

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT APPLICATION FOR APPROVAL)	
OF THE ACQUISITION BY PHILADELPHIA)	CASE NO.
SUBURBAN CORPORATION OF THE STOCK)	2002-00384
OF AQUASOURCE UTILITY, INC.)	

COMMISSION STAFF S FIRST SET OF INTERROGATORIES
AND REQUESTS FOR PRODUCTION OF DOCUMENTS
TO JOINT APPLICANTS

Pursuant to Administrative Regulation 807 KAR 5:001, Commission Staff requests that Philadelphia Suburban Corporation (Philadelphia), AquaSource, Inc. (AquaSource), AquaSource Utility, Inc. (AquaSource Utility), and Coolbrook Sanitation Division (Coolbrook) (collectively Joint Applicants) file with the Commission the original and 8 copies of the following information, with a copy to all parties of record. The information requested herein is due on or before November 22, 2002. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible. Where information requested herein has been provided, in the format requested herein, reference may be made to the specific location of said information in responding to this information request. When applicable, the information requested herein should be provided for total company operations and jurisdictional operations, separately.

1. On page 2 of the application, Joint Applicants state that local management will remain substantially in place and staffing levels will not be materially disturbed. Discuss any planned changes related to local management and staffing levels that will result in the elimination of current employees.

2. Has Philadelphia made any long-term plans that will result in the elimination of current employees?

3. Discuss the immediate and future impact that the proposed transaction will have on Coolbrook's rates.

4. On page 6 of the application, Joint Applicants state that employees of AquaSource Utility's Jefferson, Indiana office currently handle maintenance responsibilities for the Coolbrook system. Will this arrangement continue if the proposed transaction is approved? If no, who will handle maintenance responsibilities for the Coolbrook system?

5. What specific opportunities for career advancement and professional growth will Philadelphia offer to AquaSource employees?

6. Will Philadelphia utilize the same service and billing systems currently used by Coolbrook? If no, discuss the steps Philadelphia will take to ensure a smooth transition to new billing and service systems.

7. Refer to page 4 of the Application and the Purchase Agreement (Agreement), Section 1.4, Purchase Price Adjustment. The Applicants have agreed upon a Base Purchase Price (Base Price) of \$205 million for AquaSource's outstanding shares of stock. However, the Base Price is subject to either a \$10 million

increase or a \$25 million decrease, depending upon AquaSource's achievement of certain operating performance metrics.

a. Provide a schedule listing and describing each operating performance metric that AquaSource will have to achieve to obtain the \$10 million increase to the Base Price. Include detailed calculations of the impact each operating performance metric will have upon the Base Price.

b. Provide a schedule listing and describing each operating performance metric that will result in the \$25 million decrease to the Base Price. Include detailed calculations of the impact each operating performance metric will have upon the Base Price.

8. Refer to the Agreement, Section 1.3, Excludable Operations.

a. Has AquaSource exercised its option to exclude assets from the transfer? If the response is yes, identify the assets AquaSource has elected to exclude from the transfer to Philadelphia.

b. The Applicants have identified a target Rate Base of \$240 million. Provide a detailed calculation showing how the Applicants arrived at the target Rate Base. Include an explanation of the relationship between the target Rate Base of \$240 million and the \$205 million Base Price.

9. a. Provide the journal entries Philadelphia will record to reflect the purchase of AquaSource's stock at the Base Price of \$205 million.

b. Provide the journal entries Philadelphia will record to reflect the purchase of AquaSource's stock if the Base Price is reduced to \$180 million.

c. Provide the journal entries Philadelphia will record to reflect the purchase of AquaSource s stock if the Base Price is increased to \$215 million.

10. a. Provide the journal entries AquaSource, AquaSource Utility, and Coolbrook will record to reflect the sale of its stock to Philadelphia at the Base Price of \$205 million.

b. Provide the journal entries AquaSource, AquaSource Utility, and Coolbrook will record to reflect the sale of its stock to Philadelphia if the Base Price is reduced to \$180 million.

c. Provide the journal entries AquaSource, AquaSource Utility, and Coolbrook will record to reflect the sale of its stock to Philadelphia if the Base Price is increased to \$215 million.

