CASE NUMBER:

99-303

RECEIVED

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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

FILING OF JOURNAL ENTRIES

Comes now, AquaSource Utility, Inc. of Pittsburgh, Pennsylvania, by counsel, and hereby files the attached journal entries with the Public Service Commission recording the sale of Goshen Utilities, Inc. to AquaSource Utilities, Inc. that took place on December 2, 1999, as required by the Order issued by the Commission approving the transfer dated the 5th day of November, 1999.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

Journal Entries of the AquaSource, Inc. Acquisition of Goshen Utilities
As of the Closing Date, December 2, 1999
Case No. 99-303

Enclosed, please find the journal entries proposed by AquaSource, Inc. to record the acquisition of Goshen Utilities as of the closing date, December 2, 1999. For your convenience, we have enclosed a number of schedules used in determining the opening balance sheet. Further, we provide a brief description of each schedule as follows:

Schedule 1: Adjusted Balance Sheet for Goshen Utilities, Inc.

This schedule represents the opening balance sheet, by division, as of the closing date, December 2, 1999. Utility Plant in Service is recorded at original cost. In addition, a detailed listing of Utility Plant in Service and related depreciation is provided in Schedule 5. Also, Contributions in Aid of Construction (CIAC) has been adjusted in accordance with the provisions of the Order provided in Case No. 99-303. Support for these adjustments is included in Schedules 6 and 7.

Schedule 2: Final Journal Entries for Goshen Utilities and AquaSource, Inc.

This schedule provides the final closing entries for both the parent company's (AquaSource, Inc.) investment in Goshen Utilities, and the entries to record the opening balance sheet of the subsidiary.

Schedule 3: Calculation of Acquisition Adjustment – Asset Purchase Method

This schedule supports our calculation of the Acquisition Adjustment using the Net Utility Plant in Service as the basis of determination.

Schedule 4: Calculation of Acquisition Adjustment – Equity Method

This schedule supports our calculation of the Acquisition Adjustment using equity as the basis of determination. This method is used primarily as a check against the Asset Purchase Method.

Schedule 5: Listing of Utility Plant in Service by Object Account

This schedule represents the detail of the respective accounts that comprise Utility Plant in Service. Information used in this analysis was obtained from Goshen's independent Certified Public Accountant. All assets have been recorded at their original cost.

Schedule 6: Restatement of Goshen Utilities Water Plant Contributions in Aid of Construction

This schedule is provided to support the adjustment to the Water Plant CIAC account in accordance with the provisions of the Order associated with Case No. 99-303.

Schedule 7: Restatement of Goshen Utilities Sewer Plant Contributions in Aid of Construction

This schedule is provided to support the adjustment to the Sewer Plant CIAC account in accordance with the provisions of the Order associated with Case No. 99-303.

Schedule 1

ADJUSTED BALANCE SHEET FOR GOSHEN UTILITIES, INC. (1,2)
Goshen Utilities, Inc. and AquaSource Utilities, Inc.
Case No. 99-303

	Assets	Water	Sewer	Total
114	Utility Plant Acquisition Adjustment (Schedules 3 and 4)	$2,175,970	$395,487	$2,571,457
101	Utility Plant in Service (Schedule 5)	2,373,666	1,638,436	4,012,102
108.1	Accumulated Depreciation (Schedule 5)	(954,143)	(831,116)	(1,785,259)
	Net Utility Plant	3,595,493	1,202,807	4,798,300
131	Cash	149,250	74,513	223,763
135	Cash - Savings	97,891	48,872	146,763
135	Temporary Cash Investments	127,741	63,774	191,515
141	Customer Accounts Receivable	56,905	28,410	85,315
162	Prepayments	1,180	589	1,769
174	Misc. Current and Accrued Assets	17,727	8,850	26,577
	Total-Current Assets	450,693	225,009	675,702
	Total Assets	$4,046,187	$1,427,815	$5,474,002
	Liabilities			
201	Common Stock	$133,400	$66,600	$200,000
207	Other Paid In Capital	160,898	80,329	241,227
207	Other Paid In Capital - Acquisition Adjustment	2,175,970	395,487	2,571,457
207	Retained Earnings	681,684	90,861	772,545
	Total-Capital	3,151,952	633,277	3,785,229
232	Notes Payable	100,253	50,051	150,304
232	Note Payable	16,675	8,325	25,000
231	Accounts Payable	38,473	19,207	57,680
235	Customer Deposits	75,154	37,521	112,675
237	Interest Accrued	1,819	908	2,727
242	Other	28,072	14,015	42,087
	Total-Current Liabilities	260,445	130,028	390,473
271	Contribution In Aid of Construction (CIAC)	1,064,030	1,506,538	2,570,568
272	Accumulated Amortization of CIAC	(430,241)	(842,027)	(1,272,268)
	Net CIAC (Schedules 6 and 7)	633,789	664,511	1,298,300
	Total Liabilities	$4,046,187	$1,427,815	$5,474,002

1/ Balance sheet information obtained from Goshen's independent Certified Public Account as of the closing date, December 2, 1999.

2/ Current assets, capital, current liabilities and long term debt allocated 67% to water and 33% to sewer based upon the percentage of revenues included in the respective 1998 annual reports.

Schedule 2

FINAL JOURNAL ENTRIES FOR GOSHEN UTILITIES AND AQUASOURCE, INC. CLOSING
Goshen Utilities, Inc. and AquaSource Utility, Inc.
As of the Closing Date, December 2, 1999
Case No. 99-303

Accounting Entries for Goshen Utilities, Inc. After Acquisition

		Debit	Credit
114	Utility Plant Acquisition Adjustment	$2,571,457	
207	Shareholder Equity-Paid In Capital		$2,571,457

To record the Utility Plant Acquisition Adjustment on the balance sheet of the new subsidiary, Goshen Utilities, as of the closing date, December 2, 1999.

Accounting Entries for AquaSource Utilities, Inc.

		Debit	Credit
124	Investment in Goshen Utilities, Inc.	$3,785,229	
131.2	Cash		$3,285,229
224	Other Long Term Debt (Deferred payment of purchase Price in accordance with section 2.2 (c) of purchase agreement)		$500,000

To record investment in the Goshen Utilities subsidiary as of the closing date, December 2, 1999.

Schedule 3

CALCULATION OF ACQUISITION ADJUSTMENT - ASSET PURCHASE METHOD
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Summary of Utility Plant in Service as of 12/2/99

		Water	Sewer	Total
Utility Plant in Service as of 12/2/99		$2,373,666	$1,638,436	$4,012,102
Less Accumulated Depreciation		(954,143)	(831,116)	(1,785,259)
Net Utility Plant in Service		1,419,523	807,320	2,226,843
Contributions in Aid of Construction (CIAC)		1,064,030	1,506,538	2,570,568
Less Amortized CIAC		(430,241)	(842,027)	(1,272,268)
Unamoritzed CIAC		633,789	664,511	1,298,300
Net Book Value-Net Plant Less Unamortized CIAC		785,734	142,809	928,543
		84.62%	15.38%	100.00%
Purchase Price Allocated to Net Book Value (Price excluding transaction costs)	(1)	2,961,704	538,296	3,500,000
Acquisition Adjustment-Allocated Price Less Net Book		$2,175,970	$395,487	$2,571,457

(1) Purchase price is allocated based on the percentage of Net Book Value-Net Plant Less Unamortized CIAC for water and sewer to the total. Note that no costs associated with transaction fees are included in the purchase price at this time.

CALCULATION OF ACQUISITION ADJUSTMENT - EQUITY METHOD
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Estimated Acquisition Adjustment

	Water	Sewer	
Purchase Price			$3,500,000
Adjustment for Working Capital:			
Current Assets	450,693	225,009	
Current Liabilities	260,445	130,028	
Working Capital Adjustment	190,248	94,981	285,229
Cash Paid at Closing			3,785,229
Equity Including CIAC Adjustments	975,982	237,790	1,213,772
Estimated Acquisition Adjustment			$2,571,457

Schedule 5

AquaSource, Inc.
Listing of Utility Plant In Service by Object Account
As of the Acquisition Date of December 2, 1999

Account Number	Description	Water	Sewer	Total
303	Land & Land Rights	$205,231	$0	$205,231
304	Stuctures & Improvements	17,590	2,531	20,121
307	Wells & Springs	79,464	0	79,464
309	Supply Mains	0	0	0
310	Land & Land Rights	0	30,035	30,035
311	Pumping Equipment	65,747	35,092	100,839
320	Water Treatment Equipment	7,984	0	7,984
330	Distribution Reservoirs & Standpipes	484,075	0	484,075
331	Transimssion and Distribution Mains	1,108,022	0	1,108,022
333	Services	78,014	0	78,014
334	Meters & Meter Installation	152,700	0	152,700
335	Hydrants	10,737	0	10,737
339	Other Pant & Misc. Equipment	0	0	0
340	Office Furniture &Equipment	23,032	9,585	32,617
341	Transportation Equipment	60,807	31,438	92,245
343	Tools, Shop & Garage	51,965	2,878	54,843
345	Power Operated Equipment	8,700	0	8,700
346	Communication Equipment	6,125	3,091	9,216
348	Other Tangible Plant	0	0	0
348	Common Assets	13,473	13,472	26,945
348	Utility Plant Acquisition Adjustment	0	0	0
352.2	Collection Sewers - Gravity	0	1,235,307	1,235,307
363A	Pumping Equipment - Electric	0	82,674	82,674
364	Flow Measuring Devices	0	0	0
373	Treatment and Disposal Equipment	0	145,214	145,214
374	Plant Sewers	0	25,908	25,908
376	Other Treatment & Disposal Plant Equipment	0	12,907	12,907
393B	Tool, Shop & Garage Equipment	0	1,750	1,750
393F	Other Tangible Property	0	6,554	6,554
101	Utility Plant in Service	$2,373,666	$1,638,436	$4,012,102
108.1	Accumulated Depreciation	$954,143	$831,116	$1,785,259

NOTE: All amounts recorded at original cost.

RESTATEMENT OF GOSHEN UTILITIES WATER PLANT CONTRIBUTIONS IN AID OF CONSTRUCTION
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Water Plant

Year End	Additions	Cumulative Total	Annual Amortization (1)	Years to Date	Accumulated Amortization Through 12/31/98	Adjusted CIAC at 12/31/98	1999 Amortization Through 11/30/99	Adjusted CIAC at 11/30/99 (2)
1979	$513,479	$513,479	$16,046	19.5	$312,897	$200,582	$14,709	$185,873
1980	0	513,479	0	18.5	0	0	0	0
1981	0	513,479	0	17.5	0	0	0	0
1982	0	513,479	0	16.5	0	0	0	0
1983	0	513,479	0	15.5	0	0	0	0
1984	0	513,479	0	14.5	0	0	0	0
1985	0	513,479	0	13.5	0	0	0	0
1986	0	513,479	0	12.5	0	0	0	0
1987	16,500	529,979	516	11.5	5,934	10,566	473	10,093
1988	24,000	553,979	750	10.5	7,875	16,125	688	15,437
1989	32,276	586,255	1,009	9.5	9,586	22,690	925	21,765
1990	23,130	609,385	723	8.5	6,146	16,984	663	16,321
1991	15,300	624,685	478	7.5	3,585	11,715	438	11,277
1992	25,175	649,860	787	6.5	5,116	20,059	721	19,338
1993	211,685	861,545	6,615	5.5	36,383	175,302	6,064	169,238
1994	37,518	899,063	1,172	4.5	5,274	32,244	1,074	31,170
1995	17,447	916,510	545	3.5	1,908	15,539	500	15,039
1996	35,122	951,632	1,098	2.5	2,745	32,377	1,007	31,370
1997	33,868	985,500	1,058	1.5	1,587	32,281	970	31,311
1998	46,245	1,031,745	1,445	0.5	723	45,522	1,325	44,197
1999	32,285	1,064,030	1,009	n/a	0	32,285	925	31,360
Total at 12/31/98	$1,064,030				$399,759	$664,271	$30,482	$633,789

1/ Based on composite amortization rate using 1998 plant and depreciation shown below:

Utility Plant in Service-12/31/98	$2,373,666
Depreciation Expense - 1998	$73,155
Composite Amortization Period - Years	**32**

2/ Reduction in CIAC and a contra increase in retained earnings and equity.

Schedule 7

RESTATEMENT OF GOSHEN UTILITIES SEWER PLANT CONTRIBUTIONS IN AID OF CONSTRUCTION
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Sewer Plant

Year End	Additions	Cumulative Total	Annual Amortization (1)	Years to Date	Accumulated Amortization Through 12/31/98 (2)	Adjusted CIAC at 12/31/98	1999 Amortization Through 11/30/99	Adjusted CIAC at 11/30/99
1979	$920,114	$920,114	$32,861	19.5	$640,790	$279,324	$30,123	$249,201
1980	80,500	1,000,614	2,875	18.5	53,188	27,312	2,635	24,677
1981	0	1,000,614	0	17.5	0	0	0	0
1982	0	1,000,614	0	16.5	0	0	0	0
1983	0	1,000,614	0	15.5	0	0	0	0
1984	0	1,000,614	0	14.5	0	0	0	0
1985	0	1,000,614	0	13.5	0	0	0	0
1986	0	1,000,614	0	12.5	0	0	0	0
1987	67,000	1,067,614	2,393	11.5	27,520	39,480	2,194	37,286
1988	41,700	1,109,314	1,489	10.5	15,635	26,065	1,365	24,700
1989	37,000	1,146,314	1,321	9.5	12,550	24,450	1,211	23,239
1990	32,000	1,178,314	1,143	8.5	9,716	22,284	1,048	21,236
1991	25,000	1,203,314	893	7.5	6,698	18,302	819	17,483
1992	37,000	1,240,314	1,321	6.5	8,587	28,413	1,211	27,202
1993	30,000	1,270,314	1,071	5.5	5,891	24,109	982	23,127
1994	18,800	1,289,114	671	4.5	3,020	15,780	615	15,165
1995	21,000	1,310,114	750	3.5	2,625	18,375	688	17,687
1996	58,424	1,368,538	2,087	2.5	5,218	53,206	1,913	51,293
1997	9,000	1,377,538	321	1.5	482	8,518	294	8,224
1998	44,000	1,421,538	1,571	0.5	786	43,214	1,440	41,774
1999	85,000	1,506,538	3,036	n/a	0	85,000	2,783	82,217
Total at 12/31/98	$1,506,538				$792,706	$713,832	$49,321	$664,511

1/ Based on composite amortization rate using 1998 plant and depreciation shown below:

Utility Plant in Service-12/31/98	$1,638,436
Depreciation Expense - 1998	$58,962
Composite Amortization Period - Years	**28**

2/ Reduction in CIAC and a contra increase in retained earnings and equity.

	Total CIAC		Est Accum CIAC as of 12/31/98	Net CIAC as of 12/31/98	11 mos Amort	Net CIAC as of 11/30/99
Total Sewer	$1,506,538		$792,706	$713,832	$49,321	$664,511
Total Water	1,064,030		399,759	664,271	30,482	633,789
Totals	$2,570,568		1,192,465	$1,378,103	$79,803	$1,298,300
		Add 11 mos amort	79,803			
		Est Accum CIAC Amort as of 11/30/99	$1,272,268			

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

CERTIFICATE OF SERVICE

RE: Case No. 1999-303
GOSHEN UTILITIES, INC.

I, Stephanie Bell, Secretary of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the following by U.S. Mail on January 11, 2000.

Parties of Record:

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Honorable Patrick T. Schmidt
Attorneys for AquaSource Utility,Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

Stephanie J. Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

ORDER

On November 17, 1999, AquaSource Utility, Inc. ("AquaSource Utility") filed a motion for clarification of the Commission's Order of November 5, 1999. AquaSource Utility states that the Commission's Order contains a typographical error in the amount of unrecorded amortization of Contributions in Aid of Construction. AquaSource Utility requests that the Commission's Order be corrected to accurately reflect the unrecorded amortization amount of $1,221,826.

AquaSource Utility additionally requests that the record reflect that the analysis provided by AquaSource Utility in Item No. 6 of its October 8, 1999 Response to Request for Additional Information was used as one test of the reasonableness of the purchase price of Goshen Utilities, Inc. ("Goshen") and not to develop the purchase price. It requests that the record also reflect its understanding that the margin allowed Goshen in the last rate case was based on the operating ratio method rather than a return on rate base.

The Commission, having considered the motion, the evidence of record and being otherwise sufficiently advised, finds that the motion should be granted.

IT IS THEREFORE ORDERED that:

1. The amount of unrecorded amortization of Contributions in Aid of Construction stated in the Commission's Order of November 5, 1999 is corrected, nunc pro tunc, to $1,221,826.

2. The record shall reflect that the analysis provided by AquaSource Utility in Item No. 6 of its October 8, 1999 Response to Request for Additional Information was used as one test of the reasonableness of the purchase price of Goshen and not to develop the purchase price. The record shall further reflect that AquaSource Utility understood the margin allowed Goshen in the last rate case was based on the operating ratio method rather than a return on rate base.

Done at Frankfort, Kentucky, this 11th day of January, 2000.

By the Commission

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

January 7, 2000

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Patrick T. Schmidt
Attorneys for AquaSource Utility,Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

RE: Case No. 1999-303

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

Stephanie Bell
Stephanie Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

ORDER

On November 5, 1999, the Commission entered an Order approving the transfer of Goshen Utilities, Inc. ("Goshen") to AquaSource Utility, Inc. ("AquaSource Utility"). AquaSource Utility was ordered to file with the Commission, within 30 days of the completion of the transaction, the journal entries used to record the purchase. The transaction was completed on December 2, 1999; thus, the journal entries were to be filed with the Commission by January 2, 2000. On December 28, 1999, AquaSource Utility filed a motion for an extension of time to February 2, 2000 to file the journal entries. AquaSource Utility states in support of its request that it is experiencing difficulty assembling the information from Goshen's Certified Public Accountant.

The Commission, having considered the Motion and being otherwise sufficiently advised, HEREBY ORDERS that the Motion is granted and the time within which AquaSource Utility shall file the information is extended to the close of business on February 2, 2000.

Done at Frankfort, Kentucky, this 7th day of January, 2000.

By the Commission

ATTEST:

Executive Director

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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

REQUEST FOR EXTENSION OF TIME TO FILE JOURNAL ENTRIES

Comes now, AquaSource Utility, Inc. of Pittsburgh, Pennsylvania, by counsel, and hereby respectfully requests the Public Service Commission for an extension of time to file with the Commission the journal entries recording the sale of Goshen Utilities, Inc. to AquaSource Utilities, Inc. that took place on December 2, 1999, as required by the Order issued by the Commission approving the transfer dated the 5th day of November, 1999. AquaSource is having difficulty assembling the information from Goshen's Certified Public Accountant needed to completely and accurately record the proper entries to reflect this acquisition.

Therefore, AquaSource respectfully requests an extension of thirty (30) days to February 2, 2000 to file the entries as required. This motion is issued on the 27th day of December, 1999.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.))) CASE NO. 99-303

NOTIFICATION OF CLOSING OF SALE

Comes now, AquaSource Utility, Inc. of Pittsburgh, Pennsylvania, by counsel, and hereby notifies the Public Service Commission that the closing of the sale of Goshen Utilities, Inc. to AquaSource Utilities, Inc. took place on December 2, 1999.

This notice is issued on the 9th day of December, 1999, in conformity with the Order issued by the Commission approving the transfer dated the 5th day of November, 1999.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

Case No. 99-303

TILFORD, DOBBINS, ALEXANDER, BUCKAWAY & BLACK, LLP

ATTORNEYS AT LAW

1400 ONE RIVERFRONT PLAZA
LOUISVILLE, KENTUCKY 40202

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[1]Also admitted in Indiana
[2]Also admitted in New York
[3]Also admitted in District of Columbia and Maryland
[4]Also admitted in District of Columbia
[5]Also admitted in Florida and Indiana
[6]Also admitted in Georgia and Illinois
[7]Also admitted in South Carolina

NOV 17 1999

November 16, 1999

Hon. Helen Helton
Executive Director
Public Service Commission
730 Schenkel Lane
P.O. Box 615
Frankfort, Kentucky 40602

RE: Motion for AquaSource Utility, Inc.

Dear Ms. Helton:

I am enclosing the original and ten (10) copies of a motion requesting a couple of changes in the Commision's Order dated November 5, 1999 granting approval for our client, AquaSource Utility, Inc. to acquire the stock of Goshen Utilities, Inc. The additional copy is enclosed for file stamping and the return in the enclosed stamped envelope.

If you have any questions or comments, please let me know. Many thanks.

Sincerely,

Patrick T. Schmidt

Enclosures

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

MOTION

Comes AquaSource Utility, Inc., by counsel, and respectfully requests clarification of one issue and correction of a typographical error in the Public Service Commission's Order dated November 5, 1999 on the Application of AquaSource Utility, Inc. for Transfer of Ownership Rights of Goshen Utilities, Inc., Case no. 99-303.

First, AquaSource wishes to clarify the discussion concerning the basis of Goshen's allowed margin in its last rate case and development of the estimated purchase price. In the last paragraph on Page 4, the Commission refers to AquaSource's October 8, 1999 Response to Request for Additional Information Item No. 6. This response is also referenced in Footnote 4 on Page 5. In the first paragraph on Page 5, the Commission states that "The information provided indicates that AquaSource incorrectly assumed that in Goshen's last rate case the allowed margin or revenue requirement was based on a return on rate base; however, the Commission used the operating ratio method.

AquaSource understood that the margin allowed in the most recent rate case was based on the operating ratio method. The purpose of the Company's response to Item No. 6 was to provide a discussion of the evaluation of Goshen and development of the estimated purchase price. As part of its evaluation of the reasonableness of the purchase price, AquaSource calculated an investment amount that if made would have provided a reasonable rate of return to investors. AquaSource wishes to emphasize that this exercise was used as one test of the reasonableness of the purchase price. It was not used to determine the purchase price.

Secondly, AquaSource requests correction of a typographical error in the second paragraph on Page 3. The unrecorded amortization of CIAC referenced in the seventh sentence should be $1,221,826 instead of $1,231,826.

Respectfully Submitted,

By: ______________________

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

CERTIFICATE OF SERVICE

RE: Case No. 99-303
GOSHEN UTILITIES, INC.

I, Stephanie Bell, Secretary of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the following by U.S. Mail on November 5, 1999.

Parties of Record:

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Patrick T. Schmidt
Attorneys for AquaSource Utility, Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

Stephanie J. Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

O R D E R

On July 9, 1999, AquaSource Utility, Inc. ("AquaSource Utility") applied to the Commission for authority to transfer all outstanding stock in, and ownership rights of, Goshen Utilities, Inc. ("Goshen"). The application also contains requests for Commission approval to treat the difference between the purchase price of the stock of Goshen and the book value of the acquired assets as an acquisition adjustment for accounting and rate-making purposes and to amortize the acquisition premium over a fifteen-year period. In conformity with Commission regulations, AquaSource Utility filed an Adoption Notice stating that the rates and services of Goshen would be adopted.

REQUEST FOR APPROVAL OF TRANSFER OF THE STOCK OF GOSHEN

The requirements for determining if a transfer should be approved are contained in KRS 278.020(4) and (5). KRS 278.020(4) provides that the Commission must approve the transfer if the person acquiring the utility has the financial, technical, and managerial abilities to provide reasonable service. KRS 278.020(5) provides that the Commission shall approve the transfer if it finds the transfer is to be made in accordance with the law, for a proper purpose, and is consistent with the public interest.

The Commission finds that KRS 278.020(4) and (5) are applicable to the transaction proposed by AquaSource Utility and that Commission approval is necessary.

Goshen is a public utility organized under the laws of the State of Kentucky serving approximately 1,700 water and 1,200 wastewater customers in Oldham County, Kentucky. Goshen's principal mailing address is 1001 Riverside Drive, Goshen, Kentucky 40026.

AquaSource Utility is a corporation incorporated under the laws of the State of Texas. It is a wholly owned subsidiary of AquaSource, Inc., an investor-owned water utility company formed on April 1, 1997 as a subsidiary of DQE, Inc. ("DQE"). DQE has assets of more than $5.2 billion and annual revenues in excess of $1.2 billion. AquaSource, Inc. is acquiring and operating water utility systems throughout the United States and presently provides water and wastewater services to more than 370,000 customers in 12 states.

The Commission, having determined that KRS 278.020(4) and (5) are applicable to the proposed transaction, finds that the transaction will be made in accordance with law, for a proper purpose, and consistently with the public interest. The Commission further finds that the information submitted by AquaSource Utility in the application establishes that AquaSource Utility has the financial, technical, and managerial ability to provide reasonable service in Kentucky. Therefore, the request for approval to transfer the issued and outstanding stock of Goshen is consistent with the requirements of KRS 278.020(4) and (5) and should be approved.

PLANT ACQUISITION ADJUSTMENT

When the sale of a utility results in a purchase price greater than the original cost less accumulated depreciation (net book value), the difference between the purchase price and the net book value is accounted for as a plant acquisition adjustment.

AquaSource Utility and Goshen have entered into an agreement wherein AquaSource Utility will purchase all the outstanding shares of stock of Goshen for the purchase price of $3,500,000. Goshen reported in its 1998 Annual Reports a net book value of $2,292,824.[1] However, a deduction must be made from this amount to reflect Goshen's Contributions in Aid of Construction ("CIAC"). The Commission finds that in the past Goshen did not amortize its CIAC. Therefore, Goshen's CIAC balance should be reduced by the unrecorded amortization. Goshen's reported CIAC balance is $2,453,283. When the unrecorded amortization of $1,231,826 is deducted, Goshen's CIAC balance is $1,231,457. Deducting the correct CIAC balance from Goshen's reported net book value leaves a correct net book value of $1,061,367. Therefore, the plant acquisition adjustment is approximately $2,488,633. AquaSource Utility requests Commission approval of this acquisition adjustment for accounting and rate-making purposes.

---

[1] Utility Plant	$3,988,827
Accumulated Depreciation	-1,696,003
Net Utility Plant	$2,292,824

One primary source of information regarding the Commission's past position on acquisition adjustments is Case No. 9059.[2] In the Order on rehearing in that case, the Commission stated that plant acquisition adjustments should be considered on a case-by-case basis and that, if the record demonstrates that the consumers are benefited by the acquisition, the recovery should be allowed. The Commission, however, maintained its position that the net original cost of plant devoted to utility use is the fair value for rate-making purposes unless there is conclusive evidence that the overall operations and financial condition of the utility have benefited from the acquisition at a price in excess of the net book value. The Commission set forth in that case five criteria that should be taken into consideration when granting recovery of an acquisition adjustment.[3] A discussion of each of those criteria as it pertains to this case follows:

1. The purchase price was established upon arm's-length negotiations.

AquaSource Utility stated that it had no prior affiliation with Goshen or any of its principal employees or shareholders. It stated that AquaSource Utility mailed a letter of intent to Goshen and negotiated the potential transaction that the shareholders of Goshen approved.

The Commission agrees that the negotiations were at arms-length, but finds the evidence produced by AquaSource Utility to support the reasonableness of the purchase price to be based on incorrect assumptions. On October 8, 1999, in response to a request for information made by Commission Staff at the informal conference held

[2] Case No. 9059, An Adjustment of Rates of Delta Natural Gas Company, Inc.

[3] Case No. 9059, Order dated September 11, 1985, at 3.

on September 30, 1999, AquaSource Utility filed information on its due diligence.[4] The information provided indicates that AquaSource incorrectly assumed that in Goshen's last rate case the allowed margin or revenue requirement was based on a return on rate base; however, the Commission used the operating ratio method. If Goshen's revenue requirement had been based on a return on rate base, its revenue requirement would have been significantly lower.

Given that the acquisition adjustment is approximately 70 percent of the purchase price, AquaSource Utility should have been prepared to provide evidence beyond its due diligence analysis to support the requested rate-making treatment. To support the reasonableness of the acquisition adjustment, AquaSource Utility should have provided either an analysis showing the appraised value of Goshen's system or a comparison of the price paid for Goshen in relation to comparable system sales.

