for repaying the financing through an increase in sewer rates and a special sewer surcharge. In an Order entered on January 21, 1987, the Commission approved DuPage's application in Docket 85-0440 for authority to enter into two Financing Agreements and Promissory Notes of $ 400,000 and $ 260,000 to finance capital improvements of $ 260,517 and maintenance costs of $ 345,798. In addition, the Commission approved proposed rates in Docket 86-0016 intended to recover the capital and maintenance costs associated with the proposed plan of financing. Customers would pay for the maintenance portion of the program through a monthly sewer surcharge of $ 8.75 and a general rate increase would provide recovery for the utility's additional capital investment required by the survey, including a fair return thereon.

In Docket 85-0205, in response to MHA's Petition for Issuance of a Citation Order against DuPage for its failure to comply with the Commission's Order of November 20, 1984, the Commission found that DuPage had substantially complied with the Commission's **[*7]** directives in Docket No. 59474. The record showed that DuPage completed all of the utility sector work recommended by the survey. Further, the Commission found that the remaining identifiable sources of the infiltration into DuPage's sanitary sewer system were located within the customer sector and directed DuPage to enforce its tariff provision concerning the unauthorized discharge into its sanitary sewer system by disconnecting the offending customer's water service. The Commission ordered that the enforcement of the tariff provision be completed within one year of the October 3, 1990 entry of its Order.

On September 7, 1990, Citizens executed an agreement ("Agreement") to purchase the outstanding capital stock of DuPage. Under the Agreement Citizens agreed to buy DuPage's outstanding stock for $ 395,000, subject to certain conditions and adjustments. The conditions precedent specified in the Agreement include obtaining Commission approval of Citizens' proposed acquisition of, and subsequent merger with DuPage within twelve months of acquisition, and other related relief. Subsequent to acquisition, it is anticipated that DuPage will request an increase in its standard rates **[*8]** to a level not to exceed Citizens. On November 5, 1990, Citizens and DuPage filed their Joint Petition, seeking Commission approval of Citizens' Proposed acquisition of, and merger with, DuPage pursuant to Sections 7-102 and 7-204 of The Illinois Public Utilities Act ("Act").

Parties' Positions On The Issues

None of the parties to this proceeding oppose approval of the proposed acquisition and merge, or modification of DuPage's Certificates of Public Convenience and Necessity, or the accounting method for treating the ***regulatory assets***. However, the parties are in dispute over certain of the related issues. Staff, MHA and Lisle oppose Citizens' inclusion of the acquisition costs ($ 395,000 with certain adjustments) as the original cost rate base for DuPage. Citizens disputes Staff's below-the-line treatment of the Acquisition Adjustment. Citizens and DuPage request the continuation of the sewer surcharge originally authorized in Consolidated Dockets 85-0440 and 86 -0116. MHA and Lisle oppose continuation of the surcharge. Staff also opposes continuation of the surcharge since the sewer surcharge tariff has expired, but recommends a new sewer surcharge be created in this **[*9]** Docket. Staff and MHA object to the use of Citizens' rate of return as a proxy in connection with DuPage's anticipated rate case, and recommend that Citizens and DuPage should be required to maintain separate accounts and records subsequent to the merger of DuPage into Citizens until the first rate case is completed. MHA also objects to certification of DuPage's true-up report for the period May 1987 to June 1990; waiver of certain of the standard filing requirements set forth in 83 Ill.Adm. Code 285, in connection with an anticipated request by DuPage for an increase in its rates; and an extension of eighteen months from the ac-

quisition for DuPage to complete the private sector program ordered in Docket 85-0205. In addition, MHA asks that the Commission condition its approval of the acquisition and merger on Citizens' completion of its proposed program of capital improvements for DuPage.

Discussion and Analysis of Undisputed Issues

A. Acquisition and Merger

Under the Agreement admitted into evidence as Exhibit TEF-1, Citizens agreed to buy DuPage's outstanding stock for $ 395,000, subject to certain conditions and adjustments. Article IV of the Agreement specifies the **[*10]** conditions precedent. Section 4.2 of Article IV sets forth "ICC Approval of Certain Matters," and 4.3 of Article IV deals with "ICC Approval of a Construction and a Rate Change Program." With the exception of Section 4.3 which seeks approval of a construction program yet to be presented to the Commission, the acquisition proposed should be approved pursuant to the terms and conditions of the Agreement.

The evidence presented in this Docket establishes that the proposed acquisition and merger satisfies the requirements of Sections 7-102 and 7-204 of the Act. With respect to the requirements of Section 7-204, Mr. James S. Duda, Manager-Revenue Requirements of Citizens' parent company, Citizens Utilities Company, testified that the proposed acquisition and merger will in no way diminish, for the current customers of either DuPage or Citizens, either utility's ability to provide adequate, reliable, efficient, safe and least-cost water and wastewater service. Thomas E. Fricke, Citizens' General Manager, testified that the acquisition and merger should benfit DuPage's customers and result in greater operational efficiencies.

Mr. Duda further testified that the proposed acquisition and **[*11]** merger will not impair Citizens' ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure, especially given the relatively minor size of the acquisition.

In addition, neither Citizens nor DuPage currently engages in, nor expects to engage in, any non-utility business avtivity. Accordingly, the potential for unjustified subsidization by DuPage or Citizens of non-utility activities after the acquisition and merger, and the allocation of costs between utility and non-utility activities, are not in issue. Moreover, because Citizens and DuPage will continue to exclusively provide water and wastewater service after the acquisition and merger, they will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities.

With respect to the requirements of Section 7-102, the evidence shows that the proposed acquisition and merger should substantially benefit DuPage's existing customers, with no detriment to Citizens' existing customers. Mr. Fricke testified that DuPage's system is in need of significant upgrading, and neither DuPage nor its current owners have the financial **[*12]** strength, management expertise and technical depth to carry out that upgrading, if at all, in as timely and cost effective manner as Citizens. Mr. Fricke testified that DuPage's system currently suffers from inadequacies in six broad areas: (1) DuPage's existing water storage tank is inadequately sized for reliable service to its current service area; (2) the current metering system is inadequate; (3) DuPage's supply and pumping system needs substantial improvement; (4) Dupage's system lacks central controls and alarming; (5) a substantial portion of the sewer system improvements that were ordered by the Commission in Docket 59474 remain to be completed; and (6) DuPage suffers from deficiencies in the maps and records covering the water distribution and sewer collection systems. In order to correct these inadequacies, Citizens proposes to undertake an extensive program of facilities improvements for DuPage, if the acquisition is completed. Citizens estimates that the improvements program will require a capital investment of approximately $ 850,000. Wil-

liam Ide, Chief Water Engineer for Staff, confirmed the problems and inadequacies of DuPage's system, concurring in Mr. Fricke's **[*13]** assessment of those matters. Carole L. Clark, the current president of DuPage, also agreed with Mr. Fricke's assessment, and further underscored the need for these improvements by identifying additional maintenance and capital improvement problems that have recently occurred.

Thus, the proposed acquisition and merger will benefit DuPage's customers and result in substantial improvements in DuPage's quality of service, without adversely affecting the interests of Citizens' customers. Moreover, the proposed acquisition and merger fully meet the requirements of Sections 7-102 and 7-204 of the Act. Accordingly, the proposed acquisition and merger should be approved.

B. Modification of DuPage's Certificates of Public Convenience and Necessity

Petitioners have proposed that the Commission approve certain revisions to DuPage's existing Certificates of Public Convenience and Necessity so as to conform to the geographical area reflected on Appendix A attached hereto. Mr. Frickle testified that all of the proposed revisions relate to areas currently served by DuPage, are necessary for DuPage and Citizens to provide adequate, reliable and efficient service to customers in those areas, **[*14]** and represent the least -cost means of meeting those customers' service needs. Staff concurred, and recommended that the proposed revisions be approved.

Based on the evidence, the Commission concludes that the proposed revisions are in the public interest and should be approved, and the transfer of those certificates to Citizens at the time of merger should be authorized.