11. a. Provide the journal entries AquaSource Utility recorded on its books to reflect the purchase of Coolbrook s assets.¹

b. Provide the journal entries AquaSource Utility recorded on the books of Coolbrook to reflect AquaSource Utility s purchase of Coolbrook s assets.

12. a. Provide in comparative form Philadelphia s balance sheet before and after its purchase of the AquaSource s stock.

b. Provide in comparative form AquaSource s balance sheet before and after the sale of its stock to Philadelphia.

c. Provide in comparative form AquaSource Utility s balance sheet before and after the sale of AquaSource s stock to Philadelphia.

¹ Case No. 2000-00131, Application of AquaSource Utility, Inc. for All Approvals Necessary for the Sale and Purchase of the Coolbrook Sanitation Division 4-Way Enterprises, Inc. Wastewater System, Order issued May 15, 2000.

d. Provide in comparative form Coolbrook's balance sheet before and after the sale of AquaSource's stock to Philadelphia.

13. In Case No. 2000-00131, AquaSource Utility stated that it would construct capital improvements of \$116,320 to Coolbrook's facilities for the 2-year period following the transfer of Coolbrook. Provide the following information for each capital improvement project that AquaSource Utility has constructed at the Coolbrook facilities:

- a. The date construction began.
- b. The date construction was completed.
- c. A detailed description of the construction project.
- d. The original estimate of the construction cost.
- e. The actual cost of the construction project.
- f. If a Certificate of Convenience and Necessity was obtained prior to constructing each project.
- g. A description of how the construction project was funded.

14. Provide copies of the following financial statements of Philadelphia, AquaSource, AquaSource Utility and Coolbrook for the 12-month period ending October 31, 2002:

- a. Balance Sheet
- b. Income Statement
- c. Statement of Retained Earnings
- d. Cash Flow Statement.

15. a. Provide a detailed description of the corporate structure of Philadelphia.

- b. Describe the degree of government regulation over Philadelphia.
- 16. For each Philadelphia subsidiary or affiliate:
 - a. Describe the nature of that entity's business.
 - b. State Philadelphia's ownership percentage of the subsidiary or affiliate.
 - c. Describe the degree of government regulation over the subsidiary or affiliate.
 - d. State whether it has had or will have a business relationship with AquaSource or an AquaSource operating subsidiary.
- 17. Provide a narrative discussing the history of Philadelphia. This narrative shall include, but not be limited to:
 - a. Each Philadelphia corporate acquisition since 1991, including the date of acquisition, transferring entity, acquisition price, method of financing, and the nature of the acquired business.
 - b. Each business that Philadelphia has liquidated or disposed of since 1991, including the date of liquidation or disposal, sale price, acquirer, the nature of the business, and the reason(s) for liquidation or disposal.
- 18.
 - a. State the current bond and/or debt ratings for Philadelphia debt instruments and all debt instruments issued separately by a Philadelphia subsidiary or affiliate. Identify the rating agency or institution.
 - b. If any of the bond and/or debt ratings of Philadelphia have changed since January 1, 1995, describe the change(s) and the reasons that the rating agency or institution provided for the change(s).

c. If any rating agency or institution has any of the debt instruments on a credit watch or similar review that may lead to a change in any rating, identify the debt instrument and the rating agency or institution and state the reasons given for the placement on a credit watch.

d. Provide the dividend history of Philadelphia since 1991.

e. Provide charts showing the stock price activity for Philadelphia since 1991, on the applicable stock exchanges. Explain the reason(s) for any significant movements in the stock price during the period.

f. Provide investor ratings of Philadelphia and each subsidiary or affiliate since 1991. Identify any of these ratings that are currently under review and state the circumstances of such review.

19. On page 9 of the Application, the Joint Applicants list the jurisdictions where approval of the transfer of AquaSource is required. For each jurisdiction listed, state the date an application for such approval will or has been submitted, the expected date a decision will be rendered, and when available provide copies of the decisions regarding the transfer of AquaSource.

20. List all dispositions or liquidations of Philadelphia's current holdings that will be required for Philadelphia's acquisition of AquaSource.

21. a. Will Philadelphia's acquisition of AquaSource result in push down accounting (i.e., AquaSource, AquaSource Utility, and Coolbrook are required to record a portion of the goodwill resulting from the acquisition premium that Philadelphia paid for AquaSource's stock)? Explain.

b. If push down accounting is not used, explain how Philadelphia intends to recover its acquisition premium.