2. <u>The initial investment plus the cost of restoring the facilities to required standards will not adversely impact the overall costs and rates of the existing and new customers.</u>

According to AquaSource Utility, there will be no adverse impact in the overall costs as a result of the acquisition. In support of its position, AquaSource Utility pointed to its commitment to a rate freeze through the year 2000. If the anticipated savings in

[4] Item No. 6, Response to Request for Additional Information, dated October 8, 1999.

operations and maintenance expense occur, AquaSource Utility will extend the rate freeze, absent any unforeseen capital expenditures.[5]

AquaSource Utility's position regarding the impact of the acquisition on Goshen's ratepayers is based on projections that might or might not come true. Therefore, the Commission is unable at this time to find that the rates paid by Goshen's ratepayers will not be adversely impacted.

3. Operational economies can be achieved through the acquisition.

AquaSource Utility anticipates cost savings through operational efficiencies in areas such as professional fees, insurance and office operations and, over time, through regionalized operations. Upon review of AquaSource Utility's projections, the Commission has determined that they are based upon reasonable assumptions. However, there is no guarantee that they will be realized.

4. The purchase price of the utility and non-utility property can be clearly identified.

Goshen has maintained its financial records in accordance with the Uniform System of Accounts ("USoA") prescribed by the Commission. According to AquaSource Utility, the only non-utility property on Goshen's books is a dam. In negotiating its purchase price of Goshen, AquaSource Utility attributed a zero value to Goshen's dam. However, AquaSource Utility did not provide evidence to support its assumption that the dam should have a zero value and not be allocated a portion of the purchase price.

[5] Amended Petition for Transfer of Ownership Rights of Goshen Utilities, Inc., dated August 30, 1999, p. 6.

5. <u>The purchase will result in overall benefits in the financial and service aspects of the utility's operations.</u>

AquaSource Utility states that it will have the financial backing of its parents, AquaSource and DQE, and access to financial markets to attract lower cost capital than that which is otherwise available to Goshen. In addition, AquaSource Utility states that these resources, combined with DQE's experience in utility operations, demonstrate AquaSource Utility's commitment to ensure high levels of customer satisfaction, to comply more efficiently and more expeditiously with federal and state requirements, and to support future growth in the region. DQE has granted corporate approval to AquaSource to invest over $350 million in its water and wastewater subsidiaries. Since these resources are available to all subsidiaries of AquaSource, it is difficult for the Commission to determine the actual impact these resources will have on either Goshen's utility operations or the region.

The Commission finds that the acquisition adjustment should be approved for accounting purposes only and a decision on rate-making treatment deferred until the next rate proceeding. This finding is based upon Aquasource Utility's inability to prove in this proceeding the reasonableness of its purchase price. Furthermore, many of the benefits, operational efficiencies, and financial resources of AquaSource Utility's acquisition of Goshen are speculative.

<u>AMORTIZATION OF THE ACQUISITION PREMIUM</u>

AquaSource Utility requested approval to amortize its acquisition premium over a 15-year period for both accounting and rate-making purposes. The Commission's finding regarding the acquisition premium dictates the manner in which the amortization will be treated. For this reason the Commission finds that the amortization of the acquisition premium should be approved in this proceeding for accounting purposes only, with the decision on rate-making treatment deferred to the next rate proceeding.

Since the acquisition adjustment relates to the utility plant investment, it should be amortized over the remaining life of the assets. The Commission has determined that a 20-year amortization period is a closer estimation of the remaining life of Goshen's water and wastewater assets. For this reason the Commission finds that AquaSource Utility should amortize its acquisition adjustment premium over 20 years for accounting purposes.

IT IS THEREFORE ORDERED that:

1. The proposed transfer of all the outstanding stock of Goshen as well as the responsibility for its management, operation, and maintenance is approved.

2. AquaSource Utility shall notify the Commission of the transfer within 10 days of the completion thereof.

3. AquaSource Utility is granted approval to treat the difference between the purchase price of the Goshen stock and the net book value of the acquired assets as an acquisition adjustment for accounting purposes only.

4. AquaSource Utility is granted approval to amortize the acquisition premium over a 20-year period for accounting purposes only.

5. AquaSource Utility shall record the acquisition adjustment on its books in accordance with the requirements of the UsoA.

6. AquaSource Utility shall maintain the financial records of its water and wastewater divisions separately. All allocations used by AquaSource Utility to separate the shared costs and plant investment between its two divisions shall be presented in the next rate case.

7. Within 30 days of the completion of the transaction, AquaSource Utility shall file the journal entries used to record the purchase and identify the detailed plant accounts to which the assets are recorded. AquaSource Utility shall also file the proposed amortization of the acquisition adjustment as a journal entry.

8. In its next rate case, AquaSource Utility shall have the burden of demonstrating why the acquisition adjustment and amortization premium should be approved for rate-making purposes.

9. In its next rate case, AquaSource Utility shall have the burden of demonstrating that its projected operational efficiencies have been achieved and in what manner they will be used to benefit the ratepayers.

10. AquaSource Utility, having filed an adoption notice pursuant to 807 KAR 5:011, shall, within 10 days of the date of this Order, issue and file in its own name those tariffs of Goshen that it has adopted.

Done at Frankfort, Kentucky, this 5th day of November, 1999.

By the Commission

ATTEST:

Helen C. Helton

Executive Director

RECEIVED
NOV - 4 1999
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

P.S.C. Adoption Notice No. 1 for AquaSource Utility, Inc.

ADOPTION NOTICE

Comes now, AquaSource Utility, Inc. of Pittsburgh, Pennsylvania, by counsel, and hereby adopts, ratifies, and makes its own, in every respect as if the same had been originally filed and posted by it, all tariffs and supplements containing rates, rules, and administrative regulations for furnishing water and wastewater services at Goshen in the Commonwealth of Kentucky, filed with the Public Service Commission by Goshen Utilities, Inc. of Goshen, Kentucky, and in effect on the ____ day of ____________, 1999, the date on which the public service of the said Goshen Utilities, Inc. was taken over by it.

This notice is issued on the 30th day of September, 1999, in conformity with Section 11 of P.S.C. Tariff Administrative Regulations adopted by the Public Service Commission.

RECEIVED
SEP 30 1999
GENERAL COUNSEL

Respectfully Submitted,

By: [signature]

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

RECEIVED
OCT 08 1999
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

RESPONSE TO REQUEST FOR ADDITIONAL INFORMATION

Comes now, AquaSource Utility, Inc., by counsel, and respectfully submits the attached information in response to the Commission's request for additional information as a result of the informal conference held at the offices of the Commission on September 30, 1999. A schedule outlining the additional information is also attached.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

Application of AquaSource Utility, Inc. for Transfer of Ownership Rights of Goshen Utilities, Inc.
Case No. 99-303
Public Service Commission Staff Data Requests from 9/30/99 Conference

Item No. 1 **Provide copies of Goshen Utilities 1998 annual reports for water and sewer.**

Response Attached as Exhibit "A" find copies of the Goshen's annual reports.

Item No. 2 **Provide copies of Goshen Utilities financials for 1998 for water and sewer including depreciation and contributions in aid of construction (CIAC).**

Response Attached as Exhibit "B" find copies of Goshen's financials for 1998 including depreciation and CIAC.

Item No. 3 **Provide a copy of AquaSource Inc.'s organizational chart.**

Response Attached as Exhibit "C" find a high level organizational chart of AquaSource's parent company DQE, which shows the organizational structure of AquaSource Inc. Regarding the abbreviations on the organizational chart: "A/S Inc." is AquaSource, Inc.; "AS&T" is AquaSource Service and Technology; "ASU" is AquaSource Utility, Inc.; "IOU" is the independent operating utility, i.e. the regulated utilities of AquaSource, Inc.; "ACI" is AquaSource Construction, Inc. and "ASDI" is AquaSource Development, Inc.

Item No. 4 **Provide calculations and supporting work papers for the following items:**

A. **Amortization of contributions in aid of construction (CIAC)**
B. **Recomputed acquisition adjustment based on amortized CIAC**
C. **Allocation of acquisition adjustment between water and sewer**
D. **Journal entries for Goshen for water and sewer**
E. **Journal entries for AquaSource**
F. **Recalculation of embedded cost for water and sewer using the amortized CIAC**
G. **Draft of accounting order**

Response Attached as Exhibit "D", Attachments A-F find the responses to Items A-G . The supporting documentation used to develop these Attachments is provided in response to Items 1 and 2.

Item No. 5 **Provide copies of orders from other states in which AquaSource was granted approval to acquire a system.**

Response Attached as Exhibit "E" find copies of orders for the following acquisitions:

Virginia:	Blue Ridge Utility Company (Case PUA980043)
New York:	Cambridge Water Works Company (Case 98-W-1274)
New Jersey:	Maxim Sewerage Corporation (Docket No. WM98121465)
Hawaii:	Kaanapali Water Corporation (Docket No. 99-0056)

In general, the language in these orders is representative of language found in orders for other acquisitions in these states as applicable.

Application of AquaSource Utility, Inc. for Transfer of Ownership Rights of Goshen Utilities, Inc.
Case No. 99-303
Public Service Commission Staff Data Requests from 9/30/99 Conference

Item No. 6 **Provide a discussion of the evaluation of Goshen and development of the estimated purchase price.**

Response The purchase price for each system is the result of an arms length negotiation. AquaSource uses a combination of approaches including discounted cash flow techniques to compute an approximate purchase price it may pay for a system. This price is computed on an aggregate basis for water and sewer systems combined. AquaSource typically reviews the most recent rate order to establish the basis used for setting current rates, i.e. whether using rate base rate of return or an operating ratio basis. AquaSource considers current revenues and expenses, projected customer growth, projected current and future capital expenditures, local taxes, system conditions and achievable long-term operation and maintenance savings through enhanced efficiencies and economies.

Regarding an evaluation of the system, the due diligence program gathers financial and operational information regarding each acquisition to verify assets.

In developing the purchase price, AquaSource estimated that it could reduce O&M costs by over $350,000 per year. Discounting this rate of savings at 9.5% for 20 years would produce capitalized ratepayer savings of approximately $3,000,000. In Goshen's last rate case, the Commission allowed the company to collect a margin (including interest expense) of approximately $110, 000 per annum. As such, the Commission set rates at a level that would support an investment of approximately $1.2 million ($110,000/0.095). This suggests that AquaSource could have paid up to $4.2 million in order to leave ratepayers no worse off than they would otherwise have been under current ownership. Of course, this calculation does not consider any additional benefits brought about by AquaSource's acquisition due to lower financing costs for future capital improvements, improved service, and water quality. Given that AquaSource's purchase price of $3.55 million (excluding transaction costs) is less than the maximum price of $4.2 million calculated above, it suggests that the Commission could allow AquaSource to fully recover its purchase price through a future adjustment to rates and still provide substantial benefits to the ratepayers of Goshen over the long term.

Item No. 7 **Provide an expanded discussion regarding the customers impacted by the estimated $3-5M plant investment described in response to Question 16b in Data Request No. 1.**

Response As described in response to Question 16b, the $3-5M investment is an estimate to build a new regional wastewater plant. This plant is not just for the existing customers of Goshen Utilities, but also for areas being developed around Goshen. The scope would include abandonment of existing small package plants and construction of interceptors/ lift stations/force mains (for elimination of such facilities) and the construction of a new regional wastewater plant. It is planned to satisfy the needs of the region and anticipated growth over the next five years.

SEWER UTILITIES

ANNUAL REPORT

OF

GOSHEN UTILITIES, INC.

(NAME OF RESPONDENT)

1001 RIVERSIDE DRIVE

P.O. BOX 36

GOSHEN, KENTUCKY 40026

(ADDRESS OF PRINCIPAL BUSINESS OFFICE AT END OF YEAR)

TO THE

Public Service Commission of Kentucky

730 SCHENKEL LANE
P.O. BOX 615
FRANKFORT, KENTUCKY 40602

FOR THE YEAR ENDED DECEMBER 31, 1998

EXHIBIT

A

PUBLIC SERVICE COMMISSION OF KENTUCKY
PRINCIPAL PAYMENT AND INTEREST INFORMATION
FOR THE YEAR ENDING DECEMBER 31, 1998

1. Amount of Principal Payment during calendar year $ 37,760

2. Is Principal current? (Yes) X (No) ____

3. Is Interest current? (Yes) X (No) ____

SERVICES PERFORMED BY
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

Are your financial statements examined by a Certified Public Accountant? YES ____ NO X

If yes, which service is performed?

AUDIT ____
COMPILATION ____
REVIEW ____

Please enclose a copy of the accountant's report with annual report.

AUDIT OF THE ANNUAL REPORT
SEWER UTILITIES
To Be Completed and Returned With Annual Report

Page No.	Line No.		Page No.	Line No.	Yes	No	If No, Explain Why
2	4	agrees with	4	12		X	Diff. of 2,367,670 is Water Utility
2	6	agrees with	4	15 (Utility Plant)		X	Diff. of 906,900 is Water Utility
2	7	agrees with	4	17 (Utility Plant)		X	Diff. of 1,460,770 is Water Utility
4	2 (Utility Plant)	agrees with	5	40	X		
4	23	agrees with	4	15 (Utility Plant)	X		
3	4 & 5	agrees with	6	Capital Stock	X		
3	10	agrees with	7	Balance End of Year Statement of Retained Earnings	X		
3	19	agrees with	6	Long-Term Debt, Total (d)	X		
3	23	agrees with	6	Notes Payable, Total (e)	X		
3	29	agrees with	6	Interest Accrued, Balance End of Year, Total	X		
3	30	agrees with	7	21	X		
4	3 (Depreciation)	agrees with	8	25	X		
6	Interest Accrued During Year-LTD	agrees with	8	40	X		
6	Interest Accrued During Year-Other	agrees with	8	43	X		
8	24	agrees with	9	52	X		
8	27	agrees with	10	Acct. 408.1	X		
8	28	agrees with	10	Total Income Taxes Utility Operating Income	X		

AUDIT OF THE ANNUAL REPORT

SEWER UTILITIES

TO BE COMPLETED AND RETURNED WITH ANNUAL REPORT

Page No.	Line No.		Page No.	Line No.	Yes	No	If No, Explain Why
8	26	agrees with	10	Amortization Expense	X		
8	44	agrees with	10	Account 408.2	X		
8	45	agrees with	10	Total Income Taxes Nonutility Operating Income	X		
Pages 11 and 12 have been completed					X		
The Oath Page has been completed					X		

GENERAL INFORMATION

1. Exact name of utility making this report (Use the words "The", "Company", "Incorporated" only when a part of the corporate name) GOSHEN UTILITIES, INC.

2. Give the location including street, zip code and telephone number of the principal office in Kentucky 1001 RIVERSIDE DRIVE
P.O. BOX 36, GOSHEN, KENTUCKY 40026

3. Give name, title, address and telephone number of the officer to whom correspondence concerning this report should be addressed
MARGIE GAMBILL SECRETARY-TREASURER
P.O. BOX 36
GOSHEN, KENTUCKY 40026

4. Name of State under the laws of which respondent is incorporated and the date of incorporation KENTUCKY, DECEMBER 3, 1981
SUCCESSOR TO UTILITY BUSINESS OF STONE-NANCE, INC.
A KENTUCKY CORPORATION, ORGANIZED JULY 30, 1959

5. Date sewer utility began operations NOVEMBER 1971

6. Name of City, Town, Community, Sub-division and County in which respondent furnishes sewer service
PROSPECT AND GOSHEN IN OLDHAM COUNTY

7. Number of employees: Full time 8, Part time 1

PRINCIPAL OFFICERS

Title	Name	Official Address	Annual Salary and/or Fee
PRESIDENT	LLOYD T. EADES	P.O. BOX 36, GOSHEN, KY	24,073
VICE-PRESIDENT	AL J. SCHNEIDER	P.O. BOX 36, GOSHEN, KY	0
SEC. TREASURER	MARGIE P. GAMBILL	P.O. BOX 36, GOSHEN, KY	3,600

BALANCE SHEET

Line No.	ASSETS AND OTHER DEBITS	Balance First Of Year	Balance Last Of Year
1			
2	UTILITY PLANT		
3			W/S
4	Utility Plant(101-109)	3,878,430	3,988,827
5	Less: Accum. Prov. for Depr. and Amort.		
6	of Utility Plant(110)	1,577,042	1,696,003
7	Net Utility Plant	2,301,388	2,292,824
8			
9	OTHER PROPERTY AND INVESTMENTS		
10			
11	Non-Utility Property(121)		
12	Less: Accum. Prov. for Depr. and Amort.		
13	of Non-Utility Property(122)		
14	Net Non-Utility Property		
15	Other Investments(124)		
16	Special Funds(125)		
17			
18			
19	Total Other Property and Investments		
20			
21	CURRENT AND ACCRUED ASSETS		
22			
23	Cash and Working Funds(131)	152,267	124,200
24	Temporary Cash Investments(132)	167,000	172,000
25	Notes Receivable(141)		
26	Customer Accounts Receivable(142)	17,580	12,004
27	Other Accounts Receivable(143)		
28	Accum. Prov. for Uncollectible Accts.-Cr.(144)		
29	Notes Receivable from Assoc. Companies(145)		
30	Accounts Receivable from Assoc. Companies(146)		
31	Materials and Supplies(150)		
32	Prepayments(166)	70,106	69,776
33	Other Current and Accrued Assets(170)	48,591	46,635
34			
35			
36			
37	Total Current and Accrued Assets	455,544	424,615
38			
39	DEFERRED DEBITS		
40			
41	Unamortized Debt Discount and Expense(181)		
42	Extraordinary Property Losses(182)		
43	Other Deferred Debits(183)		
44			
45			
46			
47	Total Deferred Debits		
48			
49			
50	TOTAL ASSETS AND OTHER DEBITS	2,756,932	2,717,439

BALANCE SHEET

Line No.	LIABILITIES AND OTHER CREDITS	Balance First Of Year	Balance Last Of Year
1			
2	EQUITY CAPITAL		
3			
4	Common Capital Stock(201)	200,000	200,000
5	Preferred Capital Stock(204)		
6	Other Paid-In Capital(207)	241,227	241,227
7	Discount on Capital Stock(213)		
8	Capital Stock Expense(214)		
9	Appropriated Retained Earnings(215)		
10	Unappropriated Retained Earnings(216)	(417,744)	(477,675
11	Non-Corporate Proprietorship(218)		
12	Total Equity Capital	23,483	(36,448
13			
14	LONG TERM DEBT		
15			
16	Bonds(221)		
17	Advances From Associated Companies(223)	23,507	5,988
18	Other Long Term Debt(224)		
19	Total Long Term Debt	23,507	5,988
20			
21	CURRENT AND ACCRUED LIABILITIES		
22			
23	Notes Payable(231)	191,025	170,784
24	Accounts Payable(232)	357	216
25	Notes Payable to Associated Companies(233)	3,016	3,016
26	Accounts Payable to Associated Companies(234)		
27	Customer Deposits(235)	104,415	107,995
28	Taxes Accrued(236)		
29	Interest Accrued(237)	2,996	3,132
30	Other Current and Accrued Liabilities(238)		9,472
31	Total Current and Accrued Liabilities	301,809	294,615
32			
33	DEFERRED CREDITS		
34			
35	Advances for Construction(252)		
36	Other Deferred Credits(253)		
37	Accum. Deferred Investment Tax Credits(255)		
38	Total Deferred Credits		
39			
40	Operating Reserves(261-265)		
41	Water	1,030,595	1,031,745
42	Contributions in Aid of Construction(271) Sewer	1,377,538	1,421,539
43			
44	ACCUMULATED DEFERRED INCOME TAXES		
45			
46	Accum. Def. Income Taxes-Accel. Amort.(281)		
47	Accum. Def. Income Taxes-Lib. Depr.(282)		
48	Accum. Def. Income Taxes-Other(283)		
49	Total Accum. Deferred Income Taxes		
50	TOTAL LIABILITIES AND OTHER CREDITS	2,756,932	2,717,439

SUMMARY OF UTILITY PLANT

Line No.	Acct No.	Item	Amount
		UTILITY PLANT	
1		In Service:	
2	101	Plant in Service Classified(from pg. 5, line 40)	1,621,157
3	102	Completed Construction Not Classified	
4	103	Utility Plant in Process of Reclassification	
5	106	Utility Plant Purchased or Sold	
6		Total-In Service	1,621,157
7	104	Utility Plant Leased to Others	
8	105	Property Held for Future Use	
9	107	Construction Work in Progress	
10	108	Utility Plant Acquisition Adjustments	
11	109	Other Utility Plant Adjustments	
12		Total Utility Plant(to pg. 2, line 4)	1,621,157
13		Less:	
14	110	Accumulated Provision for Depreciation and	
15		Amort. of Utility Plant(to pg. 2, line 6)	789,103
16			
17		NET UTILITY PLANT(to pg. 2, line 7)	832,054

ACCUM. PROV. FOR DEPRECIATION AND AMORTIZATION OF UTILITY PLANT

Line No.	Item		Amount
1	Balance Beginning of Year		735,156
2	Accruals for Year:		
3	Depreciation		58,090
4	Amortization		
5	Other Accounts(detail):		
6			
7			
8	Total Accruals for Year		
9	Credit Adjustments(describe):		
10			
11			
12	Total Credits for Year		58,090
13			
14	Net Charges for Plant Retired:		
15	Book Cost of Plt. Ret.(same as pg. 5, line 40)		
16	Add: Cost of Removal		
17	Less: Salvage		
18	Net Charges for Plant Retired		4,143
19	Debit Adjustments(describe):		
20			
21			
22	Total Debit Adjustments for Year		4,143
23	Balance End of Year		789,103

SEWER UTILITY PLANT IN SERVICE

Report in col. (e) entries reclass. property from one acct. to another. Corrections of entries of the prec. yr. should be recorded in col. (c) or (d) as they are corrections of additions or retirements.

Line No.	Account	Depr. Rate	Balance First of Yr	Additions	Retire-ments	Adj.-Inc. or Dec.	Balance End of Year
1	INTANGIBLE PLANT						
2	Organization(301)	---					
3	Franchise and Consents(302)	---					
4	Miscellaneous Intangible Plant(303)	---	2,043		51		1,992
5	Total Intangible Plant	---	2,043		51		1,992
6	LAND AND STRUCTURES						
7	Land and Land Rights(310)	---					
8	Structures and Improvements(311)		30,035				30,035
9	Total Land and Structures		4,985				4,9[illegible]
10	COLLECTION PLANT		35,020				35,0[illegible]0
11	Collection Sewers-Force(352.1)						
12	Collection Sewers-Gravity(352.2)		1,199,809	34,576			1,234,385
13	Other Collection Plant Facilities(353)						
14	Services to Customers(354)						
15	Flow Measuring Devices(355)		5,260	500			5,760
16	Total Collection Plant		1,205,069	35,076			1,240,145
17	PUMPING PLANT						
18	Receiving Wells and Pump Pits(362)						
19	Pumping Equipment-Electric(363A)		73,731				73,731
20	Pumping Equipment-Diesel(363B)						
21	Pumping Equipment-Other(363C)						
22	Total Pumping Plant		73,731				73,731
23	TREATMENT AND DISPOSAL PLANT						
24	Oxidation Lagoon(372)						
25	Treatment and Disposal Equipment(373)		128,874				128,[illegible]4
26	Plant Sewers(374)		23,819				23,819
27	Outfall Sewer Lines(375)						
28	Other Treat. & Dis. Plt. Equip.(376)		24,388				24,388
29	Total Treatment and Disposal Plant		177,081				177,081
30	GENERAL PLANT						
31	Office Furniture and Equipment(391)		15,228	1,811	2,456		14,583
32	Transportation Equipment(392)		46,264	16,567	3,001		59,830
33	Stores Equipment(393A)						
34	Tools, Shop & Garage Equipment(393B)		7,612				7,612
35	Laboratory Equipment(393C)						
36	Power Operated Equipment(393D)						
37	Communication Equipment(393E)		4,608				4,608
38	Other Tangible Property(393F)		6,555				6,555
39	Total General Plant		80,267	18,378	5,457		93,188
40	TOTAL SEWER PLANT IN SERVICE		1,573,211	53,454	5,508		1,621,157

CAPITAL STOCK

Class and Series of Stock (a)	No. Of Shares Auth. (b)	Par Value Per Share of Par Value Stk. (c)	Stated Val. Per Share Of Nonpar Stock (d)	Outstanding Per Balance Sheet	
				Shares (e)	Amount (f)
COMMON	2000	100	N/A	2000	200,000

LONG-TERM DEBT

List Each Original Issue Amt., Class & Series of Obligation (a)	Date Of Issue (b)	Date Of Maturity (c)	Outstanding Per Balance Sheet (d)	Interest For The Year	
				Rate (e)	Amount (f)
ADVANCE FROM ASSOCIATE CO.	5-1-89	5-1-99	5,988	8%	209
(STONE-NANCE, INC.)					
Total			5,988		209

NOTES PAYABLE
(Include Notes Payable to Associated Companies Under This Heading)

Name of Payee (a)	Date Of Note (b)	Date Of Maturity (c)	Interest Rate (d)	Balance End Of Year (e)
PNC BANK	12-12-95	12-15-99	7.5%	6,781
FIRST CAPITAL BANK	9-10-96	1-10-02	8.25%	164,003
Total				170,784

INTEREST ACCRUED

Description Of Obligation (a)	Int. Accr. Balance First Of Yr. (b)	Int. Accr. During Year (c)	Int. Paid During Year (d)	Int. Accr. Balance End Of Year
INTEREST ON LONG-TERM DEBT	0	939	939	0
CUSTOMER DEPOSITS	2,996	3,162	3,026	3,132
Total	2,996	4,101	3,965	3,132

OTHER CURRENT AND ACCRUED LIABILITIES

Line No.	Sub-Account and Description	Amount
1	BELKNAP BEACH ACCRUED LIABILITY	9,472
2		
3		
4		
5		
6		
7		
8		
9		
10		
11		
12		
13		
14		
15		
16		
17		
18		
19		
20		
21	Total(Must agree with page 3. line 30. Acct. No. 238)	9,472

STATEMENT OF RETAINED EARNINGS FOR THE YEAR

Item (a)	This Year (b)	Last Year (c)
UNAPPROPRIATED RETAINED EARNINGS(216)	(417,744)	(384,426)
Balance Beginning of Year	(129,716)	(52,583)
Balance Transferred From Income(435)		
Appropriations of Retained Earnings(436):		
Dividends Declared-Preferred Stock(437)		
Dividends Declared-Common Stock(438)		
Adjustments to Retained Earnings(439):		
WATER TREATMENT PLANT EARNINGS	69,785	32,336
		(13,071)
Balance End of Year	(477,675)	(417,744)

STATEMENT OF INCOME FOR THE YEAR

Line No.	Account (a)	Number Of Customers (b)	Amount (c)
1	OPERATING REVENUES		
2	Flat Rate Revenues-General Customers:		
3	Residential Revenues(521.1)		
4	Commercial Revenues(521.2)		
5	Industrial Revenues(521.3)		
6	Revenues From Public Authorities(521.4)		
7	Total(521)		
8	Measured Revenues-General Customers:		
9	Residential Revenues(522.1)	1212	263,433
10	Commercial Revenues(522.2)	4	3,322
11	Industrial Revenues(522.3)	1	111
12	Revenues From Public Authorities(522.4)	2	2,415
13	Total(522)	1219	269,281
14	Revenues From Public Authorities(523)		
15	Revenues From Other Systems(524)		
16	Miscellaneous Sewage Revenues(526)		
17	Total Sewage Service Revenues(521-526)	1219	269,281
18	OTHER OPERATING REVENUES		
19	Customers Forfeited Discounts(532)		6,659
20	Miscellaneous Operating Revenues(536)		972
21	Total Other Operating Revenues		
22	Total Operating Revenues		276,912
23	OPERATING EXPENSES		
24	Total Sewer Operation & Maint. Exp.(from pg.9, line52)		335,393
25	Depreciation Expense(403)		58,090
26	Amortization Expense(404-407/from pg.10)		51
27	Taxes Other Than Income Taxes(408.1/from pg.10)		19,525
28	Total Income Taxes-Utility Operating Income(from pg.10)		
29	Total Sewage Operating Expenses		413,059
30	Net Operating Income		
31	OTHER INCOME		
32	Income From Nonutility Operations(417)		2,338
33	Interest and Dividend Income(419)		8,194
34	Miscellaneous Nonoperating Income(421)		
35	Other Accounts(Specify Account No. and Title):		
36			
37			
38	Total Other Income		10,532
39	OTHER DEDUCTIONS		
40	Interest on Long Term Debt(427)		939
41	Amortization of Debt Discount and Expense(428)		
42	Interest on Debt to Associated Companies(430)		
43	Other Interest Expense(431)		3,162
44	Taxes Other Than Income Taxes(408.2/from pg.10)		
45	Total Income Taxes-Nonutil. Operat. Income(from pg.10)		
46	Other Accounts(Specify Account No. and Title):		
47			
48			
49	Total Other Deductions		4,101
50	NET INCOME		(129,716)

SEWER OPERATION AND MAINTENANCE EXPENSES

Line No.	Account (a)	Amount (b)
1	OPERATION EXPENSES	
2	Supervision and Engineering(700):	
3	Owner/Manager-Management Fee(700-A)	
4	Other Expenses(700-B)	
5	Labor and Expenses(701):	50,664
6	Collection System-Labor, Mat'ls. & Expenses(701-A)	
7	Pumping System-Labor, Mat'ls. & Expenses(701-B)	
8	Treatment System(701-C):	
9	Sludge Hauling	
10	Utility Service-Water Cost	
11	Other-Labor, Mat'ls. and Expenses	
12	Rents(702)	1,326
13	Fuel and Power Purchased for Pumping & Treatment(703)	28,983
14	Chemicals(704)	20,923
15	Miscellaneous Supplies and Expenses(705):	1,388
16	Collection System(705-A)	
17	Pumping System(705-B)	
18	Treatment and Disposal(705-C)	
19	Total Operation Expenses	103,284
20	MAINTENANCE EXPENSES	
21	Supervision and Engineering(710):	
22	Routine Maintenance Service Fee(710-A)	
23	Internal Supervision and Engineering(710-B)	
24	Maintenance of Structures and Improvements(711)	925
25	Maintenance of Collection Sewer System(712)	8,326
26	Maintenance of Pumping System(713)	5,057
27	Maintenance of Treatment and Disposal Plant(714)	6,888
28	Maintenance of Other Plant Facilities(715)	281
29	Total Maintenance Expenses	21,477
30	CUSTOMER ACCOUNTS EXPENSES	
31	Supervision(901)	
32	Meter Reading Expenses and Flat Rate Inspections(902)	
33	Customer Records and Collection Expenses(903):	
34	Agency Collection Fee(903-A)	
35	Internal Labor, Materials and Expenses(903-B)	
36	Uncollectible Accounts(904)	83
37	Miscellaneous Customer Accounts Expenses(905)	1,350
38	Total Customer Accounts Expenses	1,433
39	ADMINISTRATIVE AND GENERAL EXPENSES	
40	Administrative and General Salaries(920)	61,420
41	Office Supplies and Other Expenses(921)	19,797
43	Outside Services Employed(923)	95,316
44	Insurance Expense(924)	7,756
45	Employee Pensions and Benefits(926)	13,187
46	Regulatory Commission Expense(928)	1,211
47	Transportation Expenses(929)	6,270
48	Miscellaneous General Expenses(930)	
49	Rents(931)	
50	Maintenance of General Plant(932)	4,242
51	Total Administrative and General Expenses	209,199
52	TOTAL SEWER OPERATION & MAINT. EXP.(to pg. 8, line 24)	335,393

TAXES OTHER THAN INCOME TAXES(408)

Show hereunder the various tax items which make up the amounts listed und Account Numbers 408.1 and 408.2 appearing on page 8, lines 27 and 44.