C. Treatment of ***Regulatory Assets***

Staff and Citizens agree that the amount of ***regulatory assets*** to be recorded on DuPage's books and records subsequent to the acquisition should be based on the same methodology used to determine DuPage's rate base in its two previous rate cases, Dockets 83-0153 and 86-0116. As of December 31, 1989, these ***regulatory assets*** to amounted to $ 367,833. The ***regulatory assets*** would be amortized over the estimated remaining lives of the underlying assets that give rise to them.

The Commission concludes that Staff's proposed accounting treatment of ***regulatory assets*** with respect to DuPage should be approved.

Discussion and Analysis of Disputed Issues

A. DuPage's True-Up Report

Petitioners have requested approval of DuPage's true-up report for the period May 1987 through June **[*15]** 1990, entered into evidence as Citizens Exhibit JSD-1, as being in compliance with the Commission's Order in Docket 86-0116. This report reconciles the sewer maintenance expenditures by DuPage over that period with revenues collected through the rate surcharge. Staff confirmed that this reconciliation was correctly complied and charge to ratepayers. MHA objects to the Commission approving the true-up report based on the history of this case and fact that the implementation of the RJN Plan has not been completed within the budget and financing provided. MHA's objection is irrelevant to the purpose of the true-up report which was to show the sewer surcharge revenues and the expenditures of those revenues. The Commission concludes that DuPage's true-up report for the period May 1987 through June 1990 should be approved.

B. Accounting Requirements Subsequent to the Merger

Staff proposes that Citizens and DuPage should be required to maintain separate accounts and records subsequent to the merger of DuPage into Citizens until such time as the first rate case is filed for uniform water rates for all Citizens' water and sewer holdings. In support of this proposal, Staff states **[*16]** that such a requirement is necessary so the Commission can gauge, in a future Citizens' rate case, whether DuPage water and sewer rates generated on a separate entity basis with improvements would exceed or be less than Citizens' uniform rates after the merger. Staff also submits in its initial brief that since an audit trail is already now in evidence at Citizens and direct control of expenditures already exists, separate accounting for DuPage would not be burdensome. MHA supports Staff's proposal.

Citizens argues that Staff's proposal should be rejected for at least three reasons. First, Citizens points out that Staff's assertion of an audit trail is illusory. Citizens contends administrative costs of separate accounting would be prohibitive. Second, Staff's proposal is inconsistent with Mr. Hoolhorst's own admission that eliminating the need for two sets of books and records is generally desirable. Third, Staff's proposal is contrary to longstanding Commission policy, reflected in Citizens' rates, that absent unique circumstances, a water and sewer utility's rates should be uniform across operating districts.

The evidence in the record supports Staff's assertion that an audit **[*17]** trail already exists for DuPage. Citizens must approve all DuPage capital expenditures over $ 3,000 and DuPage's service territory is not contiguous to any existing Citizens' service territory, consequently, DuPage bills for payment would reflect a Lisle, Illinois address. Petitioners base the change in rates from the existing levels for DuPage to rates not to exceed the currently approved rates of Citizens on Citizens' proposed capital investment in DuPage's system over a short period of time. Petitioners anticipate these interim rates for DuPage would remain in effect until Citizens filed a request for a change in its overall rates. Based on the circumstances of this acquisition and merger, including DuPage's anticipated filing for interim rates prior to merger and Citizens' filing for a change in its annual rates post merger, Staff's proposal that Citizens and DuPage Maintain separate accounts and records subsequent to the merger until such time as the first over-all rate case is filed is reasonable.

Thus, the Commission concludes that Staff's proposal concerning the maintenance of separate accounts and records subsequent to the merger shall be adopted.

C. Acquisition Adjustment **[*18]**

Staff proposes to amortize the acquisition adjustment ("AA") of $ 16,676, the excess by which the purchase price of $ 395,000 exceeds the Staff and Citizens' proposed original cost and ***regulatory asset*** rate base values of $ 378,324, to Account 421, Non-Utility Income, a below-the-line account. Staff's position is consistent with the general practice of excluding excess acquisition costs from rate base.

Citizens argues that a departure from the aforesaid general treatment of acquisition costs is warranted in this case because the purchase price was determined in an arm's length transaction, and because Citizens will make substantial capital improvements to DuPage's system. Neither of these arguments provides a compelling reason to warrant above-the-line treatment.

Accounting Instruction 21 requires original costs to be used to value assets. Consequently, only DuPage's original cost can be put above-the-line. Citizens' argument that the purchase was an arm's length transaction is irrelevant to the treatment of the acquisition adjustment traditionally used in Illinois and does not warrant a departure from said method.

Moreover, the fact that Citizens will be making improvements to **[*19]** the system is not related to the values for the original cost assets or the ***regulatory assets*** created in prior dockets. The improvements made in the future earn a rate of return and are recovered over their respective lives and have no effect on the acquisition adjustment which should be amortized below-the-line.

Accordingly, the Commission adopts Staff's treatment of the Acquisition Adjustment.

D. Citizens' Commitment to Proposed Capital Improvement Program

MHA recommends that the Commission expressly condition its approval of the proposed acquisition and merger on Citizens' completion of its proposed program of capital improvements and maintenance work to DuPage's system. Citizens opposes this requirement as being unnecessary. Citizens points out that Mr. Fricke presented testimony under oath as to the capital improvements and maintenance work contemplated by Citizens, that it stands behind Mr. Fricke's testimony, and that the proposed improvement projects necessarily cannot be set in stone until Citizens has the opportunity to actually take control of DuPage's operations.

After reviewing the evidence, the Commission concludes that there is nothing in the record to indicate **[*20]** that Citizens will abandon this improvements program if it completes the acquisition. Accordingly, the Commission finds that MHA's proposed condition to the acquisition and merger is not necessary, and should be rejected.

Disputed Issues More Appropriately Addressed In Other Dockets

Pursuant to a review of the record, the Commission concludes that the following disputed issues are not conducive to resolution in this Docket and are more appropriately addressed in the filing of a rate case: (1) DuPage's use in its next rate case of Citizens' most recently authorized overall cost of capital; and (2) approval of the costs of Citizens' acquisition of DuPage as the original cost rate base for DuPage.

Exceptions

A. Tariff to Collect Sewer Surcharge

Citizens, DuPage, Staff and MHA, in their Briefs on Exceptions to the Hearing Examiner's Proposed Order, disagree with the Proposed Order's conclusion that the issue of the sewer surcharge is more appropriately addressed in a separate docket. Based upon the arguments of the parties and in the interest of efficiency, the sewer surcharge issue will be addressed in this Docket.

Citizens and DuPage have requested in this proceeding that **[*21]** DuPage be authorized to continue its current rate surcharge until such time as it recovers the cost of certain "maintenance" improvements relating to the customer sector of DuPage's system that the Commission directed DuPage to perform in Docket 59474 and Docket 85-0205, or until new rates for DuPage are put into effect, whichever occurs first.

In support of their proposal, Petitioners presented evidence, and reiterated in their briefs, that the manitenance work to which the continued surcharge relates is part of the same program of maintenance work for which the rate surcharge was originally authorized. DuPage's rate surcharge was originally approved by the Commission in its final Order dated January 21, 1987 in Consolidated Dockets 85-0440 and 86-0116. As described in that Order, the surcharge was intended to recover costs associated with the sewer "maintenance" portion of a program of improvements to DuPage's sewer system ordered by the Commission in an earlier docket, Docket 59474.

Mr. Fricke and Ms. Clark testified that, although DuPage has essentially completed, and recovered through the rate surcharge the maintenance portion of the improvements program ordered in Docket 59474 **[*22]** that relates to the utility sector of DuPage's system, substantial additional maintenance work relating to the customer sector of DuPage's system remains to be completed. This is also reflected in the Commission's October 3, 1990 Order in Docket 85-0205. In that Order, the Commission directed DuPage to undertake an enforcement program designed to eliminate unauthorized sources of inflow and infiltration within the customer sector of DuPage's system, as outlined in the RJN Survey.

In addition, Citizens presented a written proposal from RJN, the authors of the original survey in Docket 59474, which describes the private sector work to be done to complete the testing program of suspect illegal connections in compliance with the Commission's enforcement order in Docket 85-0205. RJN estimated the maximum cost to perform the work at $ 133,500. (Citizens' Ex. TEF-12).