22. Describe how the Joint Applicants will ensure against the following occurrences:

a. The cross-subsidization of non-regulated activities by AquaSource Utility and/or Coolbrook.

b. Philadelphia's adjustment of AquaSource Utility's capital structure in a manner that could adversely affect its cost of capital and financial integrity.

c. Philadelphia's adjustment of AquaSource Utility's dividend policy in a manner that could adversely affect its financing requirements, financing capabilities and financial integrity.

d. Philadelphia's refusal to provide necessary capital to AquaSource Utility and /or Coolbrook that could severely impair its ability to provide utility services.

23. For each item listed below, state whether the Joint Applicants will commit to filing the listed item:

a. A report of the cost allocation factors currently used by AquaSource Utility, AquaSource and Philadelphia (annually).

b. A summary of each cost allocation study conducted and the basis for the methods used to determine the cost allocation in effect (at the time such studies are prepared).

c. A report of the methods used to update or revise the cost allocation factors in use (at least annually).

24. a. Provide the total costs related to the proposed merger that Philadelphia has incurred as of the date of this request.

b. Provide the total costs related to the proposed merger that Philadelphia expects to bear.

25. a. Provide the total costs related to the proposed merger that AquaSource and/or AquaSource Utility has incurred as of the date of this request.

b. Provide the total costs related to the proposed merger that AquaSource and/or AquaSource Utility expects to bear.

26. a. State whether AquaSource Utility and Coolbrook will bear any merger costs.

b. If yes, provide the estimated annual merger costs that AquaSource Utility and Coolbrook will bear for each year through 2010.

27. a. State whether Philadelphia's acquisition of AquaSource will result in any change in control payments to any individual or employee of AquaSource, AquaSource Utility, or Coolbrook.

b. If yes, list each employee entitled to a payment and the total amount of his or her payments.

28. Provide all letters, analyses, notes, memoranda, studies and related documents that AquaSource or AquaSource Utility prepared or commissioned the preparation of and that discuss the price to be paid by Philadelphia for AquaSource stock.

29. a. Describe the internal standards and policies of Philadelphia (including its subsidiaries and affiliates) regarding service reliability and quality of its wastewater utility operations.

b. Provide all written standards or policies related to service quality and reliability of wastewater utility operations.

30. a. State whether the Joint Applicants are willing to establish minimum service quality standards to assure the reliability and service quality that will be provided to Coolbrook's customers. Explain.

b. If no, what assurances will Joint Applicants provide to ensure that Coolbrook's wastewater operations will be adequately funded and maintained?

31. Provide a detailed analysis of all costs billed to Coolbrook from AquaSource, AquaSource Utility and any other AquaSource affiliate that transacted business with Coolbrook for calendar years 2000 and 2001. Include all workpapers, show all calculations, and state all assumptions used to prepare this analysis.

32. Provide a list and detailed description of each product or service that the merged Philadelphia/AquaSource can offer that AquaSource is currently unable to provide.

33. In its Application in Case No. 2000-00131, AquaSource Utility stated that savings in operating expenses through economies of scale and operating efficiencies would be realized and passed onto Coolbrook. AquaSource Utility projected operating expenses for Coolbrook for 2001 and 2002 if under its control would be \$93,013 and \$88,415, respectively. Based on these projections AquaSource Utility stated that there would be savings of \$21,829 and \$22,348 when compared to the projected operating

expenses if control remained with the previous owner, 4-Way Enterprises, Inc. AquaSource has submitted an application for an increase in rates² that contains actual operating expenses for 2001 of \$156,022 and pro forma operating expenses of \$179,676 both of which are significantly higher than those projected in Case No. 2000-00131.

a. Provide a detailed explanation as to why AquaSource Utility was unable to fulfill its commitment to control the operating costs of Coolbrook.

b. Provide a detailed explanation of the cost controlling measures Philadelphia will implement that AquaSource was unable to employ. Include all workpapers, assumptions, and calculations Philadelphia used to quantify the cost controlling measures.