Line No.	Item (a)	Amount (b)
1	Payroll Taxes	8,667
2	Property Taxes	10,858
3	Utility Regulatory Commission Assessment	
4	Other(Specify):	
5		
6		
7		
8		
9		
10		
11		
12	TOTAL(Same as page 8. line 27 plus 44).	19,525

OPERATING AND NON-OPERATING INCOME TAXES

Acct. No.	Account (a)	Amount (b)
409.1	Income Taxes-Federal	
409.1	Income Taxes-State	
409.1	Income Taxes-Other	
410.1	Provisions for Deferred Income Taxes	
411.1	Income Taxes Deferred in Prior Years-Credit	
412.0	Investment Tax Credits-Net	
	Total Income Taxes-Util. Operat. Income(to pg 8,line 28)	None
409.2	Income Taxes-Federal	
409.2	Income Taxes-State	
409.2	Income Taxes-Other	
410.2	Provisions for Deferred Income Taxes	
411.2	Income Taxes Deferred in Prior Years-Credit	
412.4	Investment Tax Credits-Net	
	Total Inc. Taxes-Nonutil. Op. Income(to pg. 8.line 45)	None

AMORTIZATION EXPENSE

Acct. No.	Account (a)	Amount (b)
404	Amortization of Limited-Term Utility Plant	
405	Amortization of Other Utility Plant	
406	Amortization of Utility Plant Acquisition Adjustments	51
407	Amortization of Property Losses	
-	Amortization of Rate Case Expense	
	Total Amortization Expense(to pg. 8. line 26)	51

SEWER PLANT STATISTICS

PLANT VALUATION

What method of valuation was used with reference to Sewer Utility Plant in Service appearing on page two, line four: Original Cost, Estimated Cost, Original Cost Study? ORIGINAL COST STUDY

What percentage of Sewer Utility Plant in Service was recovered, by the developer of the subdivision, through the sale of lots? NONE %

If less than one-hundred percent of the utility plant was recovered, please designate what portion(collection lines, treatment plant, ect.) of the plant that represents non-contributed plant N/A

By whom were the books of account audited? PUBLIC SERVICE COMMISSION
What was the date of the last audit? YEAR ENDING 1987
If unaudited in the past twelve months, when and by whom is the next audit anticipated?

PHYSICAL DATA OF SEWER PLANT

#1 TRAILS END PLANT #2 CARDINAL HARBOUR

Date of construction of original plant 1962 1975

Type of treatment process SECONDARY (SECRETION)

Date and additional G.P.D. Capacity of subsequent additions to plant
NONE

Population for which plant is designed including population equivalent of industrial waste load #1 1000 #2 200

TREATMENT PLANT OPERATING STATISTICS

	#1	#2
Total gallons received during the year	63,040,200	28,357,600
Total gallons received on maximum day	521,200	449,100

HEAVY STORMS JANUARY 5TH THROUGH 8TH

Maximum G.P.D. Capacity of the sewage treatment plant
#1 314,000 #2 110,000

Routine maintenance service fee:

Cost per month $ 1,200

Contract expires N/A

Sludge hauling:

Cost per load $ 402

Average number of gallons per load 5000

Number of loads this year #1 76 #2 20

SEWER PLANT STATISTICS

CUSTOMER STATISTICS-END OF YEAR

Type	Number of Customers	Bi-Monthly Or Monthly Billing?	Number of Bills Pertaining to Each Type of Customer
Residential:	1209	MONTHLY	
Single Family			
Apartments/Condominiums			
Commercial	7	MONTHLY	
Industrial	1	MONTHLY	
Other(Specify):	2	MONTHLY	
Total	1219		

INDUSTRIAL CUSTOMERS SERVED

Name And Type Of Industry	Metered Or Estimated Gals.	Pretreatment Of Wastes
LOUISVILLE GAS & ELECTRIC	METERED	

PUMPING STATIONS

Location	Size Of Motor	Type Of Motor	Capacity Gals. Per Day
ROLLINGWOOD LANE	2 - 10 H.P.	SUBMERSIBLE	144,000
CLUB DRIVE	2 - 10 H.P.	SUBMERSIBLE	144,000
YACHT CLUB ESTATES	2 - 3 H.P.	SUBMERSIBLE	115,200
HILLCREST DEVELOPMENT	2 - 56 H.P.	SUBMERSIBLE	1,238,600
1793 AT HARMONY LANDING ROAD	2 - 25 H.P.	EXTENDED SHAFT	676,000
CARDINAL HARBOUR PLANT	2 - 7½ H.P.	REPULSION INDUCTION	2,800
CARDINAL HARBOUR TOWNHOUSES	2 - 2 H.P.	"	2,400

MAINS(FEET)

Kind Of Pipe (Cast Iron, Vit. clay, concrete)	Diameter Of Pipe	No. Of Feet 1st of Year	Additions	Removed or Abandoned	No. Of Feet End Of Year
CLAY	12"	2,350			2,350
CLAY	8"	35,637			35,637
PVC	10"	6,665			6,665
PVC	8"	29,754			29,754
PVC PRESS.	6"	3,820			3,820
PVC PRESS.	4"	2,145			2,145
PVC Press.	3"	20,650			20,650
PVC Press.	2"	7,370			7,370

SERVICE LATERALS AND STUBS (IN USE 925)

Number of service laterals owned by the utility, end of year 1042

Number of stubs as of end of year 14

Number of service laterals owned by others 0

OATH

State of KENTUCKY)
) ss:
County of OLDHAM)

Before me, the undersigned officer duly authorized to administer oaths, there personally appeared LLOYD T. EADES,
(Name of affiant)

who, being first sworn by me, says on oath that he has charge of the records of GOSHEN UTILITIES, ONC.
(Exact legal name of company)

and that the foregoing report is true to the best of his knowledge and belief, and that it covers the period from January 1, 19 98, to December 31, 19 98.

(Signature of affiant)

Subscribed and sworn to before me this 31st day of MARCH, 19 99.

Notary Public, County of OLDHAM

My Commission Expires 7-25, 19 99.

(SEAL)

WATER

CLASS A & B WATER COMPANIES

ANNUAL REPORT

OF

GOSHEN UTILITIES, INC.

1001 RIVERSIDE DRIVE

P.O. BOX 36

GOSHEN, KENTUCKY 40026

TO THE

PUBLIC SERVICE COMMISSION

OF THE

COMMONWEALTH OF KENTUCKY

730 SCHENKEL LANE
P. O. BOX 615
FRANKFORT, KENTUCKY 40602

FOR THE YEAR ENDED DECEMBER 31, 1998

CLASS "A & B"

WATER COMPANIES

ANNUAL REPORT

OF

GOSHEN UTILITIES, INC.

Exact Legal Name of Respondent

For the

YEAR ENDED DECEMBER 31, 19 98

CHECKLIST FOR THE ANNUAL REPORT
FOR A AND B WATER COMPANIES
TO BE COMPLETED AND RETURNED WITH THE ANNUAL REPORT

Page No.	Account No.		Page No.		Yes	No	If No, Explain Why
4-6	The identification pages have been completed.				X		
7	101-106	agrees with	13	Total 101-106		X	Diff. of 1,619,165 is Sewer Utility
7	108-110	agrees with	14	Total 301-348 Cols c & h		X	Diff. of 789,102 is Sewer Utility
7	114-115	agrees with	15	Net Balance 114-115	X		
7	123	agrees with	16	Total 123	X		
7	124	agrees with	16	Total 124	X		
7	125	agrees with	16	Total 125	X		
7	126-127	agrees with	16	Total 126-127	X		
7	141-144	agrees with	17	Net Balance 141-144	X		
7	151-153	agrees with	18	Total 151-153	X		
7	162	agrees with	18	Total 162	X		
8	181	agrees with	19	Total 181	X		
8	182	agrees with	19	Total 182	X		
8	186	agrees with	18	Total 186	X		
8	190	agrees with	19	Total 190	X		
9	201	agrees with	20	Total Par Value of Stk Issued Col b	X		
9	204	agrees with	20	Total Par Value of Stk Issued Col c	X		
9	214-215	agrees with	23	Total 214-215	X		
9	221	agrees with	22	Total Line 10 Col 4	X		
9	221	agrees with	22	Total Col 12	X		

CHECKLIST FOR THE ANNUAL REPORT
FOR A AND B WATER COMPANIES
TO BE COMPLETED AND RETURNED WITH THE ANNUAL REPORT

age No.	Account No.		Page No.		Yes	No	If No, Explain Why
9	224	agrees with	21	Total 224 Col d	X		
9	232	agrees with	24	Total 232 Col f	X		
9	233	agrees with	24	Total 233	X		
9	234	agrees with	24	Total 234 Col f	X		
9	236	agrees with	25	Beginning & Ending Balance 236	X		
9	237	agrees with	26	Total 237 Cols b & e	X		
9	242	agrees with	27	Total 242	X		
10	251	agrees with	19	Total 251	X		
10	252	agrees with	20	Total 252	X		
10	271	agrees with	28	Beginning & Ending Balance 271	X		
10	272	agrees with	28	Accumulated Amortization 271	X		
11	400	agrees with	31	Total Water Operating Rev Col e	X		
11	401	agrees with	32	Total Col c	X		
11	406	agrees with	15	Total Accumulated Amortization 115		X	Diff. of 51 applicable to Sewer
12	427	agrees with	26	Total 237 Col c	X		
12	Net Income	agrees with	23	Balance Trans. From Inc 435 Col c		X	Diff. of (129,717) applicable to Sewer
13	101	agrees with	30	Total 301-348 Col f	X		
14	The analysis of accumulated depreciation and amortization by primary account has been completed.				X		
18	186.1	agrees with	28	Total 186.1 Col c	X		

CHECKLIST FOR THE ANNUAL REPORT
FOR A AND B WATER COMPANIES
TO BE COMPLETED AND RETURNED WITH THE ANNUAL REPORT

Page No.	Account No.		Page No.		Yes	No	If No, Explain Why
21	Schedule of Long-Term Debt has been completed.				X		
22	Schedule of Bond Maturities has been completed.				X		
22	If the Long-Term Debt consists of Notes Payable rather than Bonds, then the Notes Payable schedule has been substituted for the Schedule of Bond Maturities.				X		
30	The analysis of water utility plant accounts Cols c through k has been completed.				X		
31	Taxes collected (example: school tax, sales tax, franchise tax) have been excluded from Operating Revenue.				X		
31	The analysis of water operating revenue Cols c, d, and e has been completed.				X		
32	The analysis of water utility expense accounts Cols c through k has been completed.				X		
33	Schedule of Pumping and Purchased Water Statistics has been completed.				X		
34	466	agrees with	35	Account 466	X		
34	Line 13	agrees with	34	Line 4 Total Produced and Purchased	X		
	Oath page has been completed.				X		

PUBLIC SERVICE COMMISSION OF KENTUCKY

PRINCIPAL PAYMENT AND INTEREST INFORMATION

FOR THE YEAR ENDING DECEMBER 31, 19 98

1. Amount of Principal Payment during calendar year $37,760

2. Is Principal current? (Yes) X (No) ______

3. Is Interest current? (Yes) X (No) ______

4. Has all long-term debt been approved by the Public Service Commission?

   (Yes) X (No) ______ PSC Case No. ______

SERVICES PERFORMED BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANT

Are the financial statements examined by a Certified Public Accountant? (Yes) ______ (No) X

If yes, which service is performed?

Audit ______

Compilation ______

Review ______

Please enclose a copy of the accountant's report with annual report.

ACCOUNT 221, BONDS

Line No.	Par Value of Actual Issue (1)	Cash Realized on Actual Issue (2)	Par Value of Amount Held by or for Respondent (3)	Actually Outstanding At Close of Year (4)	Interest During Year: Accrued (5)	Interest During Year: Actually Paid (6)
1	N/A					
2						
3						
4						
5						
6						
7						
8						
9						
10 Total						

SCHEDULE OF BOND MATURITIES

(The total of column 12 must agree with the total of column 4)

Line No.	Bond Numbers (7)	Maturity Date (8)	Interest Rate (9)	Principal Amount (10)	Amounts Paid (11)	Remaining Bonds Outstanding (12)
1	N/A					
2						
3						
4						
5						
6						
7						
8						
9						
10						
11						
12						
13						
14						
15						
16						
17						
18						
19						
20						
21						
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
32						
33						
34						
35						
36						
37						
38						
39						
40						
			TOTAL			

Additional Information Required by Commission Orders

Provide any special information required by prior Commission orders, as well as any narrative explanations necessary to fully explain the data. Examples of the types of special information that may be required by Commission orders include surcharge amounts collected, refunds issued, and unusual debt repayments.

Case #	Date of Order	Item/Explanation

Attach additional sheets if more room is needed

MAJOR WATER PROJECTS

Instructions: Provide details about each major water project which is planned but has not yet been submitted for approval to the Public Service Commission. For the limited purpose of this report, a "Major Project" is defined as one which is not in the ordinary course of business, and which will increase your current utility plant by at least 20%.

Brief Project Description (improvement, replacement, building construction, expansion. If expansion, provide the estimated number of new customers):

Projected Costs and Funding Sources/Amounts:

Approval Status: (Application for financial assistance filed, but not approved; or application approved, but have not advertised for construction bids)

Location: (community, area or nearby roads)

TABLE OF CONTENTS

HISTORY

1. Exact name of utility making this report. (Use the words "The," "Company" or "Incorporated" only when a part of the corporate name.)

GOSHEN UTILITIES, INC.

2. Give the location including city, street and number, of the executive office.

1001 RIVERSIDE DRIVE

GOSHEN, KENTUCKY 40026

3. Give the location, including street and number, and telephone number of the principal office in Kentucky. (502) 228-8084

1001 RIVERSIDE DRIVE

P.O. BOX 36, GOSHEN, KENTUCKY 40026

4. Name and address of principal officer within Kentucky.

LLOYD T. EADES PRESIDENT

6995 LAGRANGE ROAD, SHELBYVILLE, KY 40065

5. Give name, title, address and telephone number of the officer to whom correspondence concerning this report should be addressed.

MARGIE P. GAMBILL SECRETARY-TREASURER

P.O. BOX 36, GOSHEN, KENTUCKY 40026

6. Date of organization. DECEMBER 3, 1981

7. Under the laws of what Government, State or Territory organized? (If more than one, name all. Give reference to each statute and amendments thereof.)

KENTUCKY

8. If a consolidated or merger company, name all contingent and all merged companies. Give reference to charters or general laws governing each, and all amendments of same. NONE

9. Date and authority for each consolidation and each merger.

NONE

10. State whether respondent is a corporation, a joint stock association, a firm or partnership, or an individual.

CORPORATION

11. If a reorganized company, give name of original corporation, refer to laws under which it was organized and the occasion for the reorganization.

GOSHEN UTILITIES, INC. WAS ORGANIZED ON DECEMBER 3, 1981 AS A WHOLLY-OWNED SUBSIDIARY OF STONE-NANCE, INC. GOSHEN UTILITIES WAS SPUN-OFF TO SHAREHOLDERS OF STONE-NANCE DURING 1988.

12. Name all other operating departments.

NONE

13. Name of counties in which you furnish water service.

OLDHAM COUNTY

REPORT OF

GOSHEN UTILITIES, INC.

For Year Ended 1998

Location where books and records are located: 1001 RIVERSIDE DRIVE
GOSHEN, KENTUCKY 40026

Contacts:

Name	Title	Principal Business Address	Salary Charged Utility
Send correspondence to: MARGIE GAMBILL	SEC-TREAS.	1001 RIVERSIDE DRIVE GOSHEN, KENTUCKY 40026	$ 3,600
Report prepared by: R. LEE SHANNON	C.P.A.	11605 SHELBYVILLE ROAD LOUISVILLE, KY 40243	$ N/A
Officers and Managers			
LLOYD T. EADES	PRESIDENT	1001 RIVERSIDE DRIVE	$56,171
		GOSHEN, KENTUCKY 40026	$
			$
AL. J.SCHNEIDER	VICE-PRES.	3270 SOUTH 7TH STREET	$ 0
		LOUISVILLE, KY 40216	$
			$
			$
			$
			$

Report every corporation or person owning or holding directly or indirectly 5 percent or more of the voting securities of the reporting utility:

Name	Percent Ownership in Utility	Principal Business Address	Salary Charged Utility
LLOYD T. EADES	50	1001 RIVERSIDE DRIVE	$ 56,171
		GOSHEN, KENTUCKY 40026	$
			$
AL J. SCHNEIDER	50	32705 7TH ST.	$ 0
		LOUISVILLE, KY 40216	$
			$
			$
			$
			$

Wd

COMPARATIVE BALANCE SHEET - ASSETS AND OTHER DEBITS

ACCT. NO. (a)	ACCOUNT NAME (b)	REF. PAGE (c)	PREVIOUS YEAR (d)	CURRENT YEAR (e)
	UTILITY PLANT			
101-106	Utility Plant	13	$ 3,876,387	$ 3,986,835
108-110	Less: Accumulated Depreciation and Amortization	13-15	1,577,042	1,696,003
	Net Plant		$ 2,299,345	$ 2,290,832
114-115	Utility Plant Acquisition Adjustments (Net)	15	2,043	1,992
116	Other Utility Plant Adjustments			
	Total Net Utility Plant		$ 2,301,388	$ 2,292,824
	OTHER PROPERTY AND INVESTMENTS			
121	Nonutility Property		$	$
122	Less: Accumulated Depreciation and Amortization			
	Net Nonutility Property		$	$
123	Investment in Associated Companies	16		
124	Utility Investments	16		
125	Other Investments	16		
126-127	Special Funds	16		
	Total Other Property & Investments		$	$
	CURRENT AND ACCRUED ASSETS			
131	Cash		$ 152,267	$ 124,200
132	Special Deposits			
133	Other Special Deposits			
134	Working Funds			
135	Temporary Cash Investments		167,000	172,000
141-144	Accounts and Notes Receivable, Less Accumulated Provision for Uncollectible Accounts	17	17,580	12,004
145	Accounts Receivable from Associated Companies			
146	Notes Receivable from Associated Companies			
151-153	Materials and Supplies	18		
161	Stores Expense			
162	Prepayments	18	70,106	69,776
171	Accrued Interest and Dividends Receivable		6,186	3,704
172	Rents Receivable			
173	Accrued Utility Revenues			
174	Misc. Current and Accrued Assets		42,405	42,931
	Total Current and Accrued Assets		$ 455,544	$ 424,615

COMPARATIVE BALANCE SHEET - ASSETS AND OTHER DEBITS (CONT'D)

ACCT. NO. (a)	ACCOUNT NAME (b)	REF. PAGE (c)	PREVIOUS YEAR (d)	CURRENT YEAR (e)
	DEFERRED DEBITS			
181	Unamortized Debt Discount & Expense.	19	$	$
182	Extraordinary Property Losses.......	19		
183	Preliminary Survey & Investigation Charges........................			
184	Clearing Accounts...................			
185	Temporary Facilities................			
186	Misc. Deferred Debits...............	18		
187	Research & Development Expenditures.			
190	Accumulated Deferred Income Taxes...	19		
	Total Deferred Debits...............		$	$
	TOTAL ASSETS AND OTHER DEBITS.......		$ 2,756,932	$ 2,717,439

NOTES TO THE BALANCE SHEET

The space below is provided for important notes regarding the balance sheet

COMPARATIVE BALANCE SHEET - EQUITY CAPITAL AND LIABILITIES

ACCT. NO. (a)	ACCOUNT NAME (b)	REF. PAGE (c)	PREVIOUS YEAR (d)	CURRENT YEAR (e)
	EQUITY CAPITAL			
201	Common Stock Issued	20	$ 200,000	$ 200,000
204	Preferred Stock Issued	20		
202,205	Capital Stock Subscribed	20		
203,206	Capital Stock Liability for Conversion	20		
207	Premium on Capital Stock			
209	Reduction in Par or Stated Value of Capital Stock			
210	Gain on Resale or Cancellation of Reacquired Capital Stock			
211	Other Paid-In Capital		241,227	241,227
212	Discount on Capital Stock			
213	Capital Stock Expense			
214-215	Retained Earnings	23	(417,744)	(477,675)
216	Reacquired Capital Stock			
218	Proprietary Capital (Proprietorship and Partnership Only)			
	Total Equity Capital		$ 23,483	$ (36,448)
	LONG-TERM DEBT			
221	Bonds	22	$	$
222	Reacquired Bonds			
223	Advances from Associated Companies		23,507	5,988
224	Other Long-Term Debt	21		
	Total Long-Term Debt		$ 23,507	$ 5,988
	CURRENT AND ACCRUED LIABILITIES			
231	Accounts Payable		$ 357	$ 216
232	Notes Payable	24	191,025	170,784
233	Accounts Payable to Associated Co.	24	3,016	3,016
234	Notes Payable to Associated Co.	24		
235	Customer Deposits		104,415	107,995
236	Accrued Taxes	25		
237	Accrued Interest	26	2,996	3,132
238	Accrued Dividends			
239	Matured Long-Term Debt			
240	Matured Interest			
241	Tax Collections Payable			
242	Miscellaneous Current and Accrued Liabilities	27		9,472
	Total Current and Accrued Liabilities		$ 301,809	$ 294,615

COMPARATIVE BALANCE SHEET - EQUITY CAPITAL AND LIABILITIES (CONT'D)

ACCT. NO. (a)	ACCOUNT NAME (b)	REF. PAGE (c)	PREVIOUS YEAR (d)	CURRENT YEAR (e)
	DEFERRED CREDITS			
251	Unamortized Premium on Debt.........	19	$	$
252	Advances for Construction...........	20		
253	Other Deferred Credits..............			
255	Accumulated Deferred Investment Tax Credits......................			
	Total Deferred Credits..............		$	$
	OTHER NON-CURRENT LIABILITIES			
	Accumulated Provision For:			
261	Property Insurance		$	$
262	Injuries and Damages			
263	Pensions and Benefits			
265	Miscellaneous Operating Reserves ...			
266	Rate Refunds			
	Total Other Non-Current Liabilities.		$	$
	CONTRIBUTIONS IN AID OF CONSTRUCTION WATER		1,030,595	1,031,745
271	Contributions In Aid of Construction SEWER	28-29	$ 1,377,538	$ 1,421,539
	Tap-on Fees - Customers			
	Federal Grants in Aid of Const. ..			
	Other			
272	Accumulated Amortization of Contributions In Aid of Construction...			
	Total Net C.I.A.C....................		$ 2,408,133	$ 2,453,284
	ACCUMULATED DEFERRED INCOME TAXES			
281	Accumulated Deferred Income Taxes Accelerated Depreciation.........		$	$
282	Accumulated Deferred Income Taxes Liberalized Depreciation.........			
283	Accumulated Deferred Income Taxes Other..........................			
	Total Accum. Deferred Income Taxes..		$	$
	TOTAL EQUITY CAPITAL AND LIABILITIES		$ 2,756,932	$ 2,717,439

COMPARATIVE OPERATING STATEMENT

ACCT. NO. (a)	ACCOUNT NAME (b)	REF. PAGE (c)	PREVIOUS YEAR (d)	CURRENT YEAR (e)
	UTILITY OPERATING INCOME			
400	Operating Revenues	32	$ 558,220	$ 565,378
401	Operating Expenses	33	$ 424,225	$ 414,314
403	Depreciation Expenses		67,394	73,155
406	Amortization of Utility Plant Acquisition Adjustment			
407	Amortization Expense			
408.1	Taxes Other Than Income		26,543	34,619
409.1	Income Taxes			(19,101)
410.10	Deferred Federal Income Taxes			
410.11	Deferred State Income Taxes			
410.12	Deferred Local Income Taxes			
411.10	Provision for Deferred Income Taxes Credit			
412.10	Investment Tax Credits Deferred to Future Periods			
412.11	Investment Tax Credits Restored to Operating Income			
	Utility Operating Expenses		$ 518,162	$ 502,987
	Utility Operating Income		$ 40,058	$ 62,391
413	Income From Utility Plant Leased to Others			
414	Gains (Losses) From Disposition of Utility Property		(955)	475
	Total Utility Operating Income		$ 39,103	$ 62,866
	OTHER INCOME AND DEDUCTIONS			
415	Revenues From Merchandising, Jobbing and Contract Deductions		$ 2,500	$ 4,645
416	Costs and Expenses of Merchandising, Jobbing and Contract Work		(3,230)	(2,042)
419	Interest & Dividend Income		3,811	3,883
420	Allowance for Funds Used During Construction			
421	Nonutility Income		9,719	19,276
426	Miscellaneous Nonutility Expenses		(250)	(295)
	Total Other Income and Deductions		$ 12,550	$ 25,467

COMPARATIVE OPERATING STATEMENT (CONT'D)

ACCT. NO. (a)	ACCOUNT NAME (b)	REF. PAGE (c)	PREVOUS YEAR (d)	CURRENT YEAR (e)
	TAXES APPLICABLE TO OTHER INCOME			
408.20	Taxes Other Than Income............		$	$
409.20	Income Taxes......................			
410.20	Provision for Deferred Income Taxes.			
411.20	Provision for Deferred Income Taxes Credit........................			
412.20	Investment Tax Credits - Net........			
412.21	Investment Tax Credits Restored to Nonoperating Income.............			
	Total Taxes Applic. to Other Income.		$	$
	INTEREST EXPENSE			
427	Interest Expense..................		$ 19,317	$ 18,547
428	Amortization of Debt Discount & Exp.			
429	Amortization of Premium on Debt.....			
	Total Interest Expense.............		$ 19,317	$ 18,547
	EXTRAORDINARY ITEMS			
433	Extraordinary Income...............		$	$
434	Extraordinary Deductions...........			
409.30	Income Taxes, Extraordinary Items...			
	Total Extraordinary Items..........		$	$
	NET INCOME......................		$ 32,336	$ 69,786

NET UTILITY PLANT (ACCTS. 101 - 106)

ACCT. NO.	PLANT ACCOUNTS	TOTAL
101	Utility Plant in Service	$ 2,367,670
102	Utility Plant Leased to Others	
103	Property Held for Future Use	
104	Utility Plant Purchased of Sold	
105	Construction Work in Progress	
106	Completed Construction Not Classified	
	Total Utility Plant	$ 2,367,670

ACCUMULATED DEPRECIATION (ACCT. 108)

DESCRIPTION	TOTAL
Balance first of year	$ 841,886
Credit during year:	
Accruals Charged to Account 108.1	73,155
Accruals Charged to Account 108.2	
Accruals Charged to Account 108.3	
Accruals Charged to Other Accounts (specify)	
Salvage	
Other Credits (specify)	
Total Credits	$ 915,041
Debits during year:	
Book Cost of Plant Retired	$
Cost of Removal	
Other Debits (specify)	
NET CHARGES FOR PLANT RETIRED	8,140
Total Debits	$ 8,140
Balance end of year	$ 906,901

ANNALYSIS OF ACCUMULATED DEPRECIATION AND AMORTIZATION BY PRIMARY ACCOUNT

ACCT. NO. (a)	ACCOUNT (b)	BALANCE BEGINNING OF YEAR (c)	CREDITS DURING THE YEAR: CHARGES TO DEP. EXP. (d)	CREDITS DURING THE YEAR: OTHER CREDITS (e)	CHARGES DURING THE YEAR: PLANT RETIREMENTS (f)	CHARGES DURING THE YEAR: OTHER CHARGES (g)	BALANCE END OF YEAR (h)
301	Organization................	$	$	$	$	$	$
302	Franchises..................						
303	Limited Term Interest in Land and Land Rights.......						
304	Structures and Improvements..	8,807	511				9,318
305	Collecting and Impounding Reservoirs...............						
306	Lake River and Other Intakes.						
307	Wells and Springs...........	61,543	2,397				63,940
308	Infiltration Galleries and Tunnels..................						
309	Supply Mains................						
310	Power Generating Equipment...						
311	Pumping Equipment...........	29,471	4,125				33,596
320	Water Treatment Equipment....	1,913	361				2,274
330	Distribution Reservoirs and Standpipes................	147,078	11,912				158,990
331	Transmission and Distribution Mains....................	375,430	25,044				400,474
333	Services....................	24,348	2,792				27,140
334	Meters & Meter Installations.	58,875	13,331				72,206
335	Hydrants....................	5,679	235				5,914
339	Other Plant and Miscellaneous Equipment................	361	132				493
340	Office Furniture and Equip...	12,870	1,151		1,140		12,881
341	Transportation Equipment.....	50,734	8,588		7,000		52,322
342	Stores Equipment............						
343	Tools, Shop & Garage Equip...	40,043	1,427				41,470
344	Laboratory Equipment.........						
345	Power Operated Equipment.....	20,182	1,089				21,271
346	Communication Equipment......	4,552	60				4,612
347	Miscellaneous Equipment......						
348	Other Tangible Plant.........						
	TOTALS	$ 841,886	$ 73,155	$	$ 8,140	$	$ 906,901

ACCUMULATED AMORTIZATION (ACCT. 110)

DESCRIPTION	TOTAL
Balance first of year	$
Credit during year:	
Accruals Charged to Account 110.1	
Accruals Charged to Account 110.2	
Other Credits (specify)	
Total Credits	$
Debits during year:	
Book Cost of Plant Retired	$
Other Debits (specify)	
Total Debits	$
Balance end of year	$ NONE

UTILITY PLANT ACQUISITION ADJUSTMENTS (ACCTS. 114 - 115)

Report each acquisition adjustment and related accumulated amortization separately. For any acquisition adjustment approved by the Commission, include the Order Number.