Mr. Duda and Mr. Fricke testified that discontinuation of the surcharge would cause the acquisition not to go forward, because it would alter the economics of the transaction previously assumed by Citizens and incorporated into the Agreement.

Staff agrees that a rate surcharge should be used to recover the costs of the **[*23]** remaining maintenance work associated with the customer sector of DuPage's system, but recommends DuPage's current surcharge tariff be canceled and replaced with a new surcharge tariff. As proposed by Staff, this new tariff would mirror the current surcharge tariff and would also include provisions that (1) limit the amount of recovery to $ 133,500, the estimated cost of completing the remaining maintenance work; if Citizens completes the work themselves at a savings, the total amount spent for these projects should be reduced and (2) require DuPage to provide at the end of the recovery period, approximately eighteen months, a reconciliation of the customer sector program costs incurred by DuPage and the revenues collected under the surcharge tariff. Citizens has indicated in its briefs that it does not oppose adoption of Staff's proposed recovery procedure.

MHA opposes continuation of DuPage's rate surcharge. In support of its position, MHA asserts that such continuation (1) is purportedly a subterfuge to have DuPage's customers pay for part of Citizens' costs of acquiring DuPage, (2) is allegedly unrelated to any specific maintenance program and (3) will somehow cause DuPage's **[*24]** customers to pay twice for completion of the remaining maintenance work.

After consideration of the evidence, the Commission concludes that continuation of DuPage's rate surcharge, in the manner recommended by Staff, is appropriate. As Citizens correctly points out, MHA's assertions are unsupported by any record evidence, and are unfounded. The evidence shows that the maintenance work to which the continued surcharge relates is part of the same program of maintenance work which the Commission previously ordered in Docket 59474, and again ordered in Docket 85-0205. Because the remaining work has yet to be performed, there is no danger that continuation of the surcharge in the manner proposed by Staff will cause DuPage's customers to pay for cost of this work twice. Inclusion of a reconciliation provision in the new surcharge tariff will further ensure that DuPage will not overrecover costs associated with the private sector work that remains to be performed.

In addition, the Commission directs Petitioners to file true-up reports every six months including the following information: (1) revenues collected or refunded by month; (2) sewer maintenance payments by month and project; **[*25]** (3) billing invoice from outside sources; and (4) if any work

is done by Citizens, the billing is to include basic costs, overhead costs and basis for overheads with no profit markups in Citizens' invoices.

Moreover, the evidence shows that, absent the surcharge, DuPage currently lacks funds to complete the required maintenance work. Accordingly, even if Citizens does not acquire DuPage, if the surcharge were not continued the quality of service to DuPage's customers would suffer.

For these reasons, the Commission concludes that, regardless of the status of DuPage's ownership, authorizing DuPage to recover through a rate surcharge the cost of completing the customer sector work ordered in Dockets 59474 and 85-0205, is appropriate. The tariff should be filed five days prior to October 3, 1991 in order to become effective October 3, 1991. The tariff shall continue for eighteen months or until $ 133,500 has been recovered or until new rates for DuPage are put into effect.

B. Standard Filing Requirements

Citizens, DuPage and Staff, in their Briefs on Exceptions, disagree with the Proposed Order's conclusion that this Docket is not the appropriate forum to address Petitioners' request **[*26]** for waivers of certain of the Standard Filing Requirements set forth in 83 Ill.Adm.Code 285. In view of the representation that DuPage will be filing for a rate increase shortly after acquisition by Citizens and in the interests of efficiency, the issue will be addressed herein.

Petitioners propose, in connection with an anticipated small utility rate case to be filed by DuPage subsequent to the acquisition, that the Commission confirm the inapplicability of, or waive, certain of the Standard Filing Requirements set forth in 83 Ill.Adm.Code 285. The specific provisions for which Citizens and DuPage seek waiver, or confirmation of their inapplicability, are *83 Ill.Adm.Code 285.150(b)(2)*, 285.210, *285.310*, *285.410*, 285.420, *285.1010*, *285.2020*, *285.2025*, *285.2030*, *285.2035*, *285.2040*, *285.2050*, *285.2055*, *285.2065*, *285.2075*, 285.2090, *285.3010*, *285.3015*, *285.3025*, *285.3040*, *285.3050*, 295.3060, 285.3061, *285.3065*, *285.3070*, 295.3075, *285.3085*, *285.3090*, 285.3110, *285.3115*, 285.3120, 285.3125, *285.4000*, 285.4005, *285.4010*, 285.4015, *285.4020*, and 285.4025.

Mr. Duda testified that DuPage is a small utility, as that term is defined in 83 Ill.Adm.Code 285. Accordingly, none of the filing **[*27]** requirements set forth in 83 Ill.Adm.Code 285 are automatically applicable to DuPage; rather, those filing requirements are meant to serve only as a guide to the type of information sought.

In addition, Mr. Duda testified that the specific filing requirements which are the subject of Petitioners' request all relate to matters where either (1) the information sought is not available, (2) the information sought would be very expensive to provide, considering the size of DuPage, or (3) the information sought would not substantially contribute to the Commissions' ability to evaluate DuPage's rate request.

Staff has concurred that Petitioners' request for waiver should be granted. MHA opposes the waiver arguing that while none of the filing requirements set forth in 83 Ill.Adm.Code 285 are automatically applicable to DuPage; they would apply to Citizens and the resulting surviving corporation.

The Commission concludes, based on the evidence, specifically given by Mr. Duda, that the waiver of the Standard Filing Requirements set forth herein should be granted.

C. Treatment of Organization Costs

Staff and Citizens point out in their Briefs on Exceptions that the Hearing Examiner's Proposed **[*28]** Order did not address Citizens' proposed accounting treatment for the transaction costs associated with Citizens' acquisition of DuPage. Staff and Citizens concur that the accounting treatment of organization costs of approximately $ 85,000 should be recorded in Account 301, Organization. No party opposed Citizens' proposed accounting treatment for those costs. Accordingly, the Commission concludes that the organization costs are appropriately capitalized.

D. Extension of Time to Complete Enforcement Program Ordered in Docket 85-0205

Citizens and DuPage take exception with the Proposed Order's conclusion that Petitioners' request for an extension of time to complete the enforcement program ordered in Docket 85-0205 is more appropriately addressed in a separate docket. In light of the approval of the sewer surcharge herein and to maintain consistency in the time frames for the sewer surcharge and the enforcement program which is funded by the surcharge, the issue will be addressed herein.

Pursuant to the Commission's Order in Docket 85-0205, DuPage is currently under instructions to complete an enforcement program to eliminate unauthorized private sector sources of inflow into **[*29]** its system by October 3, 1991. In conjunction with the acquisition, Citizens and DuPage have proposed that this deadline be extended to allow DuPage up to eighteen months from the acquisition to complete its private sector enforcement program.

Staff agrees that DuPage should be allowed an eighteen month period to complete the private sector sewer surcharge maintenance program but suggests the starting date begin with the approval date of this Order.

Based on the evidence presented, the Commission concludes that the deadline of October 3, 1991 should be extended an additional eighteen months from said date in order to allow DuPage to reasonably complete enforcement of the private sector program ordered by the Commission in Docket 85-0205. Use of the October 3, 1991 date for the eighteen month extension will parallel the inception of the eighteen month sewer surcharge approved herein.

The Commission, having considered the entire record and being fully advised in the premises, is of the opinion and finds that:

(1) Citizens and DuPage, Petitioners herein, are in the business of furnishing water and sewer utility services to the public in the State of Illinois and, as such, are public **[*30]** utilities within the meaning of The Illinois Public Utilities Act;

(2) the Commission has jurisdiction over Petitioners and over the subject matter herein;

(3) the recitals of fact and law and the conclusions set forth in the prefatory portion of this Order are supported by the evidence introduced in the record herein, and are hereby adopted as findings of fact and law;

(4) the acquisition and merger proposed herein should be approved pursuant to the terms and conditions of the Agreement admitted into evidence as Exhibit TEF-1 with the exception of Section 4.3 of Article IV of the Agreement which involves premature approval of a construction program unsupported by sufficient evidence in this Docket;

(5) Citizens' proposed acquisition of, and subsequent merger with DuPage satisfies the requirements of Sections 7-102 and 7-204 of the Act, and should be approved;

(6) Petitioners' proposed extensions to DuPage's Certificate of Public Convenience and Necessity as reflected on Appendix A attached hereto will promote the public convenience and are nec-

essary thereto, and should be granted; and for the same reason, the transfer of those Certificates to Citizens at the time of merger should **[*31]** be authorized;

(7) Petitioners' request to continue DuPage's rate surcharge in order to recover the cost of certain "maintenance" improvements relating to the customer sector program of DuPage's system as ordered in Dockets 59474 and 85-0205 should be granted predicated on the requirements provided in Findings (8), (9), (10), and (11);

(8) the surcharge will extend for a period of eighteen months beginning October 3, 1991 or until new rates for DuPage are put into effect;

(9) the maximum amount recoverable through the surcharge shall be $ 133,500 as set forth in the proposal by RJN Environmental Associates; if Citizens completes the work itself at a savings, the total amount spent on these projects should be reduced;

(10) the old sewer surcharge tariff language in DuPage tariff No. 16th. Revised Sheet, No. 1, authorized in DuPage consolidated Dockets 85-0440 and 86-0116, should be cancelled with the filing of the new tariff;

(11) the new tariff to be filed should take effect on October 3, 1991, should provide for true-up reports every six months thereafter, and should include the following information: (a) revenues collected or refunded by month; (b) sewer maintenance payments by **[*32]** month and project; (c) billing invoices from outside sources; and (d) if any work is done by Citizens, the billing is to include basic costs, overhead costs and basis for overheads with no profit mark-ups in Citizens' invoices;

(12) Petitioners' request for an extension of time to complete the private sector enforcement program ordered in Docket 85-0205 is reasonable and an eighteen month extension beyond the October 3, 1991 deadline should be granted;

(13) Petitioners' request for waiver, or confirmation of the inapplicability of, certain provisions of 83 Ill.Adm.Code 285, as specified herein, in connection with DuPage's planned rate case subsequent to the acquisition should be granted;

(14) Citizens' proposed accounting treatment for its transaction costs associated with the acquisition, approximately $ 85,000, should be approved;

(15) the Staff's proposed accounting treatment of ***regulatory assets*** with respect to DuPage should be approved;

(16) DuPage's true-up report for the period May 1987 through June 1990 comports with the reporting requirements established in Consolidated Dockets 85-0440 and 86-0116 and should be approved;

(17) separate accounts and records should be maintained **[*33]** by DuPage and Citizens until the first rate case is filed for uniform water rates for all Citizens' water and sewer holdings;

(18) Staff's treatment of the Acquisition Adjustment as a below-the-line item is consistent with the original cost principle outlined in Accounting Instruction 21 and should be adopted;

(19) MHA's recommendation that the Commission expressly condition its approval of the proposed acquisition and merger on Citizens' completion of its proposed program of capital improvements and maintenance work to DuPage's system is unnecessary and should be rejected;

(20) the following issues are more appropriately addressed in other dockets: (a) DuPage's use in its next rate case of Citizens' most recently authorized overall cost of capital; (b) approval of the costs of Citizens' acquisition of DuPage as the original cost rate base for DuPage;

IT IS THEREFORE ORDERED that Citizens Utilities Company of Illinois' proposed acquisition of, and subsequent merger with DuPage Utility Company satisfies the requirements of Sections 7-102 and 7-204 of The Illinois Public Utilities Act, be, and are, hereby approved;

IT IS FURTHER ORDERED that the acquisition and merger proposed herein **[*34]** be, and are, hereby approved pursuant to the terms and conditions of the Agreement admitted into evidence as Exhibit TEF-1 with the exception of Section 4.3 of Article IV of the Agreement;

IT IS FURTHER ORDERED that a Certificate of Public Convenience and Necessity be issued to DuPage Utility Co. evidencing the additional areas being served by DuPage outside its presently certificated area, and that said Certificate be the following:

CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

IT IS HEREBY CERTIFIED that public convenience and necessity require DuPage Utility Co. to construct, operate and maintain a public water supply and distribution system and a sewage collection and treatment facility in the areas described in Appendix A and to engage in the transaction of a public utility water and sewer business in connection therewith.

IT IS FURTHER ORDERED that DuPage's Certificates of Public Convenience and Necessity be transferred to Citizens at the time of merger.

IT IS FURTHER ORDERED that Petitioners' request to continue DuPage's rate surcharge in order to recover the cost of certain "maintenance" improvements relating to the customer sector program of DuPage's system as ordered **[*35]** in Dockets 59474 and 85-0205 be, and is, hereby granted predicated on the requirements provided in Findings (8), (9), (10), and (11).

IT IS FURTHER ORDERED that Petitioners' request for an extension of time to complete the private sector enforcement program ordered in Docket 85-0205 as set forth in Finding (12) be, and is, hereby allowed.

IT IS FURTHER ORDERED that Petitioners' request for waiver, or confirmation of the inapplicability of, certain provisions of 83 Ill.Adm.Code 285, as specified herein, in connection with DuPage's planned rate case subsequent to acquisition be, and is, hereby granted.

IT IS FURTHER ORDERED that Citizens' proposed accounting treatment for its transaction costs associated with the acquisition be, and is, hereby approved.

IT IS FURTHER ORDERED that Staff's proposed accounting treatment of ***regulatory assets*** with respect to DuPage be, and is, hereby approved.

IT IS FURTHER ORDERED that DuPage's true-up report for the period May 1987 through June 1990 be, and is, hereby approved.

IT IS FURTHER ORDERED that separate accounts and records be maintained by DuPage and Citizens until the first rate case is filed for uniform water rates for all Citizens' water **[*36]** and sewer holdings.

IT IS FURTHER ORDERED that the below-the-line treatment of the Acquisition Adjustment be, and is, hereby adopted.

APPENDIX A

[SEE ILLUSTRATION IN ORIGINAL]

2007 Fla. PUC LEXIS 579

Florida Public Service Commission
November 13, 2007, Issued
DOCKET NO. 060657-GU; ORDER NO. PSC-07-0913-PAA-GU, 07 FPSC 11:85

Reporter: 2007 Fla. PUC LEXIS 579

In re: ***Petition*** for ***approval*** of ***acquisition*** adjustment and recognition of regulatory asset to reflect purchase of Florida City Gas by AGL Resources, Inc.

Core Terms

acquisition, amortized, transition, customers, pension, savings, natural gas, deferred, cost of capital, reduction, stay-out, base rate, accelerated, attract, rate increase, five year, surveillance, decrease, revised, stock, gas plant, short-term, ownership, annual, long-term, premium

Panel: **[*1]** The following Commissioners participated in the disposition of this matter: LISA POLAK EDGAR, Chairman; MATTHEW M. CARTER II; KATRINA J. McMURRIAN; NANCY ARGENZIANO; NATHAN A. SKOP

Opinion

NOTICE OF PROPOSED AGENCY ACTION ORDER APPROVING POSITIVE ACQUISITION ADJUSTMENT AND REGULATORY ASSETS

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

I. Background

Florida City Gas (FCG or Company), formerly City Gas Co. of Florida (City Gas), sells and transports natural gas in Dade, Broward, Brevard, Indian River, Palm Beach and St. Lucie Counties. It is the second largest investor-owned natural gas utility in Florida, serving approximately 104,000 customers. FCG was incorporated in 1949 as a propane dealer, and in the late 1950's it began acquiring liquid propane (LP) companies in South Florida. In 1960, FCG gained access to the Florida Gas Transmission Company's pipeline and converted **[*2]** its existing underground pipeline systems to natural gas. Upon doing so, FCG became regulated by this Commission.

In 1988, NUI Corporation (NUI) acquired all outstanding shares of City Gas' common stock. City Gas was subsequently merged into Elizabethtown Gas Company, the principal operating subsidiary of NUI Utilities, operating as a separate division of the subsidiary corporation. On November 30, 2004, AGL Resources Inc. (AGLR) acquired all of the outstanding common stock of NUI Corporation. On December 6, 2004, the name of City Gas was changed to Florida City Gas. AGLR has gas operations in Florida, Georgia, Maryland, New Jersey, Tennessee, and Virginia.