34. On page 2 of the Application, Philadelphia states that it has, [t]he strategic focus, financial and human resources, size and scope to address the challenges facing the water and wastewater utility industry in a more cost-effective manner.

a. Has Philadelphia performed any studies or analysis to show that it will operate Coolbrook in a more cost-effective manner than AquaSource?

b. If the response to 34(a) is yes, provide copies of the studies and analysis performed by Philadelphia.

c. If the response to 34(a) is no, provide the basis for Philadelphia's statement.

² Case No. 2002-00281, Application of Coolbrook Sanitation Division of AquaSource Utility, Inc. for an Adjustment of Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities.

d. Given that AquaSource is a subsidiary of and has the financial backing of DQE, how can Philadelphia state that its financial resources and size will be a greater benefit to Coolbrook?

35. For each jurisdiction in which Philadelphia or AquaSource operates, describe the utility regulatory commission's policy regarding the recovery of plant acquisition adjustment. Refer in the response to any relevant statute, administrative regulation, or agency order that expressly addresses this issue.

36. Provide a detailed narrative chronology of the history of the Philadelphia/AquaSource merger beginning when Philadelphia management first recommended to Philadelphia shareholders that the merger or acquisition of AquaSource be pursued.

37. Provide all press releases, Web site postings, and other forms of public information disseminated by Philadelphia, AquaSource, or AquaSource Utility regarding the proposed merger since the execution of the Agreement and Plan of Merger.

38. Provide all materials and documents regarding the merger that the Joint Applicants, AquaSource, or Philadelphia have submitted to:

- a. Investment firms.
- b. Credit rating agencies
- c. Shareholders of Philadelphia or AquaSource.
- d. Employees of Philadelphia or AquaSource.

39. Provide a detailed description of any pending legal or regulatory proceeding (e.g., rate investigation, service complaint) that could adversely affect Philadelphia's or AquaSource's future earnings of the merged entity.

40. Provide all studies or analyses that Philadelphia, AquaSource or AquaSource Utility has performed or commissioned that identifies any realizable synergies that will occur as a result of the proposed merger.

41. For each regulated water or wastewater utility that Philadelphia owns or operates, provide in table format an analysis of the number and type of consumer complaints during the period from 1998 to 2001 and of how such complaints were resolved.

42. Provide all standards or codes of conduct that Philadelphia or its affiliates use to govern their affiliate and non-affiliate transactions.

43. For each jurisdiction in which Philadelphia has regulated operations, list and briefly explain each complaint filed against Philadelphia or a Philadelphia affiliate in which a violation of an established code or standard of conduct is alleged.

44. For each commitment listed below, state whether the Joint Applicants will accept unconditionally the commitment. For each commitment that cannot be unconditionally accepted, state the reasons for the party's objection.

a. The books and records of Coolbrook will be kept in Kentucky.

b. Coolbrook, and its ratepayers, directly or indirectly, shall not incur any additional costs, liabilities, or obligations in conjunction with Philadelphia's acquisition of AquaSource.

c. AquaSource Utility shall not incur any additional indebtedness, issue any additional securities, or pledge any assets to finance any part of the purchase price paid by Philadelphia for the AquaSource stock.

d. The payment for the AquaSource stock shall be recorded on Philadelphia's books, not the books of AquaSource Utility and Coolbrook.

e. The premium paid by Philadelphia for the AquaSource stock, as well as any other associated costs, shall not be pushed down to AquaSource Utility and Coolbrook.

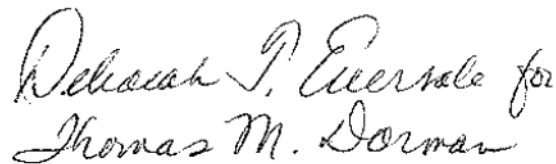
f. All transaction-related costs, including the cost of purchase and the premium paid for AquaSource, shall be excluded for rate-making purposes from Coolbrook's rates.

g. No change in control payments will be allocated to Coolbrook ratepayers.

h. If early termination costs are incurred for any senior management of AquaSource or AquaSource Utility, none of these costs will be allocated to Coolbrook.

i. Coolbrook customers will experience no material adverse change in utility service due to the merger.

j. Philadelphia, AquaSource, and AquaSource Utility will adequately fund and maintain Coolbrook's treatment and distribution systems to comply with all applicable Kentucky statutes and administrative regulations and to supply Coolbrook customers' service needs.



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DATED November 13, 2002
cc: All Parties