ACCOUNT NAME		TOTAL
Acquisition Adjustments (114)		$ 3,472
Total Plant Acquistion Adjustments		$
Accumulated Amortization (115)		
BEGINNING BALANCE	1,429	$ 3,472
AMORTIZATION EXPENSE	51	
Total Accumulated Amortization		$ 1,480
Net Acquisition Adjustments		$ 1,992

INVESTMENTS AND SPECIAL FUNDS (ACCTS. 123 - 127)

Report hereunder all investments and special funds carried in Accounts 123 thru 127.

DESCRIPTION OF SECURITY OR SPECIAL FUND (a)	FACE OR PAR VALUE (b)	YEAR END BOOK COST (c)
INVESTMENT IN ASSOCIATED COMPANIES (ACCT. 123):		
....	$	$
....		
....		
....		
....		
Total Investment in Associated Companies........		$
UTILITY INVESTMENTS (ACCT. 124):		
....	$	$
....		
....		
....		
....		
Total Utility Investments......................		$
OTHER INVESTMENTS (ACCT. 125):		
....	$	$
....		
....		
....		
....		
Total Other Investments........................		$
SPECIAL FUNDS (ACCTS. 126 & 127):		
....	$	$
....		
....		
....		
....		
Total Special Funds............................		$ NONE

ACCOUNTS AND NOTES RECEIVABLE - NET (ACCOUNTS 141 - 144)

Report hereunder all accounts and notes receivable included in Accounts 141, 142 and 144. Amounts included in Accounts 142 and 144 should be listed individually.

DESCRIPTION		TOTAL
ACCOUNTS & NOTES RECEIVABLE:		
Customer Accounts Receivable (Acct. 141)		$ 12,004
Other Accounts Receivable (Acct. 142)		
	$	
Notes Receivable (Acct. 144)		
	$	
Total Accounts and Notes Receivable		$ 12,004
Accumulated Provision for Uncollectible Accounts (Acct. 143):		
Balance first of year	$	
Add: Provision for uncollectibles for current year	$	
Collections of accounts previously written off		
Utility accounts		
Others		
Total Additions	$	
Deduct accounts written off during year:		
Utility Accounts	$	
Other		
Total accounts written off	$	
Balance end of year		$
Total Accounts and Notes Receivable - Net		$ 12,004

MATERIALS AND SUPPLIES (151 - 153)

ACCOUNT NAME	TOTAL
Plant Materials and Supplies (Account 151)...................	$
Merchandise (Account 152)...................................	
Other Materials and Supplies (Account 153)..................	
Total Materials and Supplies................................	$ NONE

PREPAYMENTS (ACCT. 162)

DESCRIPTION	TOTAL
Prepaid Insurance...	$ 15,575
Prepaid Rents...	
Prepaid Interest..	
Prepaid Taxes...... FEDERAL AND STATE INCOME TAXES	10,728
Other Prepayments (Specify) PREPAID RATE CASES	4,199
GOSHEN UPGRADE	16,333
PREPAID PERMIT FEES	2,380
PREPAID COMPUTER MAINTENANCE	285
TRAILS END PROJECT	20,276
....	
Total Prepayments...	$ 69,776

MISCELLANEOUS DEFERRED DEBITS (ACCT. 186)

DESCRIPTION	TOTAL
Miscellaneous Deferred Debits (Acct. 186):	
Deferred Rate Case Expense (Acct. 186.1)...........	$
Other Deferred Debits (Acct. 186.2)................	
Total Miscellaneous Deferred Debits.........................	$ NONE

UNAMORTIZED DEBT DISCOUNT AND EXPENSE AND PREMIUM ON DEBT (ACCTS. 181 & 251)

Report the net discount and expense or premium separately for each security issue.

DESCRIPTION	AMOUNT WRITTEN OFF DURING YEAR	YEAR END BALANCE
Unamortized Debt Discount and Expense (Acct. 181):		
....	$	$
....		
....		
....		
Total Unamortized Debt Discount and Expense.......	$	$
Unamortized Premium on Debt (Acct. 251):		
....	$	$
....		
....		
....		
Total Unamortized Premium on Debt................	$	$ NONE

EXTRAORDINARY PROPERTY LOSSES (ACCT. 182)

Report each item separately.

DESCRIPTION	TOTAL
Extraordinary Property Losses (Acct. 182):	
..	$
..	
..	
..	
Total Extraordinary Property Losses..........................	$ NONE

ACCUMULATED DEFERRED INCOME TAXES (ACCT. 190)

DESCRIPTION	TOTAL
Accumulated Deferred Income Taxes (Acct. 190):	
Federal (190.1)..	$
State (190.2)...	
Local (190.3)...	
Total Accumulated Deferred Income Taxes......................	$ NONE

ADVANCES FOR CONSTRUCTION (ACCT. 252)

DESCRIPTION	TOTAL
Balance first of year..................................	0
Add credits during year............................	
Deduct charges during year........................	
Balance end of year..................................	0

CAPITAL STOCK (ACCTS. 201 - 204)

(a)	COMMON STOCK (b)	PREFERRED STOCK (c)
Par or stated value per share.....................	100	N/A
Shares authorized..	2,000	
Shares issued and outstanding....................	2,000	
Total par value of stock issued..................	200,000	
Dividends declared per share for year...........	0	

LONG TERM DEBT (ACCT. 224)

DESCRIPTION OF OBLIGATION (INCLUDING NOMINAL DATE OF ISSUE AND DATE OF MATURITY) (a)	INTEREST RATE (b)	INTEREST AMOUNT (c)	PRINCIPAL PER BALANCE SHEET DATE (d)
N/A		$	$
Total		$	$

STATEMENT OF RETAINED EARNINGS

1. Dividends should be shown for each class and series of capital stock. Show amounts of dividends per share.
2. Show separately the state and federal income tax effect of items shown in Account No. 439.

ACCT. NO. (a)	(b)	AMOUNTS (c)
215	Unappropriated Retained Earnings:	
	Balance beginning of year	$ (417,744)
	Changes to account:	
439	Adjustments to Retained Earnings (requires Commission approval prior to use):	
	Credits	$
	Total Credits	$
	Debits	$
	Total Debits	$
435	Balance Transferred from Income	$ 69,786
	TRANSFERRED FROM SEWER	(129,717)
436	Appropriations of Retained Earnings:	
		$
	Total Appropriations of Retained Earnings	$
	Dividends Declared:	
437	Preferred Stock Dividends Declared	$
	Common Stock Dividends Declared	
	Total Dividends Declared	$
	Balance end of year	$
214	Appropriated Retained Earnings (state balance and purpose of each appropriated amount at year end):	
		$
	Total Appropriated Retained Earnings	$
	Total Retained Earnings	$ (477,675)

Notes to Statement of Retained Earnings:

NOTES PAYABLE (ACCOUNTS 232 & 234)

(a)	NOMINAL DATE OF ISSUE (b)	DATE OF MATURITY (c)	INTEREST RATE (d)	INTEREST AMOUNT OF PAYMENT (e)	PRINCIPAL AMOUNT PER BALANCE SHEET (f)
Account 232 - Notes Payable:					
PNC BANK(FOR SEWER DIV)	12-12-95	12-15-99	7.5	$ 1085	$ 6,781
FIRST CAPITAL BANK	9-10-96	1-10-02	8.25	14,304	164,003
Total Account 232...........				$	$ 170,784
Account 234 - Notes Payable To Associated Companies:					
				$	$
Total Account 234...........				$	$ NONE

ACCOUNTS PAYABLE TO ASSOCIATED COMPANIES (ACCOUNT 233)

SHOW PAYABLE TO EACH ASSOCIATED COMPANY SEPARATELY	AMOUNT
PAYABLE TO STONE-NANCE	$ 3,016
Total..	$ 3,016

TAXES ACCRUED (ACCOUNT 236)

ACCT. NO. (a)	DESCRIPTION (b)	TOTAL (c)
	Balance first of year	$ 0
	Accruals Charged:	
408.10	Utility regulatory assessment fees	
408.11	Property taxes	17,582
408.12	Payroll taxes	15,930
408.13	Other taxes and licenses	1,107
408.20	Taxes other than income, other income and deductions	
409.10	Federal income taxes	
409.11	State income taxes	
409.12	Local income taxes	
409.20	Income taxes, other inc. taxes, other inc. & deduct.	
409.30	Income taxes, extraordinary items	
410.10	Deferred federal income taxes	
410.11	Deferred state income taxes	
410.12	Deferred local income taxes	
410.20	Provisions for deferred income taxes, other income and deductions	
411.10	Deferred income taxes - credit	
411.20	Provisions for deferred income taxes - credit, other income and deductions	
412.10	ITC deferred to future periods	
412.11	ITC restored to operating income	
412.20	ITC -Net nonutility operations	
412.21	ITC -Restored to nonoperating inc., util. operations	
	Total taxes accrued	$ 34,619
	Taxes paid during year:	
408.10	Utility regulatory assessment fees	
408.11	Property taxes	17,582
408.12	Payroll taxes	15,930
408.13	Other taxes and licenses	1,107
408.20	Taxes other than income, other income and deductions	
409.10	Federal income taxes	
409.11	State income taxes	
409.12	Local income taxes	
409.20	Income taxes, other inc. taxes, other inc. & deduct.	
409.30	Income taxes, extraordinary items	
410.10	Deferred federal income taxes	
410.11	Deferred state income taxes	
410.12	Deferred local income taxes	
410.20	Provisions for deferred income taxes, other income and deductions	
411.10	Deferred income taxes - credit	
411.20	Provisions for deferred income taxes - credit, other income and deductions	
412.10	ITC deferred to future periods	
412.11	ITC restored to operating income	
412.20	ITC -Net nonutility operations	
412.21	ITC -Restored to nonoperating inc., util. operations	
	Total taxes paid	$ 34,619
	Balance end of year	$ 0

ACCRUED INTEREST (ACCOUNT 237)

DESCRIPTION OF DEBT (a)	BALANCE BEGINNING OF YEAR (b)	INTEREST ACCRUED DURING YEAR (c)	INTEREST PAID DURING YEAR (d)	BALANCE END OF YEAR (e)
Account No. 237.1 - Accrued Interest on Long-Term Debt:	$	$	$	$
FIRST CAPITAL BANK	0	14,305	14,305	0
PNC BANK	0	1,085	1,085	0
Total Acct. No. 237.1	$ 0	$ 15,390	$ 15,390	$ 0
Account No. 237.2 - Accrued Interest on Other Liabilities:	$	$	$	$
CUSTOMER DEPOSITS	2,996	3,157	3,021	3,132
Total Acct. No. 237.2	$ 2,996	$ 3,157	$ 3,021	$ 3,132
Total Acct. No. 237	$ 2,996	$ 18,547	$ 18,411	$ 3,132

MISCELLANEOUS CURRENT AND ACCRUED LIABILITIES (ACCOUNT 242)

DESCRIPTION (a)	BALANCE END OF YEAR (b)
BELKNAP BEACH ACCRUED LIABILITY	$ 9,472
Total Miscellaneous Current and Accrued Liabilities............	$ 9,472

REGULATORY COMMISSION EXPENSE - AMORTIZATION OF RATE CASE EXPENSE (ACCOUNTS 665 & 667)

DESCRIPTION OF CASE (DOCKET NO.) (a)	EXPENSE INCURRED DURING YEAR (b)	AMOUNT TRANSFERRED TO ACCOUNT NO. 186.1 (c)	CHARGED OFF DURING YEAR ACCT. (d)	CHARGED OFF DURING YEAR AMOUNT (e)
	$	$		$
Total............................	$	$		$ NONE

CONTRIBUTIONS IN AID OF CONSTRUCTION (ACCOUNT 271)

DESCRIPTION	TOTAL
Balance first of year..	$ 1,030,595
Add credits during year..	$ 1,150
Deduct charges during year..	$
Balance end of year..	$ 1,031,745
Less Accumulated Amortization..	$
Net Contributions in Aid of Construction..	$ 1,031,745

RECONCILIATION OF REPORTED NET INCOME WITH TAXABLE INCOME FOR FEDERAL INCOME TAXES
(UTILITY OPERATIONS)

1. The reconciliation should include the same detail as furnished on Schedule M-1 of the Federal tax return for the year. The reconciliation shall be submitted even though there is no taxable income for the year. Descriptions should clearly indicate the nature of each reconciling amount and show the computation of all tax accruals.
2. If the utility is a member of a group which files a consolidated Federal tax return, reconcile reported net income with taxable net income as if a separate return were to be filed, indicating intercompany amounts to be eliminated in such consolidated return. State names of group members, tax assigned to each group member, and basis of allocation, assignment, or sharing of the consolidated tax among the group members.

DESCRIPTION	REF.	AMOUNT
Net income for the year		$ 69,786
Reconciling items for the year:		
Taxable income not reported on books:		
LOSS FROM SEWER DIVISION		(129,717)
Deductions recorded on books not deducted for return:		
Income recorded on books not included in return:		
Deduction on return not charged against book income:		
Federal tax net income		$ (59,931)
Computation of tax:		

WATER UTILITY PLANT ACCOUNTS

ACCT. NO. (a)	ACCOUNT NAME (b)	PREVIOUS YEAR (c)	ADDITIONS (d)	RETIRE-MENTS (e)	CURRENT YEAR (f)	.1 INTAN-GIBLE PLANT (g)	.2 SOURCE OF SUPPLY & PUMPING PLANT (h)	.3 WATER TREATMENT PLANT (i)	.4 TRANS. & DISTRIBU. PLANT (j)	.5 GENERAL PLANT (k)
301	Organization..................	$	$	$	$	$	$XXXXXXXX	$XXXXXXXX	$XXXXXXXX	$XXXXXXXX
302	Franchises....................						XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX
303	Land and Land Rights.........	205,231			205,231	XXXXXXXX		205,231		
304	Structures and Improvements..	17,590			17,590	XXXXXXXX	16,371	1,219		
305	Collecting and Impounding Reservoirs................					XXXXXXXX		XXXXXXXX	XXXXXXXX	XXXXXXXX
306	Lake River and Other Intakes.					XXXXXXXX		XXXXXXXX	XXXXXXXX	XXXXXXXX
307	Wells and Springs............	79,465			79,465	XXXXXXXX	79,465	XXXXXXXX	XXXXXXXX	XXXXXXXX
308	Infiltration Galleries and Tunnels....................					XXXXXXXX		XXXXXXXX	XXXXXXXX	XXXXXXXX
309	Supply Mains.................					XXXXXXXX		XXXXXXXX	XXXXXXXX	XXXXXXXX
310	Power Generation Equipment...					XXXXXXXX		XXXXXXXX	XXXXXXXX	XXXXXXXX
311	Pumping Equipment............	49,926	15,821		65,747	XXXXXXXX	65,747	XXXXXXXX	XXXXXXXX	XXXXXXXX
320	Water Treatment Equipment....	2,840	5,144		7,984	XXXXXXXX	XXXXXXXX	7,984	XXXXXXXX	XXXXXXXX
330	Distribution Reservoirs and Standpipes................	479,475	4,600		484,075	XXXXXXXX	XXXXXXXX	XXXXXXXX	484,075	XXXXXXXX
331	Transmission and Distribution Mains..................	1,106,924	1,148		1,108,072	XXXXXXXX	XXXXXXXX	XXXXXXXX	1,108,072	XXXXXXXX
333	Services.....................	74,825			74,825	XXXXXXXX	XXXXXXXX	XXXXXXXX	74,825	XXXXXXXX
334	Meters & Meter Installations.	114,995	22,543		137,538	XXXXXXXX	XXXXXXXX	XXXXXXXX	137,538	XXXXXXXX
335	Hydrants.....................	9,910	826		10,736	XXXXXXXX	XXXXXXXX	XXXXXXXX	10,736	XXXXXXXX
339	Other Plant and Miscellaneous Equipment..............	1,971			1,971				1,971	XXXXXXXX
340	Office Furniture and Equip...	15,229	5,262	2,457	18,034	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	18,034
341	Transportation Equipment.....	57,712	16,566	7,002	67,276	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	67,276
342	Stores Equipment.............					XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	
343	Tools, Shop and Garage Equip.	48,981			48,981	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	48,981
344	Laboratory Equipment.........					XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	
345	Power Operated Equipment.....	25,798			25,798	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	25,798
346	Communication Equipment......	14,347			14,347	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	14,347
347	Miscellaneous Equipment......					XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	
348	Other Tangible Plant.........					XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	
	Total Water Plant............	$ 2,305,219	$ 71,910	$ 9,459	$ 2,367,670	$	$ 161,583	$ 214,434	$ 1,817,217	$ 174,436

WATER OPERATING REVENUE

ACCT. NO. (a)	(b)	BEGINNING YEAR NO. CUSTOMERS (c)	YEAR END NUMBER CUSTOMERS (d)	AMOUNTS (e)
	Operating Revenues:			
460	Unmetered Water Revenue.................			$
461	Metered Water Revenue:			
461.1	Sales to Residential Customers.........	1605	1650	$ 473,511
461.2	Sales to Commercial Customers..........	27	25	31,487
461.3	Sales to Industrial Customers..........	3	3	790
461.4	Sales to Public Authorities...........	2	2	3,516
461.5	Sales to Multiple Family Dwellings.....			
461.6	Sales through Bulk Loading Stations....			
	Total Metered Sales...................			$
462	Fire Protection Revenue:			
462.1	Public Fire Protection................	1	1	$ 242
462.2	Private Fire Protection...............			
	Total Fire Protection Revenue..........			$
464	Other Sales to Public Authorities........			$
465	Sales to Irrigation Customers...........			
466	Sales for Resale.......................	1	1	5,392
467	Interdepartmental Sales.................			
	Total Sales of Water..................	1639	1682	$ 514,938
	Other Water Revenues:			
470	Forfeited Discounts.....................................			$ 11,569
471	Miscellaneous Service Revenues...........................			4,740
472	Rents from Water Property..............................			
473	Interdepartmentsl Rents................................			
474	Other Water Revenues..............(SURCHARGE)........			34,131
475	Provision for Rate Refunds............................			
	Total Other Water Revenues...........................			$ 50,440
	Total Water Operating Revenues........................			$ 565,378

WATER UTILITY EXPENSE ACCOUNTS

ACCT. NO. (a)	ACCOUNT NAME (b)	CURRENT YEAR (c)	WATER EXPENSE ACCOUNT MATRIX							
			.1 SOURCE OF SUPPLY & EXPENSES-OPERATION (d)	.2 SOURCE OF SUPPLY & EXPENSES-MAINTEN. (e)	.3 WATER TREATMENT EXPENSES-OPERATION (f)	.4 WATER TREATMENT EXPENSES-MAINTEN. (g)	.5 TRANS. & DISTRIBU. EXPENSES-OPERATION (h)	.6 TRANS. & DISTRIBU. EXPENSES-MAINTEN. (i)	.7 CUSTOMER ACCOUNTS EXPENSE (j)	.8 ADMINIS-TRATIVE & GENERAL EXPENSES (k)
601	Salaries and Wages-Employees.	$155,560	$	$	$	$	$118,213	$	$14,209	$23,138
603	Salaries and Wages-Officers, Directors and Majority Stockholders	56,172					28,086			28,086
604	Employee Pensions & Benefits.	13,187					7,071			6,116
610	Purchased Water	39,270	39,270	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX
615	Purchased Power	43,829	43,829	XXXXXXXX		XXXXXXXX		XXXXXXXX		
616	Fuel for Power Production			XXXXXXXX		XXXXXXXX		XXXXXXXX		
618	Chemicals	2,849			2,849				XXXXXXXX	XXXXXXXX
620	Materials and Supplies	26,106		3,017			4,747	5,521	2,704	10,117
631	Contractual Services - Eng.									
632	Contractual Services - Acct.	3,825								3,825
633	Contractual Services - Legal.	6,919								6,919
634	Contractual Services - Management Fees									
635	Contractual Services - Other.	24,361			8,860				1,815	13,686
641	Rental of Bldg./Real Property	3,058								3,058
642	Rental of Equipment	1,327					68			1,259
650	Transportation Expenses	11,347	1,733	1,733	1,733	1,733	1,733	1,757		925
656	Insurance - Vehicle	4,283								4,283
657	Insurance - General Liability	1,497								1,497
658	Insurance - Worker's Compensation	5,494								5,494
659	Insurance - Other	4,541								4,541
660	Advertising Expense		XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	
666	Regulatory Commission Exp. - Amortization of Rate Case Expense		XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	
667	Regulatory Commission Exp. - Other	9,898								9,898
670	Bad Debt Expense	83	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	XXXXXXXX	83	XXXXXXXX
675	Miscellaneous Expenses	708								708
	T[illegible] Water Utility Expenses.	$414,314	$84,832	$4,750	$13,442	$1,733	$159,918	$7,278	$18,811	123,550

PUMPING AND PURCHASED WATER STATISTICS

(a)	WATER PURCHASED FOR RESALE (Omit 000's) (b)	WATER PUMPED FROM WELLS (Omit 000's) (c)	TOTAL WATER PUMPED AND PURCHASED (Omit 000's) (d)	WATER SOLD TO CUSTOMERS (Omit 000's) (e)
January............	1,782	12,568	14,350	13,673
February...........	2,189	10,481	12,670	9,290
March..............	2,272	11,784	14,056	10,177
April..............	2,065	11,943	14,008	11,654
May................	3,556	14,120	17,676	12,608
June...............	4,902	15,031	19,933	15,031
July...............	5,645	12,404	18,049	16,403
August.............	5,395	14,925	20,320	13,996
September..........	5,528	16,922	22,450	15,418
October............	4,632	12,415	17,047	20,746
November...........	3,535	11,963	15,498	13,995
December...........	2,683	13,800	16,483	11,406
Total for year......	44,184	158,356	202,540	164,397

Maximum gallons pumped by all methods in any one day (Omit 000's): 862

Date 8 / 23 / 98

Minimum gallons pumped by all methods in any one day (Omit 000"s): 266

Date 2 / 24 / 98

If water is purchased for resale, indicate the following:

Vendor OLDHAM COUNTY WATER DISTRICT

Point of delivery BUCKEYE LANE N. & U.S. HWY. 42

If water is sold to other water utilities for redistribution, list names of such utilities below: N/A

SALES FOR RESALE (466)

LINE #	COMPANY	GALLONS	AVG. RATE (CENTS)	AMOUNT
1	FRED COFFMAN	4,245,500	1.10	5,392
2				
3				
4				
5				
6				
7	TOTAL			

WATER PRODUCED, PURCHASED AND DISTRIBUTED

LINE #	ITEM	GALLONS
1	WATER PRODUCED AND PURCHASED:	
2	Water Produced	158,356,000
3	Water Purchased	44,184,000
4	TOTAL PRODUCED AND PURCHASED	202,540,000
5	DISTRIBUTION OF WATER PRODUCED AND PURCHASED:	
6	Water Sold:	
7	TOTAL SALES OF WATER	164,397,000
8	OTHER WATER USED:	
9	Free Customers (estimate portion not metered)	197,430
10	Water Used by Company (estimate portion not metered)	5,950,000
11	Line Loss and Other Unaccounted for Water (estimate)	27,995,500
12	TOTAL OTHER WATER USED	4,000,000
13	TOTAL (must agree with line 4 above)	202,540,000

PERCENTATE OF LINE LOSS (line 11 divided by line 4) 14 %

WATER STATISTICS

CUSTOMER TYPE	NUMBER OF GALLONS SOLD
Residential (460)	
Commercial (460)	
Industrial (460)	
TOTAL (460)	
Residential (461)	142,682,100
Commercial (461)	15,511,300
Industrial (461)	200,900
TOTAL (461)	164,397,000
Private Fire-Protection Service (462)	
Public Fire-Protection Service (463)	66,500
Other Sales to Public Authorities (464)	1,690,700
Sales to Irrigation Customers (465)	
Sales for Resale (466)	4,245,500
TOTAL GALLONS OF WATER SOLD	164,397,000

PLANT STATISTICS

Give the following information:

1. Number of fire hydrants, by size
2. Number of private fire hydrants, by size
3. Whether water supply is river, impounded streams, well, springs, artificial lake or collector type well
4. Whether supply is by gravity, pumping, or a combination
5. Type, capacity, and elevation of reservoirs at overflow and ground level
6. Miles of main by size and kind
7. Types of filters: gravity or pressure, number of units, and total rated capacity in gallons per minute
8. Type of chlorinators, number of units and capacity in pounds per 24 hours
9. Station equipment. List each pump separately, giving type and capacity and H.P. of driving unit and character of driving unit (steam, electric, or internal combustion). State whether pump is high or low duty.
10. Quantity of fuel used: coal in pounds, gas in cu. ft., oil in gallons, and electric in KWH.
11. Give a description and total cost of any sizable additions or retirements to plant in service outside the normal system growth for the period covered by this report
12. Capacity of clear well
13. Peak month, in gallons of water sold
14. Peak day, in gallons of water sold

1) 138 Municipal Fire Hydrants 4½" X 2½" x 2½"
2) 8 Private Fire Hydrants 4½" X 2½" X 2½"
3) Wells
4) Combination
5) Tower - 50,000 gallons - 117' high
Ground Storage Tank - 700,000 gallons - 42' high
Elevated Storage Tank - 200,000 gallons - 122' high
150,000 gallon Fresh Water Lake for standby
6) 4" Steel Transmission Mains 3000'
4" PVC Transmission Mains 4300'
6" PVC Transmission Mains 41,650'
8" PVC Transmission Mains 32,950'
2",3",4",6" PVC and Cast Iron Distribution Mains 145,350'
7) None
8) Fisher Porter (2) One at 50 lbs capacity, one at 200 lbs
9) 1 - Elec. pump 250 G.P.M. 40 H.P. 400 TDH Heavy Duty
1 - Elec pump 100 G.P.M. 20 H.P. " " " "
1 - Elec. pump 860 G.P.M. 30 H.P. 160 TDH Heavy Duty
2 - Elec. pump 400 G.P.M. 75 H.P. 525 " " "
10) 550,661 KWH
11) 8" PVC Distribution Mains - 15,000'
12) N/A
13) 20,746,400
14) 669,226

OATH

Commonwealth of KENTUCKY }
County of OLDHAM } ss:

LLOYD T. EADES makes oath and says
(Insert here the name of the affiant)

that he is PRESIDENT of
(Insert here the official title of the affiant)

GOSHEN UTILITIES, INC. ;
(Insert here the exact legal title or name of the respondent)

that it is his duty to have supervision over the books of account of the respondent and to control the manner in which such books are kept; that he knows that such books have, during the period covered by the foregoing report, been kept in good faith in accordance with the accounting and other orders of the Public Service Commission of Kentucky, effective during the said period; that he has carefully examined the said report and to the best of his knowledge and belief the entries contained in the said report have, so far as they relate to matters of account, been accurately taken from the said books of account and are in exact accordance therewith; that he believes that all other statements of fact contained in the said report are true; and that the said report is a correct and complete statement of the business and affairs of the above-named respondent during the period of time from and including

JANUARY 1, 19 98 to and including DECEMBER 31, 19 98

(Signature of affiant)

Subscribed and sworn to before me, a NOTARY PUBLIC, in and for the State and County above named, this 31ST day of MARCH, 19 99

(Apply Seal Here)

My commission expires JULY 25, 1999

(Signature of officer authorized to administer oaths)

TenEch
Environmental Consultants, Inc.

Mark W. Tenney, Sc.D., P.E.
Joseph L. Pavoni, Ph.D., P.E.

March 21, 1980
Louisville, Kentucky

Mr. Wilton F. Stone, President
Goshen Utilities
Goshen, Kentucky 40026

Dear Mr. Stone:

In accordance with your request, I have made a detailed audit of the Water and Sewer Utility Plant and property records. The study covered the period from the inception of Goshen Utilities in 1971 through December, 1979.

To develop the original cost of the plant as of December 31, 1979, entries on the plant accounts were traced to the original source documents, construction contracts, etc., before adjustments were made. Where necessary, engineers' estimates were used to apportion costs to the proper plant accounts.

I would like to take this opportunity to express my appreciation to each of you for your cooperation during the course of the study. In particular, I would like to thank your accountant, Bob Lancaster, C.P.A., for his work on the original cost study and rate case.

Herewith, I am submitting nine (9) copies of the original cost study of the Goshen Utilities Water and Sewer Plant and property accounts.

Yours truly,

Carl J. Salzman

Carl J. Salzman
Utilities Rate Consultant

Enclosures (9)

744 W. Washington Street
South Bend, Indiana 46601

Two North Riverside Plaza
Suite 1960
Chicago, Illinois 60606

615 Park Avenue
Louisville, Kentucky 40208
502/636-3686

GOSHEN UTILITIES WATER DEPARTMENT

AS OF DECEMBER 31, 1979

Contribution in Aid of Construction

Lurding Co. - Settlers Point	$ 55,000.00	
Jack Kimball	3,430.00	
Harry Neal	65,082.00	
Cardinal Ridge Farm	12,651.90	
Goshen Developers - Lakeview-Sec. 1	21,547.00	
Trails End	18,288.00	
Goshen Hills	18,905.00	
Lakeview-Sec. 2	36,458.00	
Harmony Landing County Club	4,029.00	
Armin Willig	14,415.00	
Showtime Stables	17,417.00	
Hillcrest Farm	6,375.00	
Mayo Court	6,239.20	
Malama Farm	30,597.00	
Anne Fields	3,075.00	
Emil Pferrer	1,768.00	
Cardinal Harbour	33,049.10	
Carl Cox - Spindletop Estates	21,000.00	
Sundry Customer for Services and Meter Installations, Etc.	144,153.08	
Total Contribution in Aid of Construction		$513,479.28

Exhibit 3
Sub B - Sewer
Page 3 of 4

GOSHEN UTILITIES SEWER DEPARTMENT

AS OF DECEMBER 31, 1979

Contribution in Aid of Construction

Lurding Co. - Settlers Point		$129,000.00	
Jim O'Hern		2,894.00	
Goshen Developers - Lakeview-Sec. 1		65,000.00	
Trails End		24,168.64	
Goshen Hills		10,140.00	
Lakeview-Sec. 2		81,812.00	
Carl Cox - Spindletop Estates		83,455.01	
General Realty		3,744.00	
Huckleberry Hills Co.		18,640.00	
General Realty - Harmony Lake	$223,100.00		
Less Payment for Road Construction	61,500.00	161,600.00	$671,713.65
Sewer Tap Fees:			
1974		$ 1,000.00	
1975		5,000.00	
1976		22,000.00	
1977		63,500.00	
1978		47,000.00	
1979		109,900.00	$248,400.00
Total Contribution in Aid of Construction			$920,113.65

GOSHEN UTILITIES

03-16-1999 07:48:05 F I X E D A S S E T S Y S T E M

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	----D-E-P-R-E-C-I-A-T-I-O-N---- CURRENT YTD	TOTAL
	00079				12/12	S	10 00	00/00	$0.00	$0.00	$0.00
	00214				12/96	S	01 00	12/96	$0.00	$0.00	$0.00
	00084				01/80	S	05 00	00/00	$0.00	$0.00	$0.00
	00240				12/96	S	01 00	12/96	$0.00	$0.00	$0.00
	00210				12/96	S	05 00	12/98	$0.00	$0.00	$0.00
	00090				01/01	S	10 00	00/00	$0.00	$0.00	$0.00
	00243				12/96	S	01 00	12/96	$0.00	$0.00	$0.00
	00150				01/88	S	01 00	00/00	$0.00	$0.00	$0.00
	00078				12/22	S	10 00	00/00	$0.00	$0.00	$0.00
	00216				01/96	S	01 00	12/96	$0.00	$0.00	$0.00
	00074				01/80	S	10 00	00/00	$0.00	$0.00	$0.00
	00092				01/87	S	07 00	00/00	$0.00	$0.00	$0.00
		ACCOUNT # - 12							$0.00	$0.00	$0.00
		Class - 12							$0.00	$0.00	$0.00
0	00073				01/81	S	10 00	00/00	$0.00	$0.00	$0.00
0	00071				01/01	S	10 00	00/00	$0.00	$0.00	$0.00
		ACCOUNT # - 2							$0.00	$0.00	$0.00
		Class - 2							$0.00	$0.00	$0.00
1	00022				01/72	S	40 00	12/98	$0.00	$0.00	$0.00
1	00019				01/71	S	40 00	12/98	$0.00	$0.00	$0.00
1	00007				01/58	S	40 00	12/97	$0.00	$0.00	$0.00
		ACCOUNT # - 3							$0.00	$0.00	$0.00
1	00024	METERS		000	01/73	S	40 00	12/98	$0.00	$0.00	$0.00
1	00002	LAND		303	01/58	N	00 00	00/00	$109,030.00	$0.00	$0.00
1	00151	REBUILT PUMP H		304	10/89	S	10 00	12/98	$1,019.02	$101.90	$934.10
1	00061	PUMPING		304	01/79	S	40 00	12/98	$16,371.00	$409.28	$8,185.60
		ACCOUNT # - 2							$17,390.02	✓ $511.18	$9,119.70
1	00271	WELL PUMP		307	04/93	S	10 00	12/98	$4,120.00	$412.00	$2,334.67
1	00003	WELLS		307	01/58	S	30 00	12/95	$23,830.00	$0.00	$23,830.00
1	00026	WELLS		307	01/73	S	30 00	12/98	$196.00	$6.53	$169.85
1	00018	WELLS		307	01/71	S	30 00	12/98	$1,339.00	$44.63	$1,249.94
1	00033	WELLS		307	01/75	S	30 00	12/98	$10,112.00	$337.07	$8,090.56
1	00219	MOTOR FOR WELL		307	08/90	S	10 00	12/98	$3,053.29	$305.33	$2,544.42
1	00040	WELLS		307	01/76	S	30 00	12/98	$3,749.00	$124.97	$2,874.61

GOSHEN UTILITIES

03-16-1999 07:48:05 F I X E D A S S E T S Y S T E M

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
1	00047	WELLS			307	01/77	S	30 00	12/98	$8,000.00	$266.67	$5,866.74
1	00060	WELLS			307	01/79	S	30 00	12/98	$23,710.00	$790.33	$15,806.63
1	00152	NEW OVERLOAD B			307	08/89	S	07 00	12/96	$260.00	$0.00	$260.00
1	00220	STAND-BY-MOTOR			307	08/90	S	10 00	12/98	$1,095.70	$109.57	$913.08
		ACCOUNT # -	11							$79,464.99	$2,397.10	$63,940.50
1	00130	REBUILT 2-6" C			311	03/88	S	07 00	12/95	$1,372.07	$0.00	$1,372.07
1	00217	PUMPREPAIR/PUM			311	06/90	S	07 00	12/97	$1,423.00	$0.00	$1,423.00
1	00059	PUMP STATION E			311	01/79	S	30 00	12/98	$30,305.00	$1,010.17	$20,203.40
1	00131	REBULIT 2 ALLI			311	04/88	S	07 00	12/95	$3,600.79	$0.00	$3,600.79
1	00469	PUMP			311	08/98	S	07 00	12/98	$7,897.80	$470.11	$470.11
1	00449	MOTOR REPAIR			311	09/97	S	07 00	12/98	$3,825.00	$546.43	$728.57
1	00463	EQUIP/2 HIGH S			311	02/98	S	07 00	12/98	$1,680.00	$200.00	$200.00
1	00315	2 HOR512ZONTAL			311	08/93	S	07 00	12/98	$5,443.23	$777.60	$4,147.20
1	00464	ROTATING ELEME			311	02/98	S	07 00	12/98	$4,944.11	$647.44	$647.44
1	00435	2 ROTATINGS AS			311	03/97	S	10 00	12/98	$3,957.28	$395.73	$725.50
1	00468	BLOWER			311	08/98	S	07 00	12/98	$1,299.31	$77.34	$77.34
		ACCOUNT # -	11							$65,747.59	$4,124.82	$33,595.42
1	00103	ELECTRICAL REP			320	11/87	S	15 00	12/98	$2,840.00	$189.33	$2,104.42
1	00467	PUMPHOUSE-STEE			320	07/98	S	15 00	12/98	$5,144.11	$171.47	$171.47
		ACCOUNT # -	2							$7,984.11	$360.80	$2,275.89
1	00414	DISMANTLE STAN			330	09/96	S	10 00	12/98	$5,000.00	$500.00	$1,125.00
1	00057	TRANS AND SAND			330	01/79	S	40 00	12/98	$106,324.00	$2,658.10	$53,162.00
1	00004	TANKS & STANDP			330	01/58	S	40 00	12/97	$15,775.00	$0.00	$15,775.00
1	00075	TANKS AND SAND			330	01/81	S	40 00	12/98	$4,000.00	$100.00	$1,800.00
1	00223	ALTITUDE VALVE			330	10/90	S	07 00	12/97	$1,424.30	$0.00	$1,424.30
1	00048	TANKS AND SAND			330	01/77	S	40 00	12/98	$6,068.00	$151.70	$3,337.40
1	00045	TANKS AND SAND			330	01/77	S	40 00	12/98	$27,704.00	$692.60	$15,237.20
1	00442	INSTALL NEW LI			330	05/97	S	40 00	12/98	$3,570.54	$89.26	$141.33
1	00354	BELKNAP BEACH/			330	10/94	S	40 00	12/98	$223,960.00	$5,599.00	$23,795.75
1	00072	TANKS AND SAND			330	01/80	S	40 00	12/98	$1,231.00	$30.78	$584.82
1	00058	TRANS AND SAND			330	01/79	S	40 00	12/98	$83,621.00	$2,090.53	$41,810.60
1	00218	ALTITUDE VALVE			330	06/90	S	07 00	12/97	$797.19	$0.00	$797.19
		ACCOUNT # -	12							$479,475.03	$11,911.97	$158,990.59
1	00056	TRANS AND DIST			331	01/79	S	50 00	12/98	$142,933.00	$2,858.66	$57,173.20
1	00428	GOSHEN UPGRADE			331	10/97	S	10 00	12/98	$15,325.48	$1,532.55	$1,915.69
1	00221	VALVE FOR DIST			331	09/90	S	07 00	12/97	$602.85	$0.00	$602.85
1	00044	TRANS AND DIST			331	01/77	S	50 00	12/98	$40,442.00	$808.84	$17,794.48
1	00400	PRESSURE REDUC			331	07/96	S	07 00	12/98	$1,421.00	$203.00	$490.58

GOSHEN UTILITIES

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Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
1	00224	PRESS RED VALV			331	10/90	S	07 00	12/97	$653.37	$0.00	$653.37
1	00054	TRANS AND DIST			331	01/78	S	50 00	12/98	$97,174.00	$1,943.48	$40,813.08
1	00001	TRANS AND DIST			331	01/58	S	50 00	12/98	$88,604.00	$1,772.08	$72,679.56
1	00039	TRANS AND DIST			331	01/76	S	50 00	12/98	$5,670.00	$113.40	$2,608.51
1	00440	RECORDER			331	05/97	S	07 00	12/98	$896.28	$128.04	$213.40
1	00066	WATER CONTRIBU			331	01/80	S	50 00	12/98	$513,479.00	$10,269.58	$195,122.02
1	00426	TRANS & DISTR			331	12/96	S	40 00	12/98	$199,723.09	$4,993.08	$9,986.16
1	00470	MECHANICAL-GOS			331	02/98	S	10 00	12/98	$4,600.00	$421.67	$421.67
		ACCOUNT # - 13								$1,111,524.07	$25,044.38	$400,474.57
1	00292	10 COUP STOPS			333	04/93	S	25 00	12/98	$147.02	$5.88	$33.81
1	00296	12 SADDLES			333	04/93	S	25 00	12/98	$478.95	$19.16	$110.17
1	00226	40 COUP STOPS/			333	07/90	S	25 00	12/98	$4,324.17	$172.97	$1,470.24
1	00191	SADDLES			333	04/89	S	25 00	12/98	$97.54	$3.90	$38.03
1	00260	COUP STOPS			333	08/92	S	25 00	12/98	$293.68	$11.75	$75.39
1	00200	1 SADDLE/TUBI			333	09/89	S	25 00	12/98	$305.67	$12.23	$116.19
1	00394	18 SETTERS			333	02/96	S	07 00	12/98	$364.92	$52.13	$147.70
1	00346	3 SADDLES			333	11/94	S	25 00	12/98	$115.87	$4.63	$19.29
1	00299	6 SADDLES			333	06/93	S	25 00	12/98	$179.04	$7.16	$39.98
1	00302	400' TUBING/1			333	06/93	S	25 00	12/98	$640.83	$25.63	$140.97
1	00335	10 COUP STOPS			333	05/94	S	25 00	12/98	$153.43	$6.14	$29.16
1	00495	10 COUP STOPS			333	10/98	S	25 00	12/98	$167.69	$1.12	$1.12
1	00306	300' TUBING/4			333	08/93	S	25 00	12/98	$892.09	$35.68	$190.29
1	00197	12 FORD COPSET			333	08/89	S	25 00	12/98	$867.25	$34.69	$329.56
1	00339	12 SADDLES			333	02/94	S	25 00	12/98	$325.25	$13.01	$63.97
1	00261	12 COUP STOPS			333	09/92	S	25 00	12/98	$1,270.13	$50.81	$321.80
1	00198	PE TUBINGS			333	08/89	S	25 00	12/98	$39.90	$1.60	$15.20
1	00199	1 SADDLE AND T			333	08/89	S	25 00	12/98	$43.98	$1.76	$16.72
1	00232	41 CORP-STOPS/			333	07/91	S	25 00	12/98	$2,642.71	$105.71	$792.82
1	00458	7 METERS			333	12/97	S	07 00	12/98	$535.50	$76.50	$82.88
1	00196	6 PJ WYE			333	07/89	S	25 00	12/98	$79.31	$3.17	$30.12
1	00456	10 METER BOXES			333	12/97	S	07 00	12/98	$707.55	$101.08	$109.50
1	00269	12 SADDLES			333	12/92	S	25 00	12/98	$904.33	$36.17	$217.02
1	00189	1 2" METER SE			333	02/89	S	25 00	12/98	$243.84	$9.75	$95.88
1	00190	10 METERS/COVE			333	03/89	S	25 00	12/98	$251.79	$10.07	$98.18
1	00192	10 SADDLES & C			333	04/89	S	25 00	12/98	$680.09	$27.20	$262.94
1	00478	10 COUP STOPS			333	04/98	S	25 00	12/98	$273.26	$7.29	$7.29
1	00129	WATER SERVICE			333	12/87	S	50 00	12/98	$756.00	$15.12	$166.69
1	00194	6 SADDLES & TU			333	06/89	S	25 00	12/98	$394.12	$15.76	$151.04
1	00291	6 SADDLES/10 C			333	03/93	S	25 00	12/98	$419.74	$16.79	$96.54
1	00195	6 SADDLES			333	06/89	S	25 00	12/98	$178.08	$7.12	$67.65
1	00419	6 SADDLES			333	10/96	S	25 00	12/98	$669.72	$26.79	$58.04

GOSHEN UTILITIES

03-16-1999 07:48:05 FIXED ASSET SYSTEM

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
1	00451	6 SADDLES/COUP			333	10/97	S	25 00	12/98	$984.59	$39.38	$49.23
1	00293	4 SADDLES			333	04/93	S	25 00	12/98	$148.95	$5.96	$34.27
1	00266	12 SADDLES/COU			333	11/92	S	25 00	12/98	$490.78	$19.63	$121.05
1	00203	4 SADDLES AMD			333	11/89	S	25 00	12/98	$478.30	$19.13	$181.65
1	00201	12 SADDLES ETC			333	09/89	S	25 00	12/98	$298.16	$11.93	$113.34
1	00202	20 SADDLES ETC			333	11/89	S	25 00	12/98	$1,298.49	$51.94	$493.43
1	00124	WATER SERVICE			333	08/87	S	50 00	12/98	$114.00	$2.28	$25.93
1	00471	10 COUP STOP			333	01/98	S	25 00	12/98	$162.82	$6.51	$6.51
1	00125	WATER SERVICE			333	08/87	S	50 00	12/98	$2,123.64	$42.47	$481.37
1	00492	10 SADDLES			333	10/98	S	25 00	12/98	$240.20	$1.60	$1.60
1	00017	SERVICES			333	01/71	S	40 00	12/98	$5,194.00	$129.85	$3,636.51
1	00399	10 SETTERS/TUB			333	07/96	S	07 00	12/98	$441.02	$63.00	$152.25
1	00336	600' TUBING			333	03/94	S	25 00	12/98	$300.19	$12.01	$57.05
1	00307	3 1" SADDLES			333	10/93	S	25 00	12/98	$490.10	$19.60	$102.90
1	00117	WATER SEWER EX			333	12/86	S	50 00	12/98	$2,032.68	$40.65	$487.91
1	00118	WATER SEWER EX			333	02/87	S	50 00	12/98	$2,841.13	$56.82	$672.81
1	00119	WATER SEWER EX			333	03/87	S	50 00	12/98	$312.00	$6.24	$73.60
1	00452	10 METERS			333	10/97	S	07 00	12/98	$765.00	$109.29	$136.61
1	00453	13 METERS			333	11/97	S	07 00	12/98	$936.00	$133.71	$156.00
1	00122	WATER SERVICE			333	06/87	S	50 00	12/98	$109.13	$2.18	$25.16
1	00410	13 SADDLES			333	09/96	S	25 00	12/98	$832.39	$33.30	$77.70
1	00454	5 METER BOXES/			333	11/97	S	07 00	12/98	$527.35	$75.34	$81.62
1	00345	10 COUP STOPS			333	10/94	S	25 00	12/98	$574.42	$22.98	$97.66
1	00187	12 FORD COPSET			333	02/89	S	25 00	12/98	$498.96	$19.96	$196.27
1	00127	WATER SERVICE			333	10/87	S	50 00	12/98	$528.90	$10.58	$119.02
1	00254	6 SADDLES/5 CO			333	06/92	S	25 00	12/98	$1,324.65	$52.99	$348.85
1	00415	12 SADDLES			333	09/96	S	25 00	12/98	$241.72	$9.67	$21.76
1	00446	12 SADDLES/COU			333	08/97	S	25 00	12/98	$2,084.28	$83.37	$111.16
1	00005	SERVICES			333	01/58	S	40 00	12/97	$7,244.00	$0.00	$7,244.00
1	00257	6 SADDLES			333	07/92	S	25 00	12/98	$166.12	$6.64	$43.16
1	00402	6 SADDLES			333	08/96	S	25 00	12/98	$362.26	$14.49	$35.02
1	00434	18 SADDLES/18			333	02/97	S	25 00	12/98	$1,558.90	$62.36	$114.32
1	00404	2 SADDLES			333	08/96	S	25 00	12/98	$82.59	$3.30	$7.98
1	00120	WATER SEWER EX			333	05/87	S	50 00	12/98	$1,478.05	$29.56	$342.90
1	00184	6 SADDLES ETC			333	12/88	S	25 00	12/98	$515.03	$20.60	$206.00
1	00281	10 1' COUP ST			333	12/93	S	25 00	12/98	$222.28	$8.89	$45.19
1	00282	500 INSERTS			333	12/93	S	25 00	12/98	$446.89	$17.88	$90.89
1	00185	12 SADDLES/TUB			333	01/89	S	25 00	12/98	$1,480.27	$59.21	$587.17
1	00123	WATER SERVICE			333	07/87	S	50 00	12/98	$1,495.44	$29.91	$341.71
1	00504	10 COUP STOPS			333	12/98	S	25 00	12/98	$167.69	$0.00	$0.00
1	00126	WATER SERVICE			333	10/87	S	50 00	12/98	$69.56	$1.39	$15.64
1	00444	10 COUP STOPS			333	06/97	S	25 00	12/98	$797.33	$31.89	$47.84

GOSHEN UTILITIES

03-16-1999 07:48:05 FIXED ASSET SYSTEM

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co	Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	----D-E-P-R-E-C-I-A-T-I-O-N---- CURRENT YTD	TOTAL
1	00188	1 PVC COUPLING				333	01/89	S	25 00	12/98	$26.62	$1.06	$10.52
1	00279	60 COUP STOPS				333	12/93	S	25 00	12/98	$882.13	$35.29	$179.39
1	00021	SERVICES				333	01/72	S	40 00	12/98	$3,593.00	$89.83	$2,425.82
1	00342	12SADDLES				333	05/94	S	25 00	12/98	$325.26	$13.01	$59.63
1	00433	12 SADDLES & C				333	02/97	S	25 00	12/98	$719.81	$28.79	$52.78
1	00338	8 COUP STOPS/C				333	04/94	S	25 00	12/98	$218.01	$8.72	$40.69
1	00498	3 SADDLES				333	11/98	S	25 00	12/98	$136.41	$0.91	$0.91
1	00308	10 COUP STOPS				333	10/93	S	25 00	12/98	$790.20	$31.61	$165.95
1	00441	1 SADDLES				333	04/97	S	25 00	12/98	$53.79	$2.15	$3.76
1	00247	5 SADDLES/10 C				333	01/92	S	25 00	12/98	$525.96	$21.04	$147.28
1	00193	12 SADDLES AND				333	04/89	S	25 00	12/98	$424.38	$16.98	$164.14
1	00407	4 SADDLES				333	08/96	S	25 00	12/98	$305.00	$12.20	$28.47
1	00344	8 SADDLES				333	09/94	S	25 00	12/98	$216.83	$8.67	$36.85
1	00249	4 SADDLES				333	02/92	S	25 00	12/98	$219.44	$8.78	$60.73
1	00251	6 SADDLES				333	03/92	S	25 00	12/98	$281.88	$11.28	$77.08
1	00337	6 SADDLES				333	04/94	S	24 00	12/98	$109.58	$4.57	$21.32
1	00340	10 COUP STOPS				333	02/94	S	25 00	12/98	$317.15	$12.69	$61.33
1	00183	8 SADDLES/COUP				333	12/88	S	25 00	12/98	$214.55	$8.58	$85.80
1	00311	10 COUP SADDLE				333	11/93	S	25 00	12/98	$300.72	$12.03	$62.15
1	00343	12 SADDLES				333	08/94	S	25 00	12/98	$333.17	$13.33	$57.76
1	00280	10 1" SADDLES				333	12/93	S	25 00	12/98	$372.37	$14.89	$75.69
1	00437	4 SADDLES				333	04/97	S	25 00	12/98	$199.22	$7.97	$13.95
1	00310	6 SADDLES				333	10/93	S	25 00	12/98	$398.33	$15.93	$82.31
1	00186	ONE 15' EXTENS				333	02/89	S	25 00	12/98	$142.60	$5.70	$56.53
1	00341	20 SADDLES				333	05/94	S	25 00	12/98	$728.42	$29.14	$133.56
1	00278	60 SADDLES				333	12/93	S	25 00	12/98	$2,234.26	$89.37	$454.30
		ACCOUNT # -	100								$75,972.80	$2,791.78	$27,139.92
1	00295	10 METER BOXES				334	04/93	S	07 00	12/98	$237.65	$33.95	$192.38
1	00482	20 METERS				334	07/98	S	07 00	12/98	$1,530.00	$109.29	$109.29
1	00396	10 METER BOXES				334	04/96	S	07 00	12/98	$756.42	$108.06	$288.16
1	00334	8 METERS				334	04/94	S	07 00	12/98	$137.80	$19.69	$91.88
1	00104	14 METERS WITH				334	03/87	S	40 00	12/98	$854.00	$21.35	$251.64
1	00323	5 METER BOXES				334	06/94	S	07 00	12/98	$279.37	$39.91	$179.60
1	00177	12 COUPLINGS				334	08/89	S	07 00	12/96	$87.19	$0.00	$87.19
1	00178	12 METER SETER				334	09/89	S	07 00	12/96	$1,302.78	$0.00	$1,302.78
1	00418	24 SETTERS/COU				334	10/96	S	07 00	12/98	$1,993.39	$284.77	$617.00
1	00297	3 SETTERS				334	05/93	S	07 00	12/98	$355.41	$50.77	$283.47
1	00115	24 METERS WITH				334	11/87	S	40 00	12/98	$1,165.20	$29.13	$325.29
1	00290	2 METER BOXES/				334	03/93	S	07 00	12/98	$187.73	$26.82	$154.21
1	00176	1 1" METER/BOX				334	08/89	S	07 00	12/96	$225.23	$0.00	$225.23
1	00300	2 EXTN/10 MET				334	06/93	S	07 00	12/98	$1,304.04	$186.29	$1,040.12

GOSHEN UTILITIES
FIXED ASSET SYSTEM
Depreciation Summary - INTERNAL
By Class / ACCOUNT #
For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co	Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	----D-E-P-R-E-C-I-A-T-I-O-N---- CURRENT YTD	TOTAL
1	00395	10 METER BOXES				334	03/96	S	07 00	12/98	$278.42	$39.77	$112.69
1	00331	12 METER BOXES				334	11/94	S	07 00	12/98	$547.53	$78.22	$319.40
1	00483	10 METER BOXES				334	07/98	S	07 00	12/98	$1,284.75	$76.47	$76.47
1	00263	15 METERS				334	09/92	S	07 00	12/98	$356.48	$50.93	$318.31
1	00360	1 1" METER				334	04/95	S	07 00	12/98	$255.00	$36.43	$133.58
1	00107	8 METERS WITH				334	08/87	S	40 00	12/98	$825.35	$20.63	$235.53
1	00035	METERS				334	01/75	S	40 00	12/98	$0.00	$0.00	$0.00
1	00225	2-1" & 72-3/4				334	07/90	S	07 00	12/97	$9,115.98	$0.00	$9,115.98
1	00416	36 SETTERS				334	09/96	S	07 00	12/98	$3,261.92	$465.99	$1,048.48
1	00417	6" METER				334	10/96	S	07 00	12/98	$900.18	$128.60	$278.63
1	00259	12 METERS				334	07/92	S	07 00	12/98	$546.20	$78.03	$500.69
1	00322	5 METER BOXES/				334	05/94	S	07 00	12/98	$512.94	$73.28	$335.87
1	00167	4 METER BOXES				334	03/89	S	07 00	12/96	$163.80	$0.00	$163.80
1	00168	12 METER BOXES				334	04/89	S	07 00	12/96	$567.00	$0.00	$567.00
1	00169	1" METER				334	05/89	S	07 00	12/96	$313.17	$0.00	$313.17
1	00108	10 METERS WITH				334	08/87	S	40 00	12/98	$1,030.33	$25.76	$292.25
1	00171	5 METER BOXES				334	06/89	S	07 00	12/96	$104.89	$0.00	$104.89
1	00459*	20 METERS				334	01/80	S	40 00	12/97	$1,720.00	$0.00	$764.78
1	00303	12 METERS				334	07/93	S	07 00	12/98	$557.14	$79.59	$437.75
1	00304	2 1" METERS				334	07/93	S	07 00	12/98	$249.25	$35.61	$192.89
1	00305	12 EXTN/7 METE				334	08/93	S	07 00	12/98	$445.43	$63.63	$339.36
1	00332	14 METERS				334	11/94	S	07 00	12/98	$650.01	$92.86	$386.92
1	00111	15 METERS WITH				334	12/87	S	40 00	12/98	$776.80	$19.42	$215.24
1	00398	10 METER BOXES				334	07/96	S	07 00	12/98	$1,693.24	$241.89	$584.57
1	00401	20 METER BOXES				334	08/96	S	07 00	12/98	$1,473.61	$210.52	$508.75
1	00114	1 METER WITH A				334	07/87	S	40 00	12/98	$553.85	$13.85	$158.42
1	00403	42 METERS				334	08/96	S	07 00	12/98	$1,900.61	$271.52	$656.17
1	00262	24 METERS/24				334	09/92	S	07 00	12/98	$1,579.41	$225.63	$1,428.99
1	00070	METERS				334	01/80	S	40 00	12/98	$3,430.00	$85.75	$1,809.97
1	00324	24 METERS				334	08/94	S	07 00	12/98	$1,801.28	$257.33	$1,115.10
1	00265	12 EXTENSIONS				334	11/92	S	07 00	12/98	$966.64	$138.09	$851.56
1	00170	6 METER PLATES				334	04/89	S	07 00	12/96	$296.96	$0.00	$296.96
1	00109	1 METER WITH A				334	09/87	S	40 00	12/98	$125.30	$3.13	$35.47
1	00110	8 METERS WITH				334	09/87	S	40 00	12/98	$388.40	$9.71	$109.31
1	00333	8 METER BOXES				334	12/94	S	07 00	12/98	$199.70	$28.53	$116.50
1	00112	7 METERS WITH				334	12/87	S	40 00	12/98	$339.85	$8.50	$93.71
1	00413	15 METERS				334	09/96	S	07 00	12/98	$1,031.25	$147.32	$331.47
1	00128	METERS				334	12/87	S	50 00	12/98	$802.00	$16.04	$177.78
1	00477	12 SETTERS/MET				334	04/98	S	07 00	12/98	$1,865.01	$177.62	$177.62
1	00288	8 METER BOXES				334	01/93	S	07 00	12/98	$188.68	$26.95	$159.46
1	00479	30 METERS				334	05/98	S	07 00	12/98	$2,295.00	$218.57	$218.57
1	00480	24 METERS				334	05/98	S	07 00	12/98	$1,090.21	$103.83	$103.83

GOSHEN UTILITIES

03-16-1999 07:48:05 F I X E D A S S E T S Y S T E M

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co	Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	----D-E-P-R-E-C-I-A-T-I-O-N---- CURRENT YTD	TOTAL
1	00481	10 METER BOXES				334	06/98	S	07 00	12/98	$633.46	$52.79	$52.79
1	00447	10 METER BOXES				334	08/97	S	07 00	12/98	$1,720.76	$245.82	$327.76
1	00165	24 METERS ETC				334	12/88	S	07 00	12/95	$1,464.71	$0.00	$1,464.71
1	00484	8 METER BOXES				334	07/98	S	07 00	12/98	$222.60	$13.25	$13.25
1	00485	6 COUPLINGS				334	08/98	S	07 00	12/98	$130.77	$7.78	$7.78
1	00393	10 METER BOXES				334	02/96	S	07 00	12/98	$2,001.96	$285.99	$810.31
1	00476	20 METERS				334	04/98	S	07 00	12/98	$1,530.00	$163.93	$163.93
1	00457	10 SADDLES & C				334	12/97	S	25 00	12/98	$643.42	$25.74	$27.88
1	00173	12 METERS/BOXE				334	08/89	S	07 00	12/96	$1,122.45	$0.00	$1,122.45
1	00329	10 METERS				334	10/94	S	07 00	12/98	$464.30	$66.33	$281.90
1	00491	10 METER BOXES				334	10/98	S	07 00	12/98	$299.81	$10.71	$10.71
1	00363	ONE 1" METER				334	08/95	S	07 00	12/98	$157.00	$22.43	$76.64
1	00493	3 METER BOXES				334	10/98	S	07 00	12/98	$172.74	$4.11	$4.11
1	00113	10 METERS WITH				334	07/87	S	40 00	12/98	$1,095.50	$27.39	$314.98
1	00366	6 METER BOXES				334	10/95	S	07 00	12/98	$138.02	$19.72	$64.09
1	00496	6 SETTERS				334	10/98	S	07 00	12/98	$603.00	$14.36	$14.36
1	00465	50' LINE EXTEN				334	04/98	S	07 00	12/98	$260.00	$27.86	$27.86
1	00309	10 METER BOXES				334	10/93	S	07 00	12/98	$617.61	$88.23	$463.21
1	00182	6 VAULTS				334	12/89	S	07 00	12/96	$131.25	$0.00	$131.25
1	00246	5 METERS/12 EX				334	01/92	S	07 00	12/98	$987.51	$141.09	$987.51
1	00105	6 METERS WITH				334	03/87	S	40 00	12/98	$366.00	$9.15	$107.57
1	00267	6 METERS				334	12/92	S	07 00	12/98	$444.86	$63.55	$386.60
1	00031	METERS				334	01/74	S	40 00	12/98	$0.00	$0.00	$0.00
1	00489	6 SADDLES				334	09/98	S	25 00	12/98	$439.61	$4.40	$4.40
1	00412	12 SETTERS				334	09/96	S	07 00	12/98	$691.00	$98.71	$222.10
1	00475	1 1/2" METER				334	03/98	S	07 00	12/98	$346.78	$37.16	$37.16
1	00285	2000' TUBING				334	12/93	S	07 00	12/98	$323.85	$46.26	$235.16
1	00318	5 METER COVERS				334	02/94	S	07 00	12/98	$319.18	$45.60	$224.20
1	00255	6 METERS				334	06/92	S	07 00	12/98	$337.40	$48.20	$317.32
1	00256	6 METERS				334	07/92	S	07 00	12/98	$337.40	$48.20	$313.30
1	00321	6 SETTERS/METE				334	05/94	S	07 00	12/98	$621.88	$88.84	$414.59
1	00448	3 1" METERS				334	09/97	S	07 00	12/98	$346.72	$49.53	$66.04
1	00116	METER - SHIPPI				334	08/87	S	40 00	12/98	$24.48	$0.61	$6.97
1	00450	1 1" METER BOX				334	10/97	S	07 00	12/98	$369.32	$52.76	$65.95
1	00180	A METER BOX/CO				334	11/89	S	07 00	12/96	$163.66	$0.00	$163.66
1	00166	1 METER ETC				334	04/89	S	07 00	12/96	$224.55	$0.00	$224.55
1	00233	4-1"/36 3/4" M				334	07/91	S	07 00	12/98	$6,187.50	$441.96	$6,187.50
1	00488	30 METERS				334	09/98	S	07 00	12/98	$2,295.00	$109.29	$109.29
1	00284	60 METER BOX C				334	12/93	S	07 00	12/98	$1,948.06	$278.29	$1,414.64
1	00330	6 SETTERS				334	10/94	S	07 00	12/98	$468.72	$66.96	$279.00
1	00298	12 METERS				334	05/93	S	07 00	12/98	$557.14	$79.59	$444.38
1	00490	2 METERS				334	10/98	S	07 00	12/98	$249.25	$8.90	$8.90

GOSHEN UTILITIES

03-16-1999 07:48:05 F I X E D A S S E T S Y S T E M

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co	Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
1	00362	6 METER BOXES				334	07/95	S	07 00	12/98	$157.28	$22.47	$76.77
1	00301	6 EXTN/10 MET				334	06/93	S	07 00	12/98	$562.33	$80.33	$441.82
1	00175	12 METERS/BOXE				334	07/89	S	07 00	12/96	$1,149.75	$0.00	$1,149.75
1	00365	12 METER SETTE				334	09/95	S	07 00	12/98	$1,257.28	$179.61	$583.73
1	00367	4 METER SETTER				334	10/95	S	07 00	12/98	$371.68	$53.10	$172.57
1	00289	5 METER BOXES/				334	02/93	S	07 00	12/98	$373.38	$53.34	$315.60
1	00179	1 1" METER AND				334	10/89	S	07 00	12/96	$271.30	$0.00	$271.30
1	00494	12 METER BOXES				334	10/98	S	07 00	12/98	$1,681.93	$40.05	$40.05
1	00499	24 METERES				334	11/98	S	07 00	12/98	$1,090.71	$25.97	$25.97
1	00325	12 SETTERS/COU				334	08/94	S	07 00	12/98	$1,275.44	$182.21	$789.58
1	00392	6 METERS				334	01/96	S	07 00	12/98	$266.80	$38.11	$111.16
1	00328	6 SETTERS				334	08/94	S	07 00	12/98	$439.61	$62.80	$272.13
1	00409	10 SETTERS				334	08/96	S	07 00	12/98	$876.00	$125.14	$291.99
1	00474	ONE 2" METER				334	02/98	S	07 00	12/98	$212.00	$27.76	$27.76
1	00316	5 METER BOXES/				334	03/94	S	07 00	12/98	$363.68	$51.95	$246.77
1	00473	15 METERS				334	01/98	S	07 00	12/98	$1,127.50	$161.07	$161.07
1	00253	50' RULE REEM				334	05/92	S	07 00	12/98	$357.61	$51.09	$336.34
1	00317	5 METER BOXES/				334	04/94	S	07 00	12/98	$203.67	$29.10	$135.80
1	00287	60 EXTENSIONS				334	12/93	S	07 00	12/98	$4,217.32	$602.47	$3,012.35
1	00319	10 METER BOXES				334	02/94	S	07 00	12/98	$562.33	$80.33	$388.26
1	00174	5 METER BOXES				334	06/89	S	07 00	12/96	$102.37	$0.00	$102.37
1	00368	12 METER SETTE				334	10/95	S	07 00	12/98	$1,115.04	$159.29	$504.42
1	00455	10 COUP STOPS				334	11/97	S	25 00	12/98	$185.50	$7.42	$8.04
1	00369	38 5/8 X 3/4"				334	11/95	S	07 00	12/98	$1,867.61	$266.80	$822.63
1	00370	10 METER BOXES				334	12/95	S	07 00	12/98	$613.29	$87.61	$270.13
1	00294	1 1' METER				334	04/93	S	07 00	12/98	$124.62	$17.80	$102.35
1	00422	10 METER COVER				334	11/96	S	07 00	12/98	$371.00	$53.00	$114.83
1	00423	10 METER BOXES				334	11/96	S	07 00	12/98	$614.28	$87.75	$190.13
1	00487	4 METERS				334	08/98	S	07 00	12/98	$498.50	$23.74	$23.74
1	00320	5 METER BOXES				334	04/94	S	07 00	12/98	$118.82	$16.97	$79.20
1	00361	12 METER BOXES				334	05/95	S	07 00	12/98	$985.63	$140.80	$504.54
1	00252	5 METERS				334	05/92	S	07 00	12/98	$682.12	$97.45	$649.66
1	00172	18 METERS				334	06/89	S	07 00	12/96	$699.51	$0.00	$699.51
1	00364	6 METER COVERS				334	08/95	S	07 00	12/98	$222.60	$31.80	$127.20
1	00445	24 METERS				334	08/97	S	07 00	12/98	$1,836.00	$262.29	$371.58
1	00286	60 METERS				334	12/93	S	07 00	12/98	$2,785.68	$397.95	$1,989.75
1	00312	21 METERS/BOXE				334	11/93	S	07 00	12/98	$1,786.15	$255.16	$1,318.33
1	00283	60 METER BOXES				334	12/93	S	07 00	12/98	$1,425.91	$203.70	$1,035.48
1	00472	12 SETTERS				334	01/98	S	07 00	12/98	$1,087.31	$155.33	$155.33
1	00503	9 METER BOXES				334	12/98	S	07 00	12/98	$236.21	$0.00	$0.00
1	00436	12 SETTERS/MET				334	04/97	S	07 00	12/98	$1,743.75	$249.11	$435.94
1	00406	9 SETTERS				334	08/96	S	07 00	12/98	$786.21	$112.32	$271.44

03-16-1999 07:48:06

GOSHEN UTILITIES

F I X E D A S S E T S Y S T E M

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBER	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	----D-E-P-R-E-C-I-A-T-I-O-N---- CURRENT YTD	TOTAL
1	00501	3 METERS			334	11/98	S	07 00	12/98	$516.94	$6.15	$6.15
1	00420	24 METERS/COVE			334	10/96	S	07 00	12/98	$1,520.30	$217.19	$470.58
1	00326	10 METER BOXES			334	08/94	S	07 00	12/98	$479.60	$68.51	$296.88
1	00327	5 METER BOXES/			334	07/94	S	07 00	12/98	$405.19	$57.88	$255.64
1	00486	4 SETTERS/COUP			334	08/98	S	07 00	12/98	$527.03	$25.10	$25.10
1	00250	5 METERS/12 EX			334	03/92	S	07 00	12/98	$987.50	$141.07	$963.98
1	00443	METER/10 METER			334	06/97	S	07 00	12/98	$962.64	$137.52	$217.74
1	00371	8 5/8 X 3/4" M			334	12/95	S	07 00	12/98	$512.00	$73.14	$225.52
1	00439	10 METER BOXES			334	04/97	S	07 00	12/98	$262.46	$37.49	$62.49
1	00121	WATER METER			334	05/87	S	40 00	12/98	$99.86	$2.50	$28.98
1	00405	10 METER BOXES			334	08/96	S	07 00	12/98	$776.47	$110.92	$268.06
1	00408	4 SETTERS			334	08/96	S	07 00	12/98	$104.98	$15.00	$35.00
1	00374	METERS			334	01/75	S	40 00	12/98	$826.00	$20.65	$495.70
1	00438	2 1" METERS			334	04/97	S	07 00	12/98	$371.31	$53.04	$88.40
1	00425	10 METER COVER			334	12/96	S	07 00	12/98	$661.32	$94.47	$196.81
1	00181	15 METER BOX/C			334	11/89	S	07 00	12/96	$1,217.83	$0.00	$1,217.83
1	00502	2 METERS			334	12/98	S	07 00	12/98	$249.25	$0.00	$0.00
1	00421	36 METERS			334	11/96	S	07 00	12/98	$1,626.19	$232.31	$503.34
1	00372	10 METER BOXES			334	12/95	S	07 00	12/98	$349.60	$49.94	$153.98
1	00497	1 METER BOX			334	11/98	S	07 00	12/98	$26.25	$0.63	$0.63
1	00358	5 METER BOXES			334	03/95	S	07 00	12/98	$131.07	$18.72	$71.76
1	00248	5 METERS			334	02/92	S	07 00	12/98	$403.98	$57.71	$399.16
1	00500	1 METER BOX			334	11/98	S	07 00	12/98	$41.34	$0.49	$0.49
1	00359	24 5/8 X 3/4"			334	04/95	S	07 00	12/98	$1,135.92	$162.27	$594.99
		ACCOUNT # -	164							$139,259.75	$13,331.41	$73,143.47
1	00466	HYDRANTS			335	12/98	S	15 00	12/98	$826.42	$4.59	$4.59
1	00028	HYDRANTS			335	01/74	S	50 00	12/98	$3,037.00	$60.74	$1,518.67
1	00020	HYDRANTS			335	01/72	S	50 00	12/98	$3,799.00	$75.98	$2,051.88
1	00222	FINE FLYDMOUNT			335	09/90	S	15 00	12/98	$680.37	$45.36	$374.22
1	00006	hydrants			335	01/58	S	50 00	12/98	$2,394.00	$47.88	$1,963.74
		ACCOUNT # -	5							$10,736.79	$234.55	$5,913.10
1	00508	COMPUTER			340	06/98	S	05 00	12/98	$1,656.82	$165.68	$165.68
1	00507	COMPUTER UPGRA			340	03/98	S	05 00	12/98	$1,795.64	$269.35	$269.35
		ACCOUNT # -	2							$3,452.46	$435.03	$435.03
1	00137	DRILLING MACHI			343	10/88	S	05 00	12/95	$1,426.19	$0.00	$1,426.19
1	00029	TOOLS AND EQUI			343	01/74	S	10 00	12/95	$2,004.00	$0.00	$2,004.00
1	00027	TOOLS AND EQUI			343	01/73	S	10 00	12/95	$116.00	$0.00	$116.00
1	00041	TOOLS AND EQUI			343	01/76	S	10 00	12/95	$3,137.00	$0.00	$3,137.00
1	00356	LINE TRACER/LO			343	07/95	S	10 00	12/98	$2,226.00	$222.60	$779.10

GOSHEN UTILITIES

03-16-1999 07:48:06 FIXED ASSET SYSTEM

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
1	00135	AIR PACKS (MAS			343	03/88	S	05 00	12/95	$600.00	$0.00	$600.00
1	00076	TOOLS AND EQUP			343	01/81	S	10 00	12/95	$890.00	$0.00	$890.00
1	00053	TOOLS AND EQUI			343	01/77	S	10 00	12/95	$176.00	$0.00	$176.00
1	00139	PUSH ROD			343	12/88	S	05 00	12/95	$394.38	$0.00	$394.38
1	00136	METAL DETECTOR			343	06/88	S	05 00	12/95	$649.69	$0.00	$649.69
1	00138	STEEL CUT SAWS			343	10/88	S	05 00	12/95	$789.97	$0.00	$789.97
1	00106	ARB ENCONDERS			343	06/87	S	40 00	12/98	$485.50	$12.14	$140.12
		ACCOUNT # -	12							$12,894.73	$234.74	$11,102.45
1	00411	REPAIR CASE			345	09/96	S	07 00	12/98	$1,313.83	$187.69	$437.94
1	00352	ROTO WITCH III			345	05/94	S	07 00	12/98	$2,120.00	$302.86	$1,413.34
1	00101	REPAIR DW R-65			345	02/87	S	07 00	12/95	$311.60	$0.00	$311.60
1	00102	REPAIR DW V-30			345	04/87	S	07 00	12/95	$763.18	$0.00	$763.18
1	00424	REPAIR CASE			345	11/96	S	07 00	12/98	$4,191.42	$598.77	$1,247.44
		ACCOUNT # -	5							$8,700.03	$1,089.32	$4,173.50
1	00099	ELECTRICAL REP			3932	11/87	S	15 00	12/98	$3,955.00	$263.67	$2,930.71
1	00097	SUBMERSIBLE PU			3932	02/87	S	15 00	12/98	$1,841.00	$122.73	$1,455.95
1	00094	CHLORINATOR			3932	11/87	S	40 00	12/98	$1,518.30	$37.96	$423.89
1	00096	CHECK VASLVE I	343		3932	11/87	S	15 00	12/98	$1,141.04	$76.07	$844.27
1	00095	SKIMMERS & BLO			3932	11/87	S	15 00	12/98	$6,056.73	$403.78	$4,488.04
1	00014	FORCE MAINS			3932	01/64	S	40 00	12/98	$4,633.00	$115.83	$4,055.20
1	00013	CHLORINATOR			3932	01/64	S	40 00	12/98	$4,775.00	$119.38	$4,179.49
1	00098	WIRING SKIMMER			3932	12/87	S	15 00	12/98	$600.00	$40.00	$440.11
		ACCOUNT # -	8							$24,520.07	$1,179.42	$18,817.66
		Class -	352							$2,146,152.44	$63,646.50	$809,121.80
2	00270	DAM EXPENSE			304	06/92	S	10 00	12/98	$786.38	$78.64	$517.71
2	00238	GUIDE RAILS	311		304	04/91	S	10 00	12/98	$686.08	$68.61	$531.73
2	00235	GUIDE RAILS			304	04/91	S	10 00	12/98	$858.60	$85.86	$665.42
		ACCOUNT # -	3							$2,331.06	$233.11	$1,714.86
2	00509	SUPPLY MAINS/S			309	07/98	S	40 00	12/98	$34,576.00	$432.20	$432.20
2	00213	CHLORINATOR/SE			311	01/90	S	07 00	12/97	$1,425.12	$0.00	$1,425.12
2	00429	AIR PUMP			311	04/97	S	07 00	12/98	$2,454.42	$350.63	$613.60
2	00314	ABS (MIDLAND)			311	11/93	S	07 00	12/98	$3,234.10	$462.01	$2,348.55
2	00275	SCAN PUMP	363A		311	01/93	S	07 00	12/98	$1,248.31	$178.33	$1,069.98
2	00239	MOTOR REPAIR			311	04/91	S	07 00	12/98	$594.08	$28.28	$594.08
2	00215	MTOR REPAIR/SH			311	10/90	S	07 00	12/97	$1,141.90	$0.00	$1,141.90
2	00236	MOTOR REPAIR			311	04/91	S	07 00	12/98	$1,937.74	$69.20	$1,937.74
		ACCOUNT # -	7							$12,035.67	$1,088.45	$9,130.97

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GOSHEN UTILITIES
FIXED ASSET SYSTEM
Depreciation Summary - INTERNAL
By Class / ACCOUNT #
For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
2	00237	AERATOR REPAIR		373	320	04/91	S	07 00	12/98	$1,061.00	$37.90	$1,061.00
2	00212	SLUDGE PUMP			331	01/90	S	07 00	12/96	$214.85	$0.00	$214.85
2	00387	PUMP			331	09/96	S	07 00	12/98	$1,551.61	$221.66	$517.21
2	00386	ABS PUMP MOD A		376	331	09/96	S	07 00	12/98	$3,613.54	$516.22	$1,204.51
2	00390	PUMP LABOR			331	09/96	S	07 00	12/98	$1,678.00	$239.71	$539.35
2	00244	AERATION PIT			331	06/92	S	07 00	12/98	$1,605.89	$229.41	$1,491.17
2	00242	F CHLORINE TAN			331	02/92	S	07 00	12/98	$300.00	$42.86	$292.87
		ACCOUNT # -	6							$8,963.89	$1,249.86	$4,259.96
2	00064	TOOLS AND EQUI		393B	343	01/79	S	10 00	12/95	$1,750.00	$0.00	$1,750.00
2	00209	580K CASE BREA		363A	345	11/90	S	07 00	12/97	$32,629.98	$0.00	$32,629.98
2	00088	GENERATOR			345	09/87	S	07 00	12/95	$525.00	$0.00	$525.00
		ACCOUNT # -	2							$33,154.98	$0.00	$33,154.98
2	00351	RUPTURE BASIN		363A	347	06/94	S	20 00	12/98	$1,173.42	$58.67	$268.90
2	00068	EMERGENCY EQUI			347	01/80	S	20 00	12/98	$23,920.00	$1,196.00	$22,724.00
		ACCOUNT # -	2							$25,093.42	$1,254.67	$22,992.90
2	00241	FLOW GAUGES			355	06/92	S	07 00	12/98	$4,192.09	$598.87	$3,942.56
2	00273	FLOW MEASURING			355	04/93	S	07 00	12/98	$3,806.88	$543.84	$3,127.08
2	00350	OCM FLOW METER		316	355	08/94	S	07 00	12/98	$4,027.86	$575.41	$2,541.39
2	00505	FLOW MEASURING			355	09/98	S	07 00	12/98	$500.00	$23.81	$23.81
2	00381	FLOWMETER			355	06/96	S	07 00	12/98	$5,255.59	$750.80	$1,877.00
		ACCOUNT # -	5							$17,782.42	$2,492.73	$11,511.84
2	00391	1 1/2" DIFFUSE			373	10/96	S	07 00	12/98	$2,631.92	$375.99	$845.98
2	00379	720 DRAG CHAIN			373	05/96	S	05 00	12/98	$9,980.00	$1,996.00	$5,156.33
2	00380	3" AIR LIFT SL			373	06/96	S	07 00	12/98	$2,146.69	$306.67	$792.23
2	00389	BLOWER LABOR			373	09/96	S	07 00	12/98	$1,600.50	$228.64	$514.44
		ACCOUNT # -	4							$16,359.11	$2,907.30	$7,308.98
2	00229	TRAI END PLAN			3732	12/90	S	10 00	12/98	$33,930.45	$3,393.05	$27,144.40
2	00211	TRAILS END TRE			3732	12/90	S	03 00	00/00	$0.00	$0.00	$0.00
2	00373	CH -TRIAL ENDS			3732	12/95	S	10 00	12/98	$44,178.82	$4,417.88	$13,253.64
2	00245	BLOWER REPAIR			3732	10/92	S	03 00	12/95	$1,764.48	$0.00	$1,764.48
2	00427	CH - TRAIL END		373	3732	01/96	S	10 00	12/98	$1,285.14	$128.51	$385.53
2	00228	TAIL ENDS PLAN			3732	12/90	S	08 00	12/98	$7,965.00	$995.59	$7,965.00
2	00227	TRAIL ENDS PLA			3732	12/90	S	03 00	12/95	$6,285.98	$0.00	$6,285.98
2	00230	TRAIL ENDS PLA			3732	12/90	S	20 00	12/98	$13,954.61	$697.73	$5,581.84
		ACCOUNT # -	8							$109,364.48	$9,632.76	$62,380.87

GOSHEN UTILITIES

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Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	O M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
2	00276	BLOWER/COLLAPS			374	03/93	S	07 00	12/98	$689.90	$98.56	$566.72
2	00378	BLOWER			374	04/96	S	07 00	12/98	$254.50	$36.36	$96.96
2	00382	SLUDGE RETURN			374	07/96	S	07 00	12/98	$3,039.30	$434.19	$1,049.29
2	00377	6" PIPE			374	04/96	S	10 00	12/98	$2,901.00	$290.10	$797.78
2	00375	BLOWER			374	02/96	S	07 00	12/98	$1,699.94	$242.85	$688.07
2	00388	VALVES			374	09/96	S	07 00	12/98	$962.63	$137.52	$320.88
2	00384	DRAG CHAIN			374	06/96	S	07 00	12/98	$1,025.00	$146.43	$366.07
2	00274	12 X 12 SHED			374	03/93	S	20 00	12/98	$1,400.00	$70.00	$408.33
2	00432	BLOWER			374	05/97	S	07 00	12/98	$4,721.01	$674.43	$1,124.05
2	00385	STARTER PANEL			374	08/96	S	07 00	12/98	$1,242.73	$177.53	$414.24
2	00430	CONTROL PANEL			374	03/97	S	07 00	12/98	$2,336.45	$333.78	$611.93
2	00383	SLUDGE RETURN			374	08/96	S	07 00	12/98	$2,098.59	$299.80	$724.52
2	00376	6" PIPE			374	03/96	S	10 00	12/98	$1,593.30	$159.33	$438.16
2	00431	ROTATING ASSEM			374	03/97	S	07 00	12/98	$1,943.72	$277.67	$509.07
		ACCOUNT # -	14							$25,908.07	$3,378.55	$8,116.07
2	00012	AERATION TANKS	393F		393	01/64	S	40 00	12/98	$6,554.00	$163.85	$5,736.55
2	00205	COMPLETER PUMP			3932	01/89	S	07 00	12/95	$2,426.70	$0.00	$2,426.70
2	00142	REPLACED SLUDG			3932	07/88	S	05 00	12/95	$480.00	$0.00	$480.00
2	00023	SEWER LIFT STA			3932	01/73	S	30 00	12/98	$6,920.00	$230.67	$5,998.00
2	00051	SEWER LIFT STA			3932	01/77	S	30 00	12/98	$1,292.00	$43.07	$947.54
2	00069	AERATION TANKS			3932	01/80	S	40 00	12/98	$14,465.00	$361.63	$6,870.97
2	00016	SLUDGE PUMPS			3932	01/64	S	40 00	12/98	$2,955.00	$73.88	$2,586.49
2	00206	A ABS PUMP AC			3932	01/89	S	07 00	12/95	$1,216.26	$0.00	$1,216.26
2	00140	ABS AC PUMP FO			3932	02/88	S	07 00	12/95	$1,680.60	$0.00	$1,680.60
2	00204	NEW A-B COMMIN			3932	05/89	S	05 00	12/95	$1,248.70	$0.00	$1,248.70
2	00067	CARDINAL HARBO			3932	01/80	S	25 00	12/98	$115,396.00	$4,615.84	$87,700.96
2	00083	SEWER PLANT IM	3522		3932	06/87	S	15 00	12/98	$4,769.47	$317.96	$3,683.11
2	00208	1 ABS AC PUMP			3932	01/89	S	07 00	12/96	$1,072.53	$0.00	$1,072.53
2	00093	BLOWER SEWER P			3932	05/87	S	15 00	12/98	$669.01	$44.60	$517.12
2	00062	SEWER LIFT STA			3932	01/79	S	30 00	12/98	$7,837.00	$261.23	$5,224.63
2	00015	SLUDGE HANDLIN			3932	01/64	S	40 00	12/98	$4,433.00	$110.83	$3,880.14
2	00037	SEWER LIFT STA			3932	01/76	S	30 00	12/98	$12,428.00	$414.27	$9,529.30
2	00143	REPAIR TO COMM			3932	03/88	S	10 00	12/98	$950.00	$23.75	$950.00
2	00141	REPLACED GRIND			3932	07/88	S	05 00	12/95	$400.00	$0.00	$400.00
2	00065	SEWER CONTRIBU			3932	01/80	S	50 00	12/98	$935,114.00	$18,702.28	$355,343.32
2	00008	SEWER MAINS			3932	01/64	S	50 00	12/98	$31,517.00	$630.34	$22,068.81
2	00091	SEWER PLANT IM			3932	12/87	S	15 00	12/98	$1,784.00	$118.93	$1,318.14
2	00049	AERATION TANKS			3932	01/77	S	40 00	12/98	$3,903.00	$97.58	$2,146.76
2	00087	SEWER PLANT IM			3932	09/87	S	15 00	12/98	$1,826.00	$121.73	$1,379.61
2	00063	AERATION TANKS			3932	01/79	S	40 00	12/98	$2,364.00	$59.10	$1,182.00

GOSHEN UTILITIES

03-16-1999 07:48:06 FIXED ASSET SYSTEM

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	----D-E-P-R-E-C-I-A-T-I-O-N---- CURRENT YTD	TOTAL	
2	00011	GRIT REMOVAL C			3932	01/64	S	40 00	12/98	$7,389.00	$184.73	$6,467.45	
2	00009	SEWER TREATMEN			3932	01/64	S	50 00	12/98	$24,354.00	$487.08	$17,053.14	
2	00010	SEWER SERVICE			3932	01/64	S	50 00	12/98	$9,450.00	$189.00	$6,617.07	
2	00207	2 CHECK VALVES			3932	02/89	S	07 00	12/96	$1,468.59	$0.00	$1,468.59	
		ACCOUNT # -	28							$1,199,808.86	$27,088.50	$551,457.94	
		Class -	83							$1,494,742.96	$49,959.88	$721,009.12	
3	00147	OFFICE CURTAIN			302	11/88	S	05 00	12/95	$227.32	$0.00	$227.32	
3	00145	OFFICE PRINTS		340	302	11/88	S	05 00	12/95	$617.19	$0.00	$617.19	
3	00144	OFFICE PAINTED			302	10/88	S	05 00	12/95	$1,368.83	$0.00	$1,368.83	
3	00146	OFFICE CARPET			302	10/88	S	05 00	12/95	$352.66	$0.00	$352.66	
		ACCOUNT # -	4							$2,566.00	$0.00	$2,566.00	
3	00149	EASEMENT AND L			303	09/88	N	00 00	00/00	$436.00	$0.00	$0.00	
3	00148	ROOF REPLACEME			304	06/88	S	05 00	12/95	$400.00	$0.00	$400.00	
3	00357	6 STEEL PLATES		376	339	03/95	S	15 00	12/98	$3,942.50	$262.83	$985.62	
3	00349	MONITOR/VIDEO			340	10/94	S	07 00	12/98	$424.00	$60.57	$257.42	
3	00134	COMPUTER			340	12/88	S	05 00	12/95	$9,405.00	$0.00	$9,405.00	
3	00348*	COMPUTER/PRINT			340	10/94	S	07 00	07/98	$4,913.10	~~$409.43~~	$2,690.51	→ 228108
3	00030	OFFICE EQUIPME			340	01/74	S	10 00	12/95	$1,733.00	$0.00	$1,733.00	
3	00036	OFFICE EQUIPME			340	01/75	S	10 00	12/95	$945.00	$0.00	$945.00	
3	00052	OFFICE EQUIPME			340	01/77	S	10 00	12/95	$383.00	$0.00	$383.00	
3	00055	OFFICE EQUIPME			340	01/78	S	10 00	12/95	$871.00	$0.00	$871.00	
3	00025	OFFICE EQUIPME			340	01/73	S	10 00	12/95	$380.00	$0.00	$380.00	
3	00347	BROTHER FAX MA			340	09/94	S	07 00	12/98	$614.79	$87.83	$373.28	
3	00089	TYPEWRITER			340	10/87	S	10 00	12/97	$656.25	$0.00	$656.25	
3	00506	COMPUTER			340	03/98	S	05 00	12/98	$3,619.90	$603.32	$603.32	
3	00272	COPIER			340	03/93	S	07 00	12/98	$4,756.74	$679.53	$3,907.30	
3	00153	COMPUTER EQUIP			340	05/89	S	05 00	12/95	$340.00	$0.00	$340.00	
3	00042	OFFICE EQUIPME			340	01/76	S	10 00	12/95	$2,130.00	$0.00	$2,130.00	
		ACCOUNT # -	14							$31,171.78	$1,840.68	$24,675.08	
3	00258*	GMC			341	07/92	S	05 00	10/96	$25,124.85	$0.00	$21,774.88	
3	00268	16 FOOT TRAILE			341	12/92	S	05 00	12/97	$775.00	$0.00	$775.00	
3	00397	96 CHEVY TAHOE			341	06/96	S	05 00	12/98	$30,689.60	$6,137.92	$15,344.80	
3	00277	CHEVY CK20903			341	07/93	S	05 00	12/98	$17,783.61	$2,074.76	$17,783.61	
3	00462	1998 CHEVY			341	07/98	S	05 00	12/98	$7,270.34	$727.03	$727.03	
3	00164	RADIO UNIT FOR			341	11/89	S	05 00	12/95	$696.00	$0.00	$696.00	

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GOSHEN UTILITIES

FIXED ASSET SYSTEM

Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	DEPRECIATION CURRENT YTD	DEPRECIATION TOTAL
3	00163	DODGE TRUCK			341	11/89	S	05 00	12/95	$7,543.63	$0.00	$7,543.63
3	00264	GOOSENECK TRAI			341	10/92	S	05 00	12/97	$3,250.00	$0.00	$3,250.00
3	00461	1996 BLUE CHEV			341	06/98	S	05 00	12/98	$15,969.00	$1,596.90	$1,596.90
3	00460	1995 F-150			341	02/98	S	05 00	12/98	$9,892.50	$1,813.63	$1,813.63
		ACCOUNT # -	10							$118,994.53	$12,350.24	$71,305.48
3	00085	MOWER			343	06/87	S	07 00	12/95	$895.00	$0.00	$895.00
3	00159	HEDGE TRIMMER			343	09/89	S	05 00	12/95	$146.95	$0.00	$146.95
3	00160	ONE PVC DRILL			343	11/89	S	05 00	12/95	$139.65	$0.00	$139.65
3	00162	FURNACE FOR SH			343	12/89	S	10 00	12/98	$267.70	$26.77	$240.93
3	00234	WEED SPRAYER			343	04/91	S	03 00	12/95	$703.08	$0.00	$703.08
3	00158	ONE PVC DRILL			343	07/89	S	05 00	12/95	$141.75	$0.00	$141.75
3	00157	ONE PVC DRILL			343	02/89	S	05 00	12/95	$125.00	$0.00	$125.00
3	00161	ONE WATER PUMP			343	12/89	S	05 00	12/95	$650.40	$0.00	$650.40
3	00086	LAWN MOWER			343	07/87	S	07 00	12/95	$102.00	$0.00	$102.00
		ACCOUNT # -	9							$3,171.53	$26.77	$3,144.76
3	00043	COMMUNICATION			346	01/76	S	10 00	12/95	$1,337.00	$0.00	$1,337.00
3	00155	ONE TELEPHONE			346	01/89	S	05 00	12/95	$283.00	$0.00	$283.00
3	00034	COMMUNICATION			346	01/75	S	10 00	12/95	$2,591.00	$0.00	$2,591.00
3	00050	COMMUNICATION			346	01/77	S	10 00	12/95	$1,298.00	$0.00	$1,298.00
3	00032	COMMUNICATION			346	01/74	S	10 00	12/95	$256.00	$0.00	$256.00
3	00156	TWO RADIO SYST			346	01/89	S	05 00	12/95	$2,230.80	$0.00	$2,230.80
3	00313	MOBILE PHONE			346	10/93	S	05 00	12/98	$720.24	$120.03	$720.24
3	00132	CAR PHONE			346	11/88	S	05 00	12/95	$500.00	$0.00	$500.00
		ACCOUNT # -	8							$9,216.04	$120.03	$9,216.04
3	00154	COMPUTER EQUIP		341	3912	05/89	S	05 00	12/95	$340.00	$0.00	$340.00
		Class -	49							$170,238.38	$14,600.55	$112,632.98
4	00100	TAX & LICENSE/			341	09/87	S	05 00	12/95	$194.00	$0.00	$194.00
4	00231	1990 FORD DIES			341	09/91	S	05 00	12/96	$15,140.24	$0.00	$15,140.24
4	00133*	88 RANGER PICK			341	12/88	S	05 00	12/98	$10,002.62	$0.00	$10,002.62
4	00353	94 DODGE DAKOT			341	12/94	S	05 00	12/98	$13,912.91	$2,782.58	$11,130.32
4	00081	GMC TRUCK			341	01/85	S	05 00	12/95	$10,404.00	$0.00	$10,404.00
		ACCOUNT # -	5							$49,653.77	$2,782.58	$46,871.18
4	00077	TOOLS AND EQUI			343	01/83	S	10 00	12/95	$12,415.00	$0.00	$12,415.00
4	00355	1976 FORD DUMP		341	3441	03/95	S	05 00	12/98	$3,325.50	$665.10	$2,494.13

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Depreciation Summary - INTERNAL

By Class / ACCOUNT #

For Fixed Assets 00001 Through 00509 FY=12

C L	FAS NUMBR	ASSET DESCRIPTION	LOCATN	Co Asset #	ACCOUNT #	DATE ACQRD	D M	EST LIFE	LAST DEPRC	ACQUISITION VALUE	D-E-P-R-E-C-I-A-T-I-O-N CURRENT YTD	TOTAL
4	00038	POWER OPERATED			345	01/76	S	07 00	12/95	$6,200.00	$0.00	$6,200.00
4	00046	POWER OPERATED		363A	345	01/77	S	07 00	12/95	$16,921.00	$0.00	$16,921.00
4	00082	EQUIPMENT			345	01/85	S	10 00	12/95	$1,305.07	$0.00	$1,305.07
		ACCOUNT # -	3							$24,426.07	$0.00	$24,426.07
4	00080	TOOLS AND EQUI		343	3932	01/84	S	10 00	12/95	$1,841.00	$0.00	$1,841.00
		Class -	11							$91,661.34	$3,447.68	$88,047.38
GRAND	509									$3,902,795.12	$131,654.61	$1,730,811.28

⟨409.43⟩

131,245.18

	Water	Sewer
1	63,646.50	
2	—	49,527.68
3	7095.56	7527.76
4	2413.37	1034.31
	73,155.43	58,089.75

131,245.18

TERMINAL NUMBER: A
RUN DATE: 03/12/99 GOSHEN UTILITIES, INC. PAGE 1

BALANCE SHEET

AS OF 12/31/98

ASSETS & OTHER DEBITS

UTILITY PLANT

UTILITY PLANT IN SERVICE	
COMMON ASSETS	2,566.00
LAND & LAND RIGHTS	235,266.00
STRUCTURES & IMPROVEMENTS	20,321.08
WELLS & SPRINGS	79,464.99
SUPPLY MAINS	34,576.00
PUMPING EQUIPMENT	76,358.14
WATER TREATMENT EQUIPMENT	9,005.11
DISTRIBU RESERV & STANDP	479,475.03
TRANSMIS & DISTRIBUTION MAINS	1,121,913.88
SERVICES	76,412.41
METERS & METER INSTALLATION	137,100.14
HYDRANTS	10,736.79
OTHER PLANT & MISC EQUIPMENT	9,912.50
TRANSPORTATION EQUIPMENT	136,846.33
OFFICE FURNITURE & EQUIPMENT	29,711.14
TOOLS, SHOP & GARAGE EQUIPMENT	32,072.26
POWER OPERATED EQUIPMENT	66,281.00
COMMUNICATION EQUIPMENT	9,216.04
MISCELLANEOUS EQUIPMENT	26,093.42
FLOW MEASURING DEVICES	17,782.42
TREATMENT & DISPOSAL PLANT	37,652.56
OFFICE FURNITURE & EQUIPMENT	340.00
OTHER GENERAL EQUIPMENT	1,230,883.47
T.E. TREATMENT PL. IMPROVEMENT	113,975.11
UTILITY PLANT ACQUISITION ADJ	3,260.09
ACC AMORT UTIL PLANT ACQU ADJ	(~~1,3[illegible].66~~) 1276.60
TOTAL UTILITY PLANT	$ 3,988,775.62
ACCUM PROV FOR DEPR & AMORT	
ACCUM DEPR/UTIL PLANT IN SERV	
ACCM DEPR/UTIL PLANT IN SERV W	906,980.84
ACCM DEPR/UTIL PLANT IN SERV S	789,102.54
NET UTILITY PLANT	$ ~~2,292,792.34~~ 2,292,823.40

CURRENT ASSETS

PETTY CASH	86.30
CASH IN BANK - PAYROLL	1,000.00
CASH IN BANK-REGULAR CHECKING	34,203.22
CASH IN BANK - CUST DEPOSITS	30,995.00
CASH - SEWER TAPS (SAVINGS)	38,921.63
CERTIFICATES OF DEPOSITS	9,521.25
TEMPORARY CASH INVESTMENTS	172,800.00
CUSTOMER ACCOUNTS RECEIVABLE	12,993.73

RUN DATE: 03/12/99 · GOSHEN UTILITIES, INC.

	AS OF 12/31/98		
CASH/BELKNAP BEACH ACCOUNTS	9,472.17		
PREPAYMENTS	69,776.07		
INTEREST RECEIVABLE	3,704.19		
MISC CURRENT ASSETS	2,297.10		
PAYROLL CLEARING	40,633.60		
TOTAL CURRENT ASSETS		$	124,614.68
	DEFERRED DEBITS		
TOTAL DEFERRED CREDITS		$	.00
TOTAL ASSETS & OTHER DEBITS			$ 2,~~7[illegible]~~387.02 2,717,438.08

LIABILITIES & OTHER CREDITS

EQUITY CAPITAL

PROPRIETY INTEREST			
COMMON STOCK	200,000.00		
OTHER PAID-IN CAPITAL	241,227.29		
UNAPPR RETAINED EARNINGS	(417,744.53)		
TOTAL PAID-IN CAPITAL	$ 23,482.76		
RETAINED EARNINGS			(59,930.86)
BALANCE TRANS FROM INCOME	$ (59,981.92)		
TOTAL RETAINED EARNINGS	$ (59,981.92)		
TOTAL EQUITY		$	(36,~~[illegible]~~.16) (36,448.10)

LIABILITIES

LONG TERM DEBT

NOTES PAYABLE TO ASSOC CO	128,821.00		
OTHER LONG-TERM DEBT	(122,833.49)		
DISABILITY INS.PAYABLE-PAYROLL	215.81		
TOTAL LONG-TERM DEBT		$	6,203.32

CURRENT AND ACCRUED LIAB

NOTES PAYABLE	3,016.48
NOTE(CITIZENS FIN.)T.E.PLANT	6,780.78
CUSTOMER DEPOSITS	107,395.00
INTEREST ACCRUED	3,132.30
NOTE PAYABLE-GOSHEN UPGRADE	164,003.14

RUN DATE: 03/12/99. GOSHEN UTILITIES, INC. PAGE 3

AS OF 12/31/98

BELKNAP BEACH ACCRUED LIAB	9,472.17	
TOTAL CURRENT LIABILITIES		$ 294,399.87
	DEFERRED CREDITS	
TOTAL DEFERRED CREDITS		$ .00
	CONTRIBUTIONS IN AID OF CONST	
CONT IN AID OF CONSTRUCTION		
CONT IN AID OF CONSTR - WATER	1,031,744.66	
CONT IN AID OF CONST - SEWER	1,421,538.43	
TOTAL CONT IN AID OF CONSTR		$ 2,453,282.99
TOTAL LIAB & OTHER CREDITS		$ ~~2,7[illegible],387.02~~ 2,717,438.08

Combined Statement

TERMINAL NUMBER: A
RUN DATE: 03/12/99 GOSHEN UTILITIES, INC. PAGE 1
FOR THE PERIOD 12/01/98 TO 12/31/98
INCOME STATEMENT

	CURRENT-PERIOD AMOUNT	CURRENT-PERIOD RATIO	YEAR-TO-DATE AMOUNT	YEAR-TO-DATE RATIO
UTILITY OPERATING INCOME				
OPERATING REVENUES - WATER				
SURCHARGE-GOSHEN UPGRADE	2,883.91	4.46	34,131.17	4.05
METERED WATER REVENUE	37,811.50	58.42	514,938.04	61.14
FORFEITED DISCOUNTS	1,050.84	1.62	11,568.84	1.37
MISC.CUSTOMER SERVICE REVENUES	322.00	.50	4,740.00	.56
TOTAL OPEARATING REV - WATER	$ 42,068.25	65.00	$ 565,378.05	67.12
OPERATING REVENUES - SEWER:				
MEASURED REVENUES - GEN CUST	21,071.65	32.56	269,281.23	31.97
FORFEITED DISCOUNTS/LATE CHARG	611.23	.94	6,658.76	.79
HILLCREST REVENUES SEWER SERV	971.69	1.50	971.69	.12
TOTAL OPERATING REV - SEWER	$ 22,654.57	35.00	$ 276,911.68	32.88
TOTAL WATER & SEWER OPER REV	$ 64,722.82	100.00	$ 842,289.73	100.00
OPERATING EXPENSES				
SOURCE OF SUPPLY/OPERATIONS	1,529.83	2.36	84,832.31	10.07
SOURCE OF SUPPLY EXP/MAINT	(5,751.11)	8.89-	4,750.88	.56
WATER TREATMENT EXP/OPERATIONS	1,693.96	2.62	13,442.56	1.60
WATER TREATMENT EXP/MAINTEN	329.95	.61	1,733.22	.21
SEWER TREATMENT EXP/OPER	11,429.00	17.66	103,284.34	12.26
SEWER TREATMENT EXP/MAINT	(20,163.31)	31.15-	21,477.28	2.55
TRANS & DISTR EXP/OPERATIONS	5,201.67	8.04	159,918.17	18.99
TRANS & DISTR EXPENSES /MAINT	925.13	1.43	7,277.71	.86
CUSTOMER ACCOUNTS EXPENSE	3,090.70	4.78	20,244.03	2.40
ADMINISTRATIVE & GENERAL EXP	63,421.00	97.99	332,740.35	39.51
DEPRECIATION EXPENSE	18,771.61	29.00	131,245.18	15.58
AMORTIZATION EXPENSE	102.12	.16	~~102.12~~ 51.06	.01
TAX OTHER THAN INCOME	23,299.29	36.00	54,143.38	6.43
INCOME TAXES	(10,031.00)	15.50-	(19,101.00)	2.27-
TOTAL OPERATING EXPENSES	$ 93,848.72	145.00	$ 916,097.51	108.76
OPERATING INCOME	$ (29,125.90)	45.00-	$ (73,807.78)	8.76-
OTHER OPERATING INCOME				
TOTAL OTHER OPERATING INCOME	$ .00	.00	$ .00	.00

RUN DATE: 03/12/99 GOSHEN UTILITIES, INC. PAGE 2
FOR THE PERIOD 12/01/98 TO 12/31/98

OTHER INCOME & DEDUCTIONS

		CURRENT-PERIOD AMOUNT	RATIO		YEAR-TO-DATE AMOUNT	RATIO
OTHER INCOME						
REVENUES FROM MERCH JOB & CONT		2,010.00	3.11		26,863.00	3.19
COST & EXP OF MERCH, JOB & CON		(888.31)	1.37-		(21,327.79)	2.60-
INTEREST & DIVIDEND INCOME		3,626.65	5.60		12,076.58	1.43
INCOME (OTHER THAN OPERATING)		(389.89)	.60-		19,750.55	2.34
TOTAL OTHER INCOME	$	4,357.96	6.73	$	36,768.34	4.37
OTHER INCOME DEDUCTIONS						
MISCELLANEOUS NONUTILITY EXP		.00	.00		295.00	.04
TOTAL OTHER INCOME DEDUCTIONS	$	.00	.00	$	295.00	.04
TOTAL OTHER INCOME & DEDUCTIONS	$	4,357.95	5.73	$	36,473.34	4.33

INTEREST CHARGES

		CURRENT-PERIOD AMOUNT	RATIO		YEAR-TO-DATE AMOUNT	RATIO
INTEREST ON LONG TERM DEBT		87.46	.14		1,084.93	.13
INTEREST ON LONG TERM DEPT		1,217.07	1.88		18,400.84	2.18
OTHER INTEREST EXPENSE		73.90	.11		3,161.71	.38
TOTAL INTEREST CHARGES	$	1,378.43	2.13	$	22,647.48	2.69
NET INCOME	$	(26,146.38)	40.40-	$	(59,981.92)	7.12-

<59,930.86>

Alter fees to journal entry

TERMINAL NUMBER: A
RUN DATE: 03/12/99 GOSHEN UTILITIES, INC. PAGE 1
FOR THE PERIOD 12/01/98 TO 12/31/98
INCOME STATEMENT - WATER DIV

	CURRENT-PERIOD AMOUNT	CURRENT-PERIOD RATIO	YEAR-TO-DATE AMOUNT	YEAR-TO-DATE RATIO
UTILITY OPERATING INCOME				
OPERATING REVENUES - WATER				
SURCHARGE-GOSHEN UPGRADE	2,883.91	4.46	34,131.17	4.05
METERED WATER REVENUE	37,812.50	58.42	514,938.04	61.14
FORFEITED DISCOUNTS	1,050.00	1.62	11,568.84	1.37
MISC.CUSTOMER SERVICE REVENUES	322.00	.50	4,740.00	.56
TOTAL OPERATING REV - WATER	$ 42,060.25	65.00	$ 565,378.05	67.12
OPERATING EXPENSES				
SOURCE OF SUPPLY/OPERATIONS				
PURCHASED WATER/OPERATIONS	3,285.96	5.08	39,269.70	4.66
PURCHASED POWER/OPERATIONS	3,057.89	4.72	43,829.39	5.20
MATERIALS & SUPPLIES/OPERATIONS	(5,144.11)	7.95-	.00	.00
TRANSP EXPENSES/OPERATIONS	329.95	.51	1,733.22	.21
SOURCE OF SUPPLY EXP/MAINT				
MATERIALS & SUPPLIES/MAINT	(6,081.06)	9.40-	3,016.06	.36
TRANSPORTATION EXPENSE/MAINT	329.95	.51	1,733.22	.21
WATER TREATMENT EXP/OPERATIONS				
CHEMICALS/OPERATIONS	509.01	.79	2,848.64	.34
CONTR SERV OTHER/OPERATIONS	855.00	1.32	8,860.00	1.05
TRANSPORTATION EXP/OPERATIONS	329.95	.51	1,733.72	.21
WATER TREATMENT EXP/MAINTEN				
TRANSPORT EXP/MAINTENANCE	329.95	.51	1,733.22	.21
TRANS & DISTR EXP/OPERATIONS				
SAL & WAGES EMPLOYEES/OPER	12,997.79	20.08	118,213.45	14.03
SAL & WAGES OFFICERS/OPERATION	9,342.02	14.44	28,085.80	3.33
EMPLOYEE PEN & BENEFITS/OPER	1,995.64	3.08	7,071.08	.84
MATERIALS & SUPPLY/OPERATIONS	(19,464.53)	30.07-	4,747.12	.56
RENT OF EQUIPMENT/OPERATIONS	.00	.00	67.50	.01
TRANSPORTATION EXP/OPERATIONS	329.95	.51	1,733.22	.21
TRANS & DISTR EXPENSES /MAINT				
MATERIALS & SUPPLY/MAINT	595.10	.92	5,520.85	.66
TRANSPORTATION EXP/MAINT	329.95	.51	1,756.86	.21
CUSTOMER ACCOUNTS EXPENSE				
SAL & WAGES EMPLOYEES/CUST	1,589.92	2.46	14,209.01	1.69
MATERIALS & SUPPLY/CUST	1,386.09	2.14	2,704.31	.32
CONTR SERV OTHER/CUST	.00	.00	1,815.45	.22
BAD DEBT EXPENSE/CUST	.00	.00	82.65	.01
ADMINISTRATIVE & GENERAL EXP				
SAL & WAGES EMPLOYEES/ADEG	2,404.62	3.72	23,137.91	2.75
SAL & WAGES OFFICERS/ADEG	9,342.02	14.44	28,085.80	3.33
EMPL PENSION & BENEFITS/ADEG	504.50	.78	6,115.92	.73

RUN DATE: 03/12/99 GOSHEN UTILITIES, INC.

FOR THE PERIOD 12/01/98 TO 12/31/98

		CURRENT-PERIOD			YEAR-TO-DATE	
		AMOUNT	RATIO		AMOUNT	RATIO
MATERIALS & SUPPLY/ADGG		808.23	1.25		10,117.22	1.20
CONTR SERV - ACCT/ADGG		.00	.00		3,825.00	.45
CONTR SERV - LEGAL/ADGG		1,376.47	2.13		6,919.83	.82
CONTR SERV - OTHER/ADGG		10,440.04	16.13		13,685.85	1.62
RENT OF BLG REAL PROP/ADGG		799.21	1.23		3,058.05	.36
RENT OF EQUIPMENT		65.79	.10		1,250.90	.15
TRANSPORTATION EXP/ADGG		137.52	.21		925.58	.11
INSURANCE VEHICLE/ADGG		317.05	.49		4,282.70	.51
INSUR GENERAL LIABILITY/ADGG		241.00	.37		1,497.13	.18
INSURANCE WRKM'S COMP/ADGG		457.80	.71		5,493.60	.65
INSURANCE - OTHER/ADGG		202.03	.31		4,540.59	.54
REG COMM EXP OTHER/ADGG		9,897.93	15.29		9,897.93	1.18
MISCELLANEOUS EXP/ADGG		225.00	.35		708.00	.08
DEPRECIATION EXPENSE		11,661.60	18.02		73,155.43	8.69
TAX OTHER THAN INCOME						
UNEMPLOYMENT TAXES		11.56	.02		279.83	.03
PROPERTY TAX		8,677.76	13.41		17,582.00	2.09
PAYROLL TAX EMPLOYER		2,215.45	3.42		16,650.51	1.86
OTHER TAXES-SCHOOL AND SALES		1,688.70	2.61		1,106.28	.13
INCOME TAXES		(10,031.00)	15.50-		(19,101.00)	2.27-
		---------------			---------------	
TOTAL OPERATING EXPENSES	$	58,950.06	90.15	$	502,987.55	59.72
		---------------			---------------	
OPERATING INCOME	$	(16,282.21)	25.16-	$	62,390.50	7.41
OTHER OPERATING INCOME						
		---------------			---------------	
TOTAL OTHER OPERATING INCOME	$	.00	.00	$	.00	.00

OTHER INCOME & DEDUCTIONS

		CURRENT-PERIOD AMOUNT	RATIO		YEAR-TO-DATE AMOUNT	RATIO
OTHER INCOME						
REVENUES FROM MERCH JOB & CONT		.00	.00		4,645.00	.55
COST & EXP OF MERCH, JOB & CON		.00	.00		(2,041.56)	.24-
INTEREST & DIVIDEND INCOME		1,442.32	2.23		2,132.90	.25
INCOME (OTHER THAN OPERATING)		(389.89)	.60-		19,750.55	2.34
INTEREST RECEIVED ON CUST DEP		560.09	.87		1,749.73	.21
		---------------			---------------	
TOTAL OTHER INCOME	$	1,612.52	2.49	$	26,236.62	3.11
OTHER INCOME DEDUCTIONS						
MISCELLANEOUS NONUTILITY EXP		.00	.00		295.00	.04
		---------------			---------------	
TOTAL OTHER INCOME DEDUCTIONS	$	.00	.00	$	295.00	.04
		---------------			---------------	

RUN DATE: 03/12/99 GOSHEN UTILITIES, INC. PAGE 3

FOR THE PERIOD 12/01/98 TO 12/31/98

	CURRENT-PERIOD			YEAR-TO-DATE	
	AMOUNT	RATIO		AMOUNT	RATIO
TOTAL OTHER INCOME & DEDUCTIONS	1,612.52	2.49	$	25,941.62	3.08

INTEREST CHARGES

INTEREST EXPENSE						
INTEREST ON LONG TERM DEBT		87.46	.14		1,084.93	.13
INTEREST ON CUSTOMER ACCOUNTS		68.25	.11		3,157.22	.37
INTEREST - GOSHEN UPGRADE		1,135.12	1.75		14,304.43	1.70
		---------------			---------------	
TOTAL INTEREST CHARGES	$	1,290.83	1.99	$	18,546.58	2.20
		---------------			---------------	
NET INCOME	$	(15,960.52)	24.66-	$	63,785.54	8.29
		===============			===============	

RUN DATE: 03/12/99 GOSHEN UTILITIES, INC. PAGE 4
FOR THE PERIOD 12/01/98 TO 12/31/98

	CURRENT-PERIOD		YEAR-TO-DATE	
	AMOUNT	RATIO	AMOUNT	RATIO

INCOME STATEMENT - SEWER DIV

	CURRENT-PERIOD		YEAR-TO-DATE	
	AMOUNT	RATIO	AMOUNT	RATIO
OPERATING REVENUES - SEWER:				
MEASURED REVENUES - GEN CUST	21,071.65	32.56	269,281.23	31.97
FORFEITED DISCOUNTS/LATE CHARG	611.23	.94	6,658.76	.79
HILLCREST REVENUES SEWER SERV	971.69	1.50	971.69	.12
	---------------		---------------	
TOTAL OPERATING REV - SEWER	$ 22,654.57	35.00	$ 276,911.68	32.88
OPERATING EXPENSES				
SEWER TREATMENT EXP/OPER				
LABOR & RELATED EXPENSES	5,570.47	8.61	50,663.55	6.02
FUEL & POWER FOR PUMPING & TR	1,487.53	2.30	28,982.79	3.44
CHEMICALS	4,042.29	6.25	20,923.44	2.48
RENTS	65.79	.10	1,325.42	.16
MISC OPERATING SUPPLY & EXP.	262.92	.41	1,387.74	.16
SEWER TREATMENT EXP/MAINT				
STRUCTURES & IMPROVEMENTS	.00	.00	925.00	.11
MAINT OF COLLECTIONS SEWER SYS	823.33	1.27	8,325.85	.99
MAINT OF OTHER PLANT FACILITY	.00	.00	281.46	.03
MAINTENANCE OF PUMPING SYSTEM	(7,897.80)	12.20-	5,056.95	.60
MAINT OF TREAT & DISPOSAL PL	(13,088.84)	20.22-	6,888.02	.82
CUSTOMER ACCOUNT EXPENSE				
CUSTOMER ACCOUNTS EXPENSES	114.77	.18	1,349.99	.16
BAD DEBT EXPENSE/CUST	.00	.00	82.62	.01
ADMINISTRATIVE & GENERAL EXP				
ADMINS & GENERAL SALARIES	12,002.66	18.54	61,419.66	7.29
EMPLOYEES PENSIONS & BENEFITS	2,500.53	3.86	13,186.83	1.57
OFFICE SUPPLIES & EXPENSE	5,490.75	8.48	19,797.18	2.35
OUTSIDE SERVICES	7,533.57	11.64	95,316.39	11.32
TRANSPORTAION EXPENSES	942.60	1.46	6,269.59	.74
REGULATORY COMMISSION EXPENSE	(3,252.30)	5.02-	1,210.65	.14
PROPERTY & GENERAL INSURANCE	103.33	.16	860.60	.10
INJURIES & DAMAGES (INSURANCE)	399.04	.62	6,895.00	.82
MAINT OF GENERAL PLANT ADMINIS	479.65	.74	4,243.12	.50
DEPRECIATION	7,110.03	10.99	58,083.75	6.90
AMORTIZATION EXPENSE	102.12	.16	102.12	.01 → $51.06
INTEREST ON LONG TERM DEBT	13.70	.02	939.19	.11
TAX OTHER THAN INCOME				
UNEMPLOYMENT TAXES	11.54	.02	279.77	.03

RUN DATE: 03/12/99 GOSHEN UTILITIES, INC.
FOR THE PERIOD 12/01/98 TO 12/31/98

		CURRENT-PERIOD			YEAR-TO-DATE	
		AMOUNT	RATIO		AMOUNT	RATIO
PROPERTY TAX		9,570.28	14.79		10,857.67	1.29
PAYROLL TAX EMPLOYER		1,124.04	1.74		8,387.32	1.00
TOTAL OPERATING EXPENSES	$	35,511.96	54.87	$	414,049.15	49.16
OPERATING INCOME	$	(12,857.39)	19.87-	$	(137,137.47)	16.28-

OTHER INCOME & DEDUCTIONS

OTHER INCOME						
MAINENENANCE REVENUE GRINDERS		2,010.00	3.11		22,224.00	2.64
INTEREST INCOME		1,064.16	1.64		6,444.30	.77
INTEREST RECEIVED ON CUST DEP		560.08	.87		1,749.65	.21
TOTAL OTHER INCOME	$	3,634.24	5.62	$	30,417.95	3.61
OTHER INCOME DEDUCTIONS						
MAINTENANCE EXPENSES GRINDERS		888.81	1.37		19,886.23	2.36
OTHER INTEREST EXPENSE		73.90	.11		3,161.71	.38
TOTAL OTHER INCOME DEDUCTIONS	$	962.71	1.49	$	23,047.94	2.74
TOTAL OTHER INCOME & DEDUCTIONS	$	2,671.53	4.13	$	7,370.01	.87
NET INCOME	$	(10,185.86)	15.74-	$	(129,767.46)	15.41-

Corporate Organizational Chart

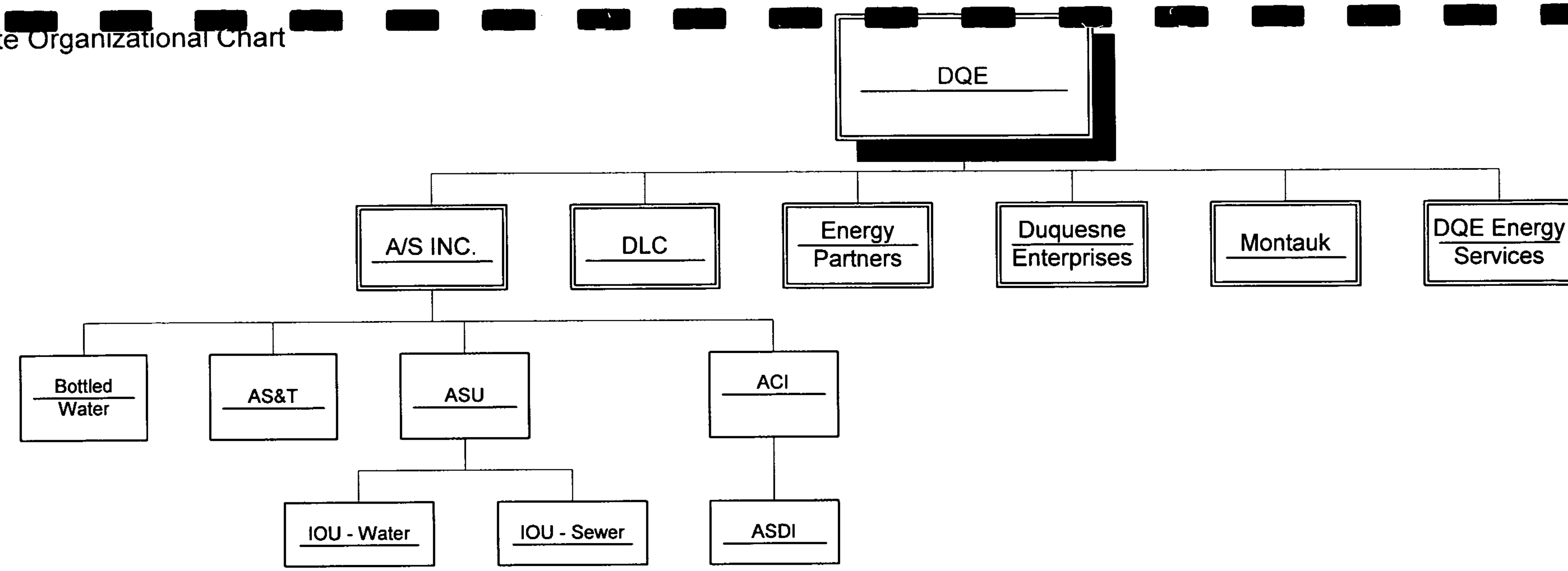

EXHIBIT
C

As of September 15, 1999

RESTATEMENT OF GOSHEN UTILITIES WATER PLANT CONTRIBUTIONS IN AID OF CONSTRUCTION
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Water Plant

Year End	Additions	Cumulative Total	Annual Amortization (1)	Years to Date	Accumulated Amortization Through 12/31/98 (2)	Adjusted CIAC at 12/31/98
1979	513,479	513,479	16,046	19.5	312,901	200,578
1980	0	513,479	0	18.5	0	0
1981	0	513,479	0	17.5	0	0
1982	0	513,479	0	16.5	0	0
1983	0	513,479	0	15.5	0	0
1984	0	513,479	0	14.5	0	0
1985	0	513,479	0	13.5	0	0
1986	0	513,479	0	12.5	0	0
1987	16500	529,979	516	11.5	5,930	10,570
1988	24,000	553,979	750	10.5	7,875	16,125
1989	32,276	586,255	1,009	9.5	9,582	22,694
1990	23,130	609,385	723	8.5	6,144	16,986
1991	15,300	624,685	478	7.5	3,586	11,714
1992	25,175	649,860	787	6.5	5,114	20,061
1993	211,685	861,545	6,615	5.5	36,383	175,302
1994	37,518	899,063	1,172	4.5	5,276	32,242
1995	17,447	916,510	545	3.5	1,908	15,539
1996	35,122	951,632	1,098	2.5	2,744	32,378
1997	33,868	985,500	1,058	1.5	1,588	32,280
1998	46,245	1,031,745	1,445	0.5	723	45,522
Total at 12/31/98	1,031,745				399,753	631,992

1/ Based on composite amortization rate using 1998 plant and depreciation shown below:

Utility Plant in Service-12/31/98	2,367,670
Depreciation Expense - 1998	73,155
Composite Amortization Period - Years	**32**

2/ Reduction in CIAC and a contra increase in retained earnings and equity.

EXHIBIT
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RESTATEMENT OF GOSHEN UTILITIES SEWER PLANT CONTRIBUTIONS IN AID OF CONSTRUCTION
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Sewer Plant

Year End	Additions	Cumulative Total	Annual Amortization (1)	Years to Date	Accumulated Amortization Through 12/31/98 (2)	Adjusted CIAC at 12/31/98
1979	920,114	920,114	34,078	19.5	664,527	255,587
1980	80,500	1,000,614	2,981	18.5	55,157	25,343
1981	0	1,000,614	0	17.5	0	0
1982	0	1,000,614	0	16.5	0	0
1983	0	1,000,614	0	15.5	0	0
1984	0	1,000,614	0	14.5	0	0
1985	0	1,000,614	0	13.5	0	0
1986	0	1,000,614	0	12.5	0	0
1987	67,000	1,067,614	2,481	11.5	28,537	38,463
1988	41,700	1,109,314	1,544	10.5	16,217	25,483
1989	37,000	1,146,314	1,370	9.5	13,019	23,981
1990	32,000	1,178,314	1,185	8.5	10,074	21,926
1991	25,000	1,203,314	926	7.5	6,944	18,056
1992	37,000	1,240,314	1,370	6.5	8,907	28,093
1993	30,000	1,270,314	1,111	5.5	6,111	23,889
1994	18,800	1,289,114	696	4.5	3,133	15,667
1995	21,000	1,310,114	778	3.5	2,722	18,278
1996	58,424	1,368,538	2,164	2.5	5,410	53,014
1997	9,000	1,377,538	333	1.5	500	8,500
1998	44,000	1,421,538	1,630	0.5	815	43,185
Total at 12/31/98	1,421,538				822,073	599,465

1/ Based on composite amortization rate using 1998 plant and depreciation shown below:

Utility Plant in Service-12/31/98	1,621,157
Depreciation Expense - 1998	58,962
Composite Amortization Period - Years	**27**

2/ Reduction in CIAC and a contra increase in retained earnings and equity.

CALCULATION OF ACQUISITION ADJUSTMENT
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Summary of Utility Plant in Service as of 12/31/98

	Water	Sewer	Total
Utility Plant in Service as of 12/31/98	2,367,670	1,621,157	3,988,827
Less Accumulated Depreciation	(906,900)	(789,103)	(1,696,003)
Net Utility Plant in Service	1,460,770	832,054	2,292,824
Contributions in Aid of Construction (CIAC)	1,031,745	1,421,538	2,453,283
Less Amortized CIAC	(399,753)	(822,073)	(1,221,826)
Unamoritzed CIAC (1)	631,992	599,465	1,231,457
Net Book Value-Net Plant Less Unamortized CIAC	828,778	232,589	1,061,367
Purchase Price Allocated to Net Book Value (Price excluding transaction costs)	2,772,048	777,952	3,550,000
Acquisition Adjustment-Allocated Price Less Net Book	1,943,270	545,362	2,488,633

1/ Refer to Exhibit D, Attachment A for CIAC calculations.

ADJUSTED BALANCE SHEET FOR GOSHEN UTILITIES, INC. (1,2)
Goshen Utilities, Inc. and AquaSource Utilities, Inc.
Case No. 99-303

Assets	Water	Sewer	Total
Utility Plant in Service	2,367,670	1,621,157	3,988,827
Accumulated Depreciation	(906,900)	(789,103)	(1,696,003)
Net Utility Plant	1,460,770	832,054	2,292,824
Cash	86,940	37,260	124,200
Temporary Cash Investments	120,400	51,600	172,000
Customer Accounts Receivable	8,403	3,601	12,004
Prepaid Expenses	48,843	20,933	69,776
Accrued Interest	2,593	1,111	3,704
Misc. Current and Accrued Assets	30,052	12,879	42,931
Total-Current Assets	297,231	127,385	424,615
Total Assets	1,758,001	959,439	2,717,439

Liabilities	Water	Sewer	Total
Common Stock	140,000	60,000	200,000
Other Paid In Capital	168,859	72,368	241,227
Retained Earnings (3)	65,381	678,771	744,151
Total-Capital	374,239	811,139	1,185,378
Notes Payable	119,549	51,235	170,784
Accounts Payable	152	65	217
Notes Payable to Associated Cos.	2,111	905	3,016
Customer Deposits	75,597	32,399	107,995
Interest Accrued	2,192	940	3,132
Other	6,630	2,842	9,472
Total-Current Liabilities	206,231	88,385	294,616
Long Term Debt	0	0	0
Advances from Associated Cos.	4,192	1,796	5,988
Total-Long Term Debt	4,192	1,796	5,988
Net CIAC (3)	631,992	599,465	1,231,457
Total Liabilities	1,216,654	1,500,785	2,717,439

1/ Balance sheet information identified in Goshen's 1998 annual reports for water and sewer.
2/ Current assets, capital, current liabilities and long term debt allocated 70% to water and 30% to sewer per discussions with current owner. For illustration purposes.
3/ Refer to Exhibit D, Attachment A for CIAC adjustments.

ESTIMATED JOURNAL ENTRIES FOR GOSHEN AND AQUASOURCE UTILITIES
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

Estimated Acquisition Premium

	Water	Sewer	
Total at Closing			3,550,000
Adjustment for Working Capital:			
Current Assets	297,231	127,385	
Current Liabilities	206,231	88,385	
Working Capital Adjustment	90,999	39,000	129,999
Expected Purchase Price			3,679,999
Equity Including CIAC Adjustments	374,239	811,139	
Add Contribution of Capital by Sellers to Retire Advances from Associated Cos.	4,192	1,796	
Estimated Equity	378,431	812,935	1,191,366
Estimated Acquisition Premium			2,488,633

Accounting Entries for Goshen Utilities, Inc. After Acquisition

	Debit	Credit
Utility Plant Acquisition Adjustment	2,488,633	
Shareholder Equity-Paid In Capital		2,488,633

Accounting Entries for AquaSource Utilities, Inc.

	Debit	Credit
Investment in Goshen Utilities, Inc.	3,679,999	
Cash		3,679,999

CALCULATION OF EMBEDDED COST PER CUSTOMER
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

	Water	Sewer	Total
Utility Plant in Service as of 12/31/98	2,367,670	1,621,157	3,988,827
Less Accumulated Depreciation	(906,900)	(789,103)	(1,696,003)
Net Utility Plant in Service	1,460,770	832,054	2,292,824
Contributions in Aid of Construction (CIAC)	1,031,745	1,421,538	2,453,283
Less Amortized CIAC	(399,753)	(822,073)	(1,221,826)
Net CIAC	631,992	599,465	1,231,457
Net Book Value	828,778	232,589	1,061,367
Estimated Acquisiton Adjustment	1,943,270	545,362	2,488,633
Embedded Cost Including Acquisition Adjustment	2,772,048	777,952	3,550,000
Customers	1,682	1,219	2,901
Average Embedded Cost per Customer	$1,648	$638	$1,224

DRAFT ACCOUNTING ORDER
Goshen Utilities, Inc. and AquaSource Utility, Inc.
Case No. 99-303

1. In connection with the purchase of Goshen Utilities, Inc. by AquaSource Utility, Inc. (the "Company"), the Kentucky Public Service Commission approves the following accounting entries and accounting entries applicable to Goshen Utilities, Inc.

2. That the financial statements at December 31, 1998 be adjusted for amortization of contributions in aid of construction (CIAC) to comply with the uniform system of accounts in accordance prescribed by the Kentucky Public Service Commission.

3. That the Company may use a straight-line composite rate to amortize the CIAC account.

4. That the straight-line composite rates of 32 years for water and 27 years for sewer may be used to amortize CIAC.

5. That the Company may charge the CIAC account at December 31, 1998 in the amount of $1,221,826 ($399,753 related to water plant and $822,073 related to sewer plant) to reflect amortization of CIAC from the year received to December 31, 1998 with an offsetting credit to Shareholder Equity - Retained Earnings of $1,221,826.

6. That the difference between the purchase price at the date of closing and the shareholders equity at the date of closing be recorded on the books of Goshen as Utility Plant Acquisition Adjustment and a credit to Shareholder Equity – Paid In Capital.

7. That the acquisition adjustment be amortized over a ten year period.

SCC-62

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STATE CORPORATION COMMISSION

1999 MAR 31 P 3:38

AT RICHMOND, MARCH 31, 1999

PETITION OF

AQUASOURCE UTILITY, INC.

CASE NO. PUA980043

For approval to acquire control of
Blue Ridge Utility Company, Inc.

ORDER GRANTING APPROVAL

On November 23, 1998, AquaSource Utility, Inc., ("AquaSource", the "Company") filed a petition under the Utility Transfers Act requesting approval for AquaSource to acquire from Winfred W. Ortts and Kitty L. Ortts (the "Ortts"), all the issued and outstanding stock of Blue Ridge Utility Company, Inc., ("Blue Ridge"). AquaSource Utility, Inc., is a wholly-owned subsidiary of AquaSource, Inc. which is, in turn, a wholly-owned subsidiary of DQE, Inc., a publicly traded utility holding company. In addition to water and wastewater utilities, AquaSource and AquaSource, Inc., also own non-regulated water and wastewater related businesses such as construction and engineering companies, water and

EXHIBIT

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wastewater system leasing and fabrication businesses, and contract operation services for other owners of water and wastewater facilities.

AquaSource and AquaSource, Inc., (the "Companies") received approval from their Boards to invest over $200 million in water and wastewater utility companies. The Companies provide potable water and wastewater services to more than 300,000 customers and are currently negotiating to acquire numerous additional water utilities across the country, including Virginia. AquaSource is headquartered in Houston, Texas and has several other offices in various areas of the country.

DQE, Inc., the parent company of AquaSource, Inc., is a Pennsylvania based energy service company and parent of Duquesne Light Company. DQE, Inc., has assets of more than $4.6 billion and annual revenues in excess of $1.2 billion. AquaSource and AquaSource, Inc., report their financial data on a consolidated basis with DQE, Inc.

The Ortts currently own all of the issued and outstanding stock of Blue Ridge Utility Company, Inc. Blue Ridge is a Virginia small water company providing water services to households in Shenandoah County, Virginia. Blue Ridge currently serves 182 customers and 520 additional lots throughout the housing subdivisions.

AquaSource proposes to purchase, and the Ortts propose to sell to AquaSource all of the issued and outstanding stock of Blue Ridge. As stated in the petition, upon consummation of the transaction, Blue Ridge will become a wholly-owned subsidiary of AquaSource and will continue to operate as a separate

Virginia small water company. Additionally, AquaSource will provide operation, maintenance, and other services to Blue Ridge by contract.

As agreed by AquaSource and the Ortts, AquaSource will pay the Ortts $158,272.00 in cash for the Blue Ridge stock plus additional amounts for new connections made to the Blue Ridge system prior to December 21, 2001. In accordance with the Stock Purchase Agreement, AquaSource will pay an additional $870.00 per household, less AquaSource's connection cost. The purchase price will additionally be adjusted pursuant to the Stock Purchase Agreement. AquaSource represents that adequate service at just and reasonable rates will not be impaired or jeopardized by the proposed transfer of control of Blue Ridge. AquaSource further represents that it plans to provide system improvements without change in the current water rates to Blue Ridge's customers. In addition, the Company states that the acquisition will benefit Blue Ridge's customers without an increase in rates. AquaSource's mission, as stated in its petition, is to:

1) provide safe, clean, reasonably priced drinking water to its customers;

2) achieve high levels of customer service and satisfaction; and

3) keep all of its water and wastewater systems in regulatory compliance.

AquaSource represents that, by Blue Ridge operating as a part of the AquaSource family of companies, economies of scale will help maintain or lower future operating expenses, thereby mitigating the need for future rate increases.

AquaSource further represents that, as part of a larger company with a publicly-traded parent, Blue Ridge will have access to the less expensive, public capital markets to finance future capital improvements to its plant and equipment, thereby reducing the need for potential future rate increases.

The Company represents that AquaSource proposes to offset any need to increase rates, due to increased investment directly attributable to the acquisition, against expense reductions it expects to achieve in Blue Ridge's operations. AquaSource also represents that, to the extent AquaSource is able to achieve and retain expense reductions resulting from operating efficiencies achieved over time, ratepayers will be insulated from any need to increase rates.

AquaSource currently owns and operates over 300,000 connections in six states. AquaSource is headquartered in and operates more than 200,000 connections in Texas. AquaSource represents that it has not filed a rate case in the eighteen months it has owned and operated facilities in Texas. AquaSource is negotiating rate settlements in various other states. AquaSource represents that it has been able to improve service provided by companies it has acquired particularly in Texas.

THE COMMISSION, upon consideration of the petition and representations of the Company and having been advised by its Staff, is of the opinion and finds that the above-described transfer of control will neither impair nor jeopardize the provision of adequate service to the public at just and reasonable rates and should, therefore, be approved. Accordingly,

IT IS ORDERED THAT:

1) Pursuant to §§ 56-88.1 and 56-90 of the Code of Virginia, AquaSource Utility, Inc., is hereby granted approval to acquire control of Blue Ridge Utility Company, Inc., under the terms and conditions and at the price of $158,272.00, plus additional amounts for new connections made prior to December 21, 2001, and adjustments made pursuant to the Stock Purchase Agreement described herein.

2) The approval granted herein shall have no ratemaking implications.

3) Any excess earnings resulting from operational efficiencies or cost reductions shall be at issue in any filings or proceedings addressing rates.

4) The approval granted herein shall in no way be deemed to include the recovery of any portion of the consideration paid in excess of the rate base, at the time of closing, through either an acquisition adjustment or any other type of adjustment for ratemaking purposes.

5) Blue Ridge Utility Company, Inc., shall file a Report of Action with the Director of Public Utility Accounting of the Commission on or before May 28, 1999. Such report shall contain the date of transfer, the sales price, and all accounting entries reflecting the transfer.

6) There appearing nothing further to be done in this matter, the same be, and it hereby is, dismissed.

AN ATTESTED COPY hereof shall be sent to: Anthony J. Gambardella, Esquire, Woods, Rogers & Hazlegrove, 823 East Main Street, Suite 1200, Richmond, VA 23219; and delivered to the Director of Public Utility Accounting, and the Director of Energy Regulation of the Commission.

A True Copy
Teste:
Joel H. Peck
Clerk of the
State Corporation Commission

FILED: SESSION OF DEC 1 0 1998

CASE 98-W-1274

Approved as Recommended
and so Ordered
By the Commission

DEBRA RENNER
Acting Secretary

ISSUED & EFFECTIVE JAN 0 8 1999

STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

December 7, 1998

TO: THE COMMISSION

FROM: GAS AND WATER DIVISION - WATER RATES SECTION
OFFICE OF ACCOUNTING AND FINANCE

SUBJECT: CASE 98-W-1274 - Joint Petition of AquaSource Utility, Inc. and Cambridge Water Works Company for Approval of the Transfer of all Cambridge Water Works Company Stock to AquaSource Utility, Inc.

SAPA: 98-W-1274SA1 - Published in State Register on September 30, 1998.

SUMMARY OF RECOMMENDATION: That the petition be approved subject to the conditions described in this Order.

* * *

<u>Summary</u>

By joint petition dated September 8, 1998, AquaSource Utility, Inc. (AquaSource or ASI) and Cambridge Water Works Company (Cambridge or the company) request Commission approval, pursuant to Public Service Law §89-h, for ASI to acquire all Cambridge stock. Cambridge provides