On October 3, 2006, FCG filed its petition requesting that we approve a positive acquisition adjustment to be amortized over a period of 30 years. In addition, FCG also requested regulatory asset treatment for the outstanding amount of the former NUI pension plan allocated to FCG.

On May 4, 2007, FCG provided updated figures, revising the purchase price premium to $ 21,656,835. The revised transaction and transition costs are $ 1,615,149 and $ 1,991,998 respectively. The revised pension costs are $ 1,365,897, net of deferred taxes. [*3] On October 1, 2007, the Company filed a proposal refining certain points of its initial filing and reflecting the figures in its May 4, 2007, update.

An acquisition adjustment is the difference between the purchase price of a utility and an original cost calculation. Such an adjustment provides an incentive for stronger companies to purchase weak or troubled companies. Acquisition adjustments have been allowed in extraordinary circumstances if a company could demonstrate that customers will derive certain benefits attributable to the acquisition. Historically, we have considered five factors when determining whether the recognition of an acquisition adjustment is appropriate for a natural gas utility. Those factors are:

1. Increased quality of service;
2. Lower operating costs;
3. Increased ability to attract capital for improvements;
4. Lower overall cost of capital; and
5. More professional and experienced managerial, financial, technical and operational resources. [1]

[*4]

Although the utility is not requesting a rate increase at this time, it provided testimony and exhibits in conjunction with its petition to provide additional support and information for its request.

We have jurisdiction in this matter pursuant to *Sections 366.06* and *366.076, Florida Statutes* (F.S.).

II. Positive Acquisition Adjustment

On October 1, 2007, FCG filed a proposal "to reach a favorable resolution by the Commission in this matter." In the proposal, FCG reflected the amounts from schedules that it revised on May 4, 2007, in response to questions from our staff. The dollar figures differed from those in the original petition due to the removal of a small LP gas company, a change in the tax rate, and the use of actual 2006 expenses instead of projected expenses. Using the revised figures, the acquisition of FCG by AGLR resulted in a purchase price premium of $ 117,127,285 in excess of the book value of the original assets, of which $ 21,656,835 was allocated to FCG. The transaction and transition costs are $ 1,615,149 and $ 1,991,998, respectively. The Pension Regulatory Asset is $ 1,365,897, [*5] net of deferred tax, for a total of $ 26,629,879. Transaction and transition costs, and the Pension Regulatory Asset are addressed in other sections of this Order.

FCG asks that the acquisition adjustment and the associated annual amortization be included in rate base and cost of service, respectively. The Company believes that this regulatory treatment will more accurately portray the Company's actual investment and earnings level. FCG is not request-

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[1] Order No. 23376, issued August 21, 1990, in Docket No. 891309-WS, In re: Investigation of Acquisition Adjustment Policy; Order No. 23858, issued December 11, 1990, in Docket No. 891353-GU, In re: Application of Peoples Gas Systems, Inc. for a rate increase; and Order No. PSC-04-1110-PAA-GU, issued November 8, 2004, in Docket No. 040216-GU, In re: Application for a rate increase by Florida Public Utilities Company.

ing a rate adjustment associated with the acquisition adjustment at this time. Rather, FCG proposes a three to five year base rate stay-out period, which is addressed later in this Order.

A. Five Factors for Approving Positive Acquisition Adjustment

The Company recognizes that, in the past, we have generally considered five factors when determining whether recognition of such an adjustment is appropriate for a natural gas utility. Those factors are increased quality of service; lower operating costs; increased ability to attract capital for improvements; lower overall cost of capital; and more professional and experienced managerial, financial, technical and operational resources. [2]

[*6]

To determine whether the Company has adequately demonstrated the potential or actual qualitative and quantitative benefits to FCG's customers as a result of the acquisition by AGLR, we analyze each of the five factors.

1. Increased quality of service

FCG explains that it has improved customer service by centralizing the call center function in Atlanta, offering third-party payment locations for customers to pay their bills in person, and instituting monthly meter reading using automated meter reading devices, along with other such technological improvements. The Company provided data showing a reduction in call volume as well as a decline in both volume and percentage of abandoned calls. Although AGLR eliminated customer payment locations previously provided by FCG, it replaced them with four free payment locations as well as accepting payments at 109 Western Union locations for a one dollar fee. The Company also increased its number of meter readers to ensure more timely reading of meters.

However, the Commission complaint activity for FCG has remained consistent following its acquisition by AGLR. Prior to its acquisition by AGLR, we logged 144 and 134 consumer complaints against **[*7]** FCG in 2003 and 2004, respectively. Since acquisition by AGLR, in 2005, FCG received 134 consumer complaints, followed by 136 consumer complaints received in 2006. As of October 8, 2007, FCG received 118 complaints for the year. Thus, it appears that the complaints received by us have remained relatively steady. Also, on March 19, 2007, the Company moved its call center function to India. Therefore, our review shows that the level of customer complaints shows neither an improvement nor a decline in quality of service.

2. Lower operating costs

FCG made a number of improvements to reduce operating costs. AGLR centralized its facilities and implemented an inventory management system that it believes is more efficient. By increasing controls over material purchasing and ordering, stock inventory has been reduced. As a result, the Company was able to close one warehouse that it was leasing, thereby reducing related operations and maintenance expense.

The Automated Dispatch (AD) system, known as Field Force Automation (FFA), was implemented in all Florida locations in 2005. The purpose of FFA is to maximize electronic orders and minimize paper orders to increase efficiency and performance. **[*8]** FFA allows for more efficient assignment of work orders and enhances FCG's ability to respond more quickly to emer-

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[2] See Orders Nos. 23376, 23858, and PSC-04-1110-PAA-GU.

gency situations. The Company advises that the use of the automated dispatch system has resulted in an increase in the number of work orders completed per field technician from 12 to 16 per day, and allowed the reduction of 18 field distribution employees.

FCG has put a greater emphasis on reducing its response time to reports of natural gas leaks. It has employed Geographic Information System (GIS) mapping and mobility tracking, which is a technology that allows dispatchers to locate the leak and assign the work order to the closest available field technician. Mobility tracking allows dispatchers to electronically assign the work order directly to the selected field technician. The Company shows a decrease in average leak response time from 39.1 minutes in May, 2005, to 29.3 minutes in April, 2006.

The Company also believes the relationships between AGLR and its multiple contractors has opened FCG's contracted services to more competition. FCG points out that most of the new growth is in Brevard, Indian River, and St. Lucie counties. The contract services for this area **[*9]** were bid out in early 2005 with a resulting 20 percent reduction in pricing. The Company advises that simplification of the blanket contract pricing structure has reduced engineering labor costs for design and estimating. Conversion to AGLR's work management system has reduced engineering administration labor. These cost reductions have afforded FCG the ability to provide new service to more customers in the area by eliminating or significantly reducing the need for customer contributions.

The Company states that AGLR ownership has resulted in an annual reduction in gas capacity cost of $ .5 million. This reduced gas cost represents a reduction in the gas reservation charge payments made by FCG to Florida Gas Transmission Company (FGT). FCG states that AGLR personnel, using their forecasting and modeling tools, determined that a portion of the capacity under the FGT contract could be released without affecting customer deliverability or reliability.

The Company's revised schedules also show annualized savings of $ 1,305,000, which takes into consideration the federal tax rate of 34 percent rather than 35 percent (excluding the impact of state taxes), as originally filed. However, **[*10]** the schedules do not include amortization of the Pension Regulatory Asset, nor do they reflect the accelerated amortization of the transaction and transition costs proposed by the Company. When adjustments are made for these items, a cost savings is still apparent. A review of FCG's quarterly surveillance reports also shows evidence of a reduction in costs.

3. Increased ability to attract capital for improvements

FCG is a division of Pivotal Utility Holdings, Inc., which became a wholly-owned subsidiary of AGLR when AGLR merged with NUI Corporation (NUI) on November 30, 2004. AGLR has an equity market capitalization of approximately $ 3.0 billion as of August 2007, is traded on the New York Stock Exchange, and has an investment grade credit rating. With natural gas operations in Florida, Georgia, Maryland, New Jersey, Tennessee, and Virginia, AGLR has become the largest natural gas distribution company along the East Coast of the United States in terms of number of customers. As a result, FCG is now able to benefit from AGLR's ability to attract capital for improvements.

Moody's Investors Service (Moody's) had assigned NUI and NUI Utilities non-investment grade (speculative) **[*11]** credit ratings of Caa1 and B1, respectively. For comparison, AGLR is assigned investment grade credit ratings of Baa1 and A- from Moody's and Standard & Poors' (S&P), respectively. This improved ability to attract capital is demonstrated by AGLR's ability to refinance NUI's short-term debt, which carried an interest rate of London Interbank Offered Rate (LIBOR) plus 4.83 percent (10.15 percent at the time of acquisition) , into fixed rate long-term

debt with an interest rate of 5.50 percent. Additionally, AGLR was able to refinance two series of long-term debt held by NUI at fixed interest rates of 6.35 percent and 6.40 percent, respectively, into long-term debt with variable interest rates of 3.63 percent and 3.82 percent, respectively, as of June 30, 2006. Prior to the acquisition, FCG had been overly reliant on short-term debt due to NUI's inability to obtain new long-term financing under reasonable terms. FCG is now able to obtain both short-term and long-term financing as needed through AGLR.

Another example of FCG's improved ability to attract capital is demonstrated by the performance of AGLR's stock. NUI's stock price had been in a state of decline, falling from $ 26.78 per **[*12]** share on July 1, 2002, to $ 13.30 on July 15, 2004 (the date of the announcement of the acquisition) . In contrast, AGLR's stock price had risen from $ 18.95 on July 1, 2002, to $ 25.99 on July 15, 2004. As of October 5, 2007, AGLR's stock closed at $ 40.68.

For the reasons discussed above, we find FCG is now better positioned to attract the debt and equity capital needed to support its operations as a result of AGLR's acquisition of NUI.

4. Lower overall cost of capital

As noted earlier, FCG's ability to attract capital under reasonable terms was in a state of decline prior to the acquisition by AGLR. Due to NUI's deteriorating financial condition, it was required to pre-pay for its gas supply, including the gas supply for FCG. As a result of the acquisition by AGLR, FCG was able to resume the practice of post-paying for its gas supply. Post paying for its gas supply allowed FCG to decrease its amount of working capital which resulted in a one -time reduction in financing costs of approximately $ 375,000. Additionally, due to its poor credit rating, NUI was borrowing at short-term rates of LIBOR plus 4.83 percent. In contrast, as a result of the acquisition, FCG is now able to **[*13]** borrow at short-term rates of LIBOR plus 0.05 percent.

In addition to the reduction in borrowing costs discussed above, AGLR used three methods to compare the overall cost of capital under NUI ownership versus the cost of capital under AGLR. Each of the three methods showed a decrease in the overall cost of capital under AGLR ownership compared to NUI ownership. Two of the three cost of capital calculation methods showed a decrease in the revenue requirement while one of the methods showed an increase in revenue requirement. Our own comparison of the overall cost of capital under NUI and AGLR as of June 30, 2006, shows a decrease in both the overall cost of capital and the revenue requirement.

Even though two of the three methods used by AGLR showed a decrease in the revenue requirement and support the Company's position that FCG has a lower cost of capital under AGLR ownership, the Company did not include an amount associated with the reduction in the cost of capital in the calculation of the savings resulting from the acquisition. The Company stated that it excluded the impact on cost of capital due to the conflicting results and to present a conservative estimate of the savings. **[*14]** Based on our own analysis, we find FCG has a lower cost of capital as a result of AGLR's acquisition of NUI.

5. More professional and experienced managerial, financial, technical and operational resources

AGLR is among the largest gas distributors in the country, the single largest operator of liquefied natural gas (LNG) peaking facilities, and states it is consistently one of the top quartile operators according to industry metrics. It serves 2.2 million natural gas customers, owns more than 35,000 miles of natural gas pipelines and five LNG facilities. Further, AGLR advises that it was named the 2003 Gas Company of the year by Platt's Global Energy Awards, and was a finalist for that award in 2004. In 2006, AGLR was ranked as the 10th Best Managed Utility Company in the United States by Forbes.

AGLR contends that this experience in operating a natural gas utility benefits FCG's customers and allows AGLR to develop a number of best practices and metric measurements with regard to operations, inventory management, productivity improvements, safety and reliability. AGLR also states that FCG has been able to tap into the expertise and employ these techniques and processes to enhance **[*15]** the operation of the FCG system and it has been able to take advantage of the synergies to reduce costs and deploy advanced technologies which allow additional efficiency gains for work processes in the field. We have no evidence to the contrary.

B. Savings

In the table below, we show the savings reported by the Company and the impact of the amortization resulting from the acquisition. Column 1 shows the revised amounts as filed by the Company as of 2004, adjusted by us to reflect the transaction and transition costs and the amortization of the Pension Regulatory Asset discussed later in this Order. Column 2 shows the impact of accumulated amortization on rate base through December 2006. We note that although the Company filed 2006 savings information, no adjustment for accumulated amortization was made to show the effect of the amortization on rate base.

Because we are approving a 5-year amortization period for transaction and transition costs later in this Order, the transaction and transition costs will be fully amortized by November 2009. The pension costs will also be fully amortized over a shorter timeframe than the acquisition adjustment. As the acquisition adjustment **[*16]** and regulatory assets are amortized, the impact will be to increase the net savings, assuming savings in O&M expenses remain unchanged.

Net Savings to Florida City Gas as a Result of the AGL Resources Inc. Acquisition		
	(1)	**(2)**
	Company Proposed 2004	**EOY 2006 Balances**
Operation and Maintenance Expense Savings	$ 4,170,000	$ 4,170,000
Reduction in Gas Cost--Financing	415,000	415,000
Reduction in Gas Cost--Release of Excess Capacity	495,000	495,000
Total Savings Due to Acquisition	$ 5,080,000	$ 5,080,000
Acquisition Adjustment Allocated to Florida City Gas		
Purchase Premium	$ 21,656,835	$ 20,092,730
Transaction and Transition Costs	3,607,147	2,044,050
Pension	1,365,897	1,143,939
Total	$ 26,629,879	$ 23,281,000
Multiplied by Wtd. Ave. Cost of Capital (After-tax)	7.11%	7.11%
Return on Rate Base - Operating Income Requirement	$ 1,893,384	$ 1,655,259
Gross-Up Factor	1.6329	1.6329
Revenue Requirement	$ 3,091,707	$ 2,702,873

Net Savings to Florida City Gas as a Result of the AGL Resources Inc. Acquisition	(1) Company Proposed 2004	(2) EOY 2006 Balances
Annual Amortization*	1,546,023	1,545,766
Total Revenue Requirement	$ 4,637,730	$ 4,248,639
Annualized Savings as a Result of the Acquisition	$ 442,270	$ 831,361
*Amortization includes the Acquisition Adjustment, Transaction and Transition Costs, and Pension Costs		

[*17]
C. Provisional Treatment

At this time, the Company has demonstrated that the acquisition of FCG by AGLR has resulted in a benefit to FCG's customers. AGLR brings substantial expertise in the business to bear, and has made considerable effort to improve the operations of the Company. What remains to be seen is whether these benefits will continue in the future. Further, the approval of the acquisition in this case would represent the first time we have approved an acquisition adjustment outside of a rate proceeding. Given that, we find that it is appropriate to revisit the effects of the adjustment in the future. There is precedent for our approval of acquisition adjustments on a provisional basis.

In Order No. 18716, issued January 26, 1988, [3] a $ 200,000 acquisition adjustment for Central Florida Gas Company (Central Florida) was approved based on projected savings due to the acquisition of Central Florida Gas Company by Chesapeake Utilities Corporation in 1985. The acquisition adjustment was approved with the caveat that the projected savings would be analyzed in future rate cases to determine if the projected savings actually occurred or had eroded. However, it was later **[*18]** found that Central Florida had experienced a total increase in its revenue requirements after its acquisition by Chesapeake. As a result, the acquisition adjustment of $ 200,000 was removed from Central Florida's rate base. [4]

A positive acquisition was approved for Peoples Gas System (Peoples) when it demonstrated extraordinary circumstances to justify a positive acquisition adjustment resulting from its purchase of Southern Natural Gas. [5] We determined that the adjustment "should be amortized over 30 years and all funds ... held subject to refund with interest at the short-term average commercial paper rate (as reported in the Wall Street Journal) pending review of the anticipated sav-

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[3] In Docket No. 870118-GU, In re: Petition of Central Florida Gas Company to increase its rates and charges.

[4] Order No. 23166, issued July 10, 1990, in Docket No. 891179-GU, In re: Petition of Central Florida Gas Co. and Plant City Natural Gas Co, Divisions of Chesapeake Utilities Corp. for a rate increase, pp. 3-4.

[5] Order No. 23858, issued December 11, 1990, in Docket No. 891353-GU, In re: Application of Peoples Gas Systems, Inc. for a rate increase.

ings, [*19] in the Company's next rate case." [6] In Peoples' next rate case, the Commission found that no portion of the revenues held subject to refund as a result of the approved acquisition should be refunded. [7] FCG is not requesting an increase in rates; thus, unlike Peoples Gas System, there is no rate increase to hold subject to refund.

Per the Uniform System of Accounts, acquisition adjustments are to be recorded in Account 114, Gas Plant Acquisition Adjustments. The related acquisition adjustment amortization is to be recorded in Account 425, Miscellaneous Amortization, unless we authorize the use of another account. Account 425 is a below-the-line expense account that is not included for ratemaking [*20] or earnings surveillance purposes. However, we can authorize the use of Account 406, Amortization of Gas Plant Acquisition Adjustments, as an above-the-line expense account. The amortization amounts recorded in Account 406 would be included for ratemaking and earnings surveillance purposes. As discussed previously, the customers have derived benefits from the acquisition. Therefore, we find that FCG shall amortize the acquisition adjustment to Account 406 for ratemaking and earnings surveillance purposes.

However, FCG shall file its quarterly earnings surveillance reports (ESR) showing the effects of the acquisition adjustment, and showing the earnings if the acquisition adjustment is not included. The effect of not including the acquisition adjustment shall be shown in the appropriate "Pro Forma Adjustment" sections of the ESR. This will allow our staff to monitor the impact until the next rate proceeding.

Based on the above, Florida City Gas shall be allowed to record the $ 21,656,835 purchase price premium as a positive acquisition adjustment to be amortized over a 30-year period beginning November 2004. The amortization shall be recorded in Account 406, Amortization of Gas Plant [*21] Acquisition Adjustments. The permanence of the cost savings supporting FCG's request shall be reviewed in the Company's next rate proceeding. The Company shall file its earnings surveillance reports with and without the effect of the acquisition adjustment. If it is determined that the cost savings no longer exist, the acquisition adjustment may be partially or totally removed as deemed appropriate by this Commission.

III. Creation of Regulatory Asset for Transaction and Transition Costs

In addition to the purchase premium, AGLR incurred transaction costs and transition costs as a result of the acquisition, which were allocated in part to FCG. The numbers reflect the use of a 34 percent federal tax rate instead of the 35 percent rate used by the Company (excluding the state tax impact).

Transaction Costs

Transaction costs are those costs necessary to effect the acquisition of FCG by AGLR. FCG stated that AGLR incurred $ 8,735,259 in transaction costs, of which $ 1,615,149 or 18.49 percent was allocated to FCG. Approximately two thirds of the total costs were incurred for the investment banker ($ 3,081,847) and legal fees ($ 2,774,279). Other costs include such items as consultants [*22] and Federal Trade Commission filing fees.

Transition Costs

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[6] Id. at 6.

[7] Order No. PSC-92-0924-FOF-GU, issued September 3, 1992, in Docket No. 911150-GU, In re: Application for a rate increase by Peoples Gas System, Inc., p. 4.

Transition costs are costs incurred after the acquisition. The total transition costs were $ 165,399,973. Of that amount, $ 5,383,831 or 18.49 percent was allocated to FCG. The Company decreased the amount by $ 2,025,936, for deferred taxes, resulting in net transition costs of 3,357,895. Those costs were further reduced by the regulatory asset for pensions of $ 1,365,897, net of deferred tax. The details of these costs are discussed below. The regulatory asset for pensions is discussed in the next section of this Order.

1. Employee Severance Payments: The Company explained that it operates under a business model to lower costs through increased efficiencies. One of the areas where the Company achieved lower costs was improved employee productivity, which resulted in a reduced number of employees. According to FCG, the reduced number of employees performed the same amount of work without sacrificing the level of service. This increased productivity enabled the Company to reduce the number of FCG employees by 34 since the acquisition. The result was a reduction to payroll and employee benefits of approximately $ 1.3 **[*23]** million and $ .4 million, respectively, for the twelve-month period ended September 2004. The total severance payments were $ 2,180,930.

2. Information System Write-Offs: Another part of AGLR's business model was the consolidation of its subsidiaries' technology systems into a single system, to the extent possible. These systems included, but were not limited to, financial, general networks and programs, and customer management. The consolidation rendered existing systems obsolete, requiring the write-off of NUI's financial and general information systems. The cost of the write-offs was $ 926,670.

3. Change of Control Payments: These payments were the result of agreements between NUI and certain NUI executives that were made prior to the acquisition by AGLR. Under the agreements, the executives were to be compensated if they were terminated within a three-year period if there was a change in control, which in this case was an acquisition. The payments totaled $ 871,726.

4. Retention Compensation: Retention compensation was paid to certain FCG and NUI employees prior to and during the transition period after AGLR's acquisition. Total payments of $ 435,033 were made to mitigate **[*24]** the financial and operational impact of the acquisition.

5. Directors' and Officers' Insurance: AGLR agreed to provide liability insurance for the former directors and officers of NUI. FCG states that this coverage was a necessary part of the transition of ownership and was one of the terms of the acquisition agreement. The cost was $ 647,519.

6. Transition Costs Not Allocated to FCG: AGLR incurred $ 75,230,524 of transition costs that were not allocated to FCG. These costs were related to other companies acquired from NUI, non -jurisdictional operations, or the impairment of non-FCG assets.

7. Pensions and Post-retirement Benefits Other Than Pensions: First, as a result of the acquisition, Generally Accepted Accounting Principals (GAAP) require the recognition of accelerated pension costs. Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions (FAS 87), requires the acquiring company to recognize the full projected benefit obligation in excess of plan assets at the time of the acquisition. The projected benefit obligation included deferred investment plan asset gains and losses and prior service costs. These costs are typically amortized **[*25]** over the average remaining service period of active employees expected to receive the benefits. The effect of the FAS 87 requirement is to accelerate these costs at the time of the acquisition. The $ 2,189,990 in accelerated pension costs recognition was assigned to FCG based on an actuarial study. The Company is requesting regulatory asset treatment of this, and that request is considered in the next section of this Order.

Second, this item includes a $ 321,953 reduction to the acquisition adjustment to reflect the appropriate level of pension assets for FCG. As of this acquisition date, FCG had a liability recorded on its books, but the records should have reflected an asset. An adjustment was made to correct the books for this item.

8. Deferred Tax Adjustment: This item reflects the effect on accumulated deferred income taxes for each component of the transition costs. The $ 1,201,843 in deferred taxes (net of deferred taxes on the Pension Regulatory Asset) was calculated by applying the 37.63 percent combined federal and state tax rate to each of the transition items.

Analysis

The FERC Uniform System of Accounts adopted by us prescribes the accounts to be used by regulated **[*26]** natural gas utilities. Account 114, Gas Plant Acquisition Adjustments, is the appropriate account for use in recording acquisition adjustments. This account states in part that "[t]his account shall include the difference between (a) the cost to the accounting utility of gas plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property...."

We find that the transaction and transition costs do not fit the description of plant costs to be included in Account 114. These costs are more appropriately recorded as a regulatory asset to be amortized over five years. A regulatory asset is a cost that is capitalized and recovered over a future period, rather than charged to expense when incurred. This approach has been used by us for recording of gains and losses for plant sales. Normally, gains are amortized back to customers over an appropriate period as decided by this Commission, usually five years. For instance, Southern States Utilities, Inc. was required to amortize gains on the sale of facilities and land over a period of five years. [8] We found that "[when] a utility **[*27]** sells property that was formerly used and useful or included in uniform rates, the ratepayers should receive the benefit of the gain on sale of such utility property." [9] Similarly, in an FPL rate proceeding, [10] we stated:

> We have addressed the issue of the actual sale of Utility property in FPL's last full rate case and in a number of other rate cases. In those cases, we determined that gains or losses on disposition of property devoted to, or formerly devoted to, public service should be recognized above the line and that those gains or losses, if prudent, should be amortized over a five-year period. We reaffirm our existing policy on this issue.

[*28]

More recently, we approved petitions by Florida Public Utilities Company's gas division to amortize gains on the sale of property above the line. [11]

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[8] Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, In re: Application for rate increase and increase in service availability charges by Southern States Utilities, Inc. for Orange-Osceola Utilities, Inc. in Osceola County, and in Bradford, Brevard, Charlotte, Citrus, Clay, Collier, Duval, Highlands, Lake, Lee, Marion, Martin, Nassau, Orange, Osceola, Pasco, Putnam, Seminole, St. Johns, St. Lucie, Volusia, and Washington Counties.

[9] Id. at 202.

[10] Order No. 13537, issued July 24, 1984, in Docket No. 830465-EI, In re: Petition of Florida Power and Light Company for an increase in its rates and charges, pp. 17-18.

[11] Order No. PSC-02-1159-PAA-GU, issued August 23, 2002, in Docket No. 020521-GU, In re: Petition for approval to amortize gain on sale of property over five-year period by Florida Public Utilities Company; and Order No. PSC-02-1727-PAA-GU, issued December 9, 2002, in Docket No. 021014-GU, In re: Petition for approval to amortize gain on sale of property by Florida Public Utilities Company.

Based on the above, we find that transaction and transition costs of $ 1,615,149 and $ 1,991,998, respectively, shall be recorded as a regulatory asset and amortized over five years beginning November **[*29]** 2004. This approval to record the regulatory asset for accounting purposes does not limit our ability to review the amounts for reasonableness in future rate proceedings.

Further, we will allow above-the-line treatment of these expenses in this case because the Company has agreed not to seek rate relief for a period of five years, and the Company has agreed to an accelerated amortization period such that these costs will be fully amortized by the end of the 5-year "stay out" period. Thus, allowing above-the-line accounting of these costs in this case will not raise rates. Approval of this accounting treatment for these transaction and transition costs, as specified herein, is strictly limited to the facts of this case and shall not be considered precedential for purposes of future Commission proceedings addressing similar costs associated with other utility acquisition adjustment proposals.

IV. Creation of a Net Regulatory Asset for Pensions

FCG and AGLR account for pension costs in accordance with FAS 87. We have recognized FAS 87 for ratemaking purposes. Essentially, this means that utilities must account for benefit plan costs using accrual accounting, as opposed to "pay-as-you-go" **[*30]** methods which were prevalent prior to the promulgation of the above standard. FAS 87 requires that the acquiring company in a merger recognize the full projected benefit obligation in excess of plan assets at the time of acquisition. For a pension plan, the projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to that date.

According to FCG, an amount of $ 2,189,990 in accelerated pension cost recognition was assigned to FCG based on an actuarial study. FCG is requesting the creation of a regulatory asset for this amount, net of the associated deferred income taxes. The Company states that the amount of the deferred taxes is $ 824,093. The Company also states that the appropriate period for amortization of the regulatory asset is 13.3 years, which is the approximate remaining service period of FCG employees expected to receive benefits from the pension plan. In its petition, the Company notes that prior to the acquisition, FCG had recovered pension costs in its base rates. Further, FCG states that establishing the regulatory asset and amortizing it over 13.3 years will result in recognition **[*31]** of the accelerated items over a period which approximates the normal pension expense recognition under FAS 87.

FAS 71 allows regulated companies to defer costs and create regulatory assets, provided that it is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes. To create a regulatory asset or liability, a regulated company must have the approval of its regulator. This concept of deferral accounting allows companies to defer costs due to events beyond their control and seek recovery through rates at a later time. The alternative would be for the Company to seek a rate case each time it experiences an exogenous event.

We find FCG's request to create a regulatory asset to record charges that would otherwise have been recorded in equity under the provisions of FAS 87 meets the requirements of FAS 71, and it is approved. The amount of the regulatory asset shall be $ 1,365,897 ($ 2,189,990 gross, less $ 824,093 accumulated deferred taxes) and this amount shall be amortized over 13.3 years, beginning November 2004. Our approval to record the regulatory asset for accounting purposes **[*32]** does not limit our ability to review the amounts for reasonableness in future rate proceedings.

V. Five-Year Stay-Out Period

In its October 1, 2007, proposal, FCG indicated a willingness to agree to a three to five- year stay -out period, beginning with the date of a favorable vote on its proposal. The Company advises that the stay-out period would not include the annual cost recovery proceedings such as the Purchased Gas Adjustment (PGA). It also would be subject to certain exceptions, such as unforeseen acts, force majeure, acts of God, and/or terror-related events.

We find that a five-year base rate stay-out period is in the best interests of the customers. Under such a provision, base rates will not be increased for five-years from October 23, 2007. The exceptions proposed by the Company are reasonable; however, unforeseen acts shall be items beyond the control of the Company.

The base rate stay-out provision does not preclude us from initiating proceedings, such as, but not limited to, overearnings proceedings. We may also reevaluate the reasonableness of the acquisition adjustment at any time during the stay-out period.

Accordingly, FCG's proposal for a five-year base rate **[*33]** stay-out period is accepted. The stay -out period shall not include annual cost recovery proceedings, and shall begin on October 23, 2007, if there is no protest. Exceptions to the base rate stay-out shall include items such as unforeseen acts, force majeure, acts of God, and terror-related events.

In consideration of the above, it is

ORDERED by the Florida Public Service Commission that Florida City Gas shall be allowed to record the $ 21,656,835 purchase price premium as a positive acquisition adjustment to be amortized over a 30-year period beginning November 2004. It is further

ORDERED that the amortization shall be recorded in Account 406, Amortization of Gas Plant Acquisition Adjustments. It is further

ORDERED that the permanence of the cost savings supporting Florida City Gas' request shall be subject to continuing review. It is further

ORDERED that Florida City Gas shall file its earnings surveillance reports with and without the effect of the acquisition adjustment. It is further

ORDERED that in Florida City Gas' next rate proceeding, if it is determined that the cost savings no longer exist, the acquisition adjustment may be partially or totally removed as deemed appropriate **[*34]** by this Commission. It is further

ORDERED that transaction costs of $ 1,615,149 and transition costs of $ 1,991,998 shall be recorded as a regulatory asset and amortized over five years beginning November 2004. It is further

ORDERED that the approval to record the regulatory asset for accounting purposes does not limit our ability to review the amounts for reasonableness in future rate proceedings. It is further

ORDERED that Florida City Gas shall be authorized to use deferral accounting to create a net regulatory asset in the amount of $ 1,365,897 to recognize and offset the accelerated treatment for pension costs the company must record in accordance with Statement of Financial Accounting Standards (FAS) 87. It is further

ORDERED that this amount shall be amortized over a period of 13.3 years, beginning November 2004. It is further

ORDERED that the approval to record the regulatory asset or liability for accounting purposes does not limit our ability to review the amounts for reasonableness in future rate proceedings. It is further

ORDERED that the proposal of Florida City Gas for a five-year base rate stay-out period is accepted. The stay-out period shall not include annual cost **[*35]** recovery proceedings, and shall begin on October 23, 2007, if there is no protest. It is further

ORDERED that exceptions to the base rate stay-out shall include items such as unforeseen acts, force majeure, acts of God, and terror-related events. It is further

ORDERED that the provisions of this Order are issued as proposed agency action, and shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Office of Commission Clerk and Administrative Services, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that if no person whose substantial interests are affected by this Proposed Agency Action files a protest within 21 days of the Order, a Consummating Order will be issued and the docket will be closed.

By ORDER of the Florida Public Service Commission this 13th day of November, 2007.

ORDER 07-0914 IS AVAILABLE UPON REQUEST