

FILED
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MEMORANDUM

Missouri Public
Service Commission

TO: Missouri Public Service Commission Official Case File
Case No. WM-99-238
Capital Utilities, Inc., Riverside Utility Company, Inc.,
Foxfire Utility Company, Inc. and AquaSource, Inc.

FROM: Ron Bible, Case Coordinator
Roberta McKiddy, Financial Analysis Department *RU*
Jim Schwieterman, Accounting Department *J.S.*
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R.E. Schellenberg 1-28-99
Director, Utility Services Division/Date

W. Henderson for Wess Henderson 1/28/99
Director, Utility Operations Division/Date

Wm K Hear 1/29/99
General Counsel's Office/Date

SUBJECT: Staff Recommendation in Support of the Requested Authority
to Sell and Transfer Stock and to Transfer Control

DATE: January 28, 1999

On November 25, 1998, Capital Utilities, Inc., Riverside Utility Company, Inc. and Foxfire Utility Company, Inc. filed a Joint Application seeking "Authority to Sell and Transfer Their Stock and to Transfer Control of Said Companies to operating subsidiaries of AquaSource, Inc."

Capital Utilities, Inc. (CU) is a Missouri corporation providing regulated water and sewer services to Missouri customers in its Commission-authorized service areas pursuant to certificates of public convenience and necessity granted in the following Commission cases: SA-90-224, WM-92-195, WM-98-130 and WM-98-165. The stock of CU is wholly owned by Mr. and Mrs. Garah F. Helms (Mr./Mrs. Helms), who also manage the operation of CU from their offices in Jefferson City.

Riverside Utility Company, Inc. (RU) is a Missouri corporation providing regulated water services to Missouri customers in its Commission-authorized service areas pursuant to certificates of public convenience and necessity granted in the following Commission cases: WA-81-255, WM-93-43, and WM-94-240. The stock of RU is wholly owned by Mr./Mrs. Helms, who also manage the operation of RU from their offices in Jefferson City.

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Foxfire Utility Company, Inc. (FU) is a Missouri corporation providing regulated water and sewer services to Missouri customers in its Commission-authorized service area pursuant to a certificate of public convenience and necessity granted in the Commission case docketed as WA-95-31. The majority of the stock of FU is owned by Mr./Mrs. Helms, who also manage the operations of FU from their offices in Jefferson City.

AquaSource, Inc. (AquaSource) is a Texas corporation and a wholly owned subsidiary of DQE, Inc. (DQE), a utility services company headquartered in Pennsylvania.

On October 16, 1998, AquaSource, through its wholly-owned subsidiary AquaSource Services and Technologies, Inc., acquired Water Management Services of Missouri (WMS) via a stock merger. This transaction was negotiated in conjunction with, and contingent upon, the proposed stock purchase of CU, RU and FU by subsidiaries of AquaSource. WMS is an unregulated company that provides contract operations of water and sewer utility facilities, and that prior to October 16, 1998 was also wholly owned by Mr./Mrs. Helms.

AquaSource proposes that RU, CU and FU become three separate AquaSource subsidiaries, under the AquaSource subsidiary AquaSource Utility, Inc. (ASI). AquaSource also proposes that RU, CU and FU operate under the names of AquaSource/CU, Inc., AquaSource/RU, Inc. and AquaSource/FU, Inc. (hereafter referred to as "the Subsidiaries"), upon completion of the merger. AquaSource further proposes that the Subsidiaries remain as Missouri corporations and continue the operations and responsibilities of CU, RU and FU, respectively, as utilities regulated by the Missouri Public Service Commission (Commission) under the existing CU, RU and FU certificates and tariffs. Additionally, AquaSource states that "No change to the rates, services or service areas currently authorized by CU, RU or FU are contemplated as a direct result of the proposed transactions." Lastly, AquaSource notes that the Subsidiaries and WMS will continue to be operated under the direction of Mr. Helms, and that both Mr. and Mrs. Helms have executed employment agreements with AquaSource.

The Commission's Financial Analysis Department has reviewed the pre and post-merger capitalization of CU, RU and FU, respectively. Information relating to said capitalization is summarized in Attachment A to this Memorandum. Although the Subsidiaries will have a capital structure of 100% equity upon completion of the proposed transactions, the Staff believes that access to funds provided by AquaSource's holding company (DQE) will only strengthen the operations of the Subsidiaries.

As noted previously, AquaSource is a Texas corporation and a wholly owned subsidiary of DQE, which is headquartered in Pennsylvania. According to DQE's 1997 Annual Report, AquaSource was formed in 1997 for the purpose of acquiring small and mid-sized water, wastewater and water services companies on behalf of DQE. The subject Joint Application states that AquaSource had operating revenues through the third quarter of 1998 in excess of thirteen million dollars, and had operations in the states of Connecticut, Indiana, Massachusetts, Rhode Island and Texas. Furthermore, DQE's 1997 Annual Report showed operating revenues of \$1.2 billion in 1997, as well as a total capitalization of \$3.103 billion. DQE also reported a common equity ratio of 48.3% and a long-term debt ratio of 44.4% for 1997. DQE's debt ratio is below the industry average of 56% as published by Standard and Poor's Corporations Utilities Rating Service on June 30, 1998. DQE's pre-tax interest coverage was stated as 2.76 for 1997. The Staff believes these financial indicators suggest that the Missouri acquisitions (i.e., the Subsidiaries) will continue to operate in a financially sound manner and, therefore, that the proposed transactions set out in the Joint Application would not be detrimental to the ratepayers of CU, RU and FU, nor to the public interest.

The Staff of the Commission's Water and Sewer Department also believes the proposed transactions will not be detrimental to the affected ratepayers or the public interest, since they will effectively be invisible. Rates and rules will remain as they now exist, and the same people (i.e., Mr. and Mrs. Helms) will supervise system operations and business matters.

Since a change in the names of the affected companies will result from approval of the proposed transactions, the Subsidiaries will need to adopt the appropriate existing CU, RU and FU tariffs. These actions can be accomplished through the filing of adoption notices consistent with the sample notice that is included with this Memorandum as Attachment B. The adoption notices, and any necessary tariff index sheets reflecting the existence of the adoption notices, should be filed upon the issuance of a Commission order granting the authority requested in the Joint Application, and should bear an effective date that coincides with the completion of the transactions proposed in the Joint Application.

Additionally, and as is normally done, the Staff believes that the Commission should direct the Subsidiaries to keep their books and records in accordance with the Uniform System of Accounts on an on-going basis.

Lastly, by stating its support for the authority requested in the subject Joint Application, the Staff should not be deemed to have approved or acquiesced to any ratemaking principle or any method of cost determination or cost allocation.

Based upon the above, the Staff recommends that the Commission issue an order that:

1. Authorizes the acquisition of the stock of Capital Utilities, Inc., Riverside Utility Company, Inc. and Foxfire Utility Company, Inc. by AquaSource/CU, AquaSource/RU and AquaSource/FU, respectively, and authorizes the mergers of these companies, respectively;
2. Directs each of the Subsidiaries to adopt the appropriate existing CU, RU and FU tariffs by filing adoption notices and modified index sheets consistent with the Staff's discussion of this matter set out in this Memorandum;
3. Directs each of the Subsidiaries to keep their books and records in accordance with the Uniform System of Accounts on an on-going basis; and
4. Makes no finding that would bind any party to any ratemaking principle or any method of cost determination or cost allocation in any future case.

Attachments:

Attachment A - Pro Forma Capitalization as of November 30, 1998

Attachment B - Sample Tariff Adoption Notice

Copies: Director - Utility Operations Division
Director - Utility Services Division
Director - Research and Public Affairs Division
General Counsel's Office
Manager - Accounting Department
Manager - Depreciation Department
Manager - Financial Analysis Department
Manager - Water and Sewer Department
Office of the Public Counsel
Garah F. Helms (CU, RU and FU)
Michael Ashfield (AquaSource)
Charles Brent Stewart (Counsel for Joint Applicants)

Pro Forma Capitalization as of November 30, 1998

Capital Utilities, Inc., Riverside Utility Company, Inc., Foxfire Utility Company, Inc. and AquaSource Inc.
Case No. WM-99-238

<u>Capital Utilities Inc.</u>				Pro Forma	Pro Forma
Capital Component	Percentage of Capital	Capital Dollars	Pro Forma Adjustments	Capital Dollars	Percentage of Capital
Common Equity	50.92%	\$171,853	\$165,612	\$337,465	100.00%
Preferred Stock	0.00%	\$0	\$0	\$0	0.00%
Long-Term Debt (1)	49.08%	\$165,612	(\$165,612)	\$0	0.00%
Short-Term Debt	0.00%	\$0	\$0	\$0	0.00%
Total	100.00%	\$337,465	\$0	\$337,465	100.00%

<u>Riverside Utility Company, Inc.</u>				Pro Forma	Pro Forma
Capital Component	Percentage of Capital	Capital Dollars	Pro Forma Adjustments	Capital Dollars	Percentage of Capital
Common Equity	98.73%	\$232,071	\$2,989	\$235,020	100.00%
Preferred Stock	0.00%	\$0	\$0	\$0	0.00%
Long-Term Debt (1)	1.27%	\$2,989	(\$2,989)	\$0	0.00%
Short-Term Debt	0.00%	\$0	\$0	\$0	0.00%
Total	100.00%	\$235,020	\$0	\$235,020	100.00%

<u>Foxfire Utility Company, Inc.</u>				Pro Forma	Pro Forma
Capital Component	Percentage of Capital	Capital Dollars	Pro Forma Adjustments	Capital Dollars	Percentage of Capital
Common Equity	41.80%	\$259,698	\$361,652	\$621,350	100.00%
Preferred Stock	0.00%	\$0	\$0	\$0	0.00%
Long-Term Debt (1)	58.20%	\$361,652	(\$361,652)	\$0	0.00%
Short-Term Debt	0.00%	\$0	\$0	\$0	0.00%
Total	100.00%	\$621,350	\$0	\$621,350	100.00%

Financial Ratio Benchmarks

Total Debt / Total Capital - Including Preferred Stock

Standard & Poor's Corporation's
Utilities Rating Service, June 30, 1998
Water Utilities
(Financial Medians)

AA	A	BBB
N/A	56%	N/A

Name of Utility: AquaSource/CU, Inc.

Service Area: Missouri Service Areas in Callaway, Cole, and Pettis Counties

Rules Governing Rendering of
Sewer Service

ADOPTION NOTICE

Capital Utilities, Inc. merged with AquaSource/CU, Inc., and will continue under the name AquaSource/CU, with approval granted in Case No. WM-99-238. Accordingly, AquaSource/CU, Inc. hereby adopts, ratifies, and makes its own, in every respect as if the same had been originally filed by it, all tariffs, schedules, rules, notices or other instruments filed with the Public Service Commission, State of Missouri, under the name Capital Utilities, Inc. currently on file with and approved by the Commission.

- * Indicates new rate or text
- + Indicates change

DATE OF ISSUE _____
Month Day Year

DATE EFFECTIVE _____
Month Day Year

ISSUED BY _____
name of officer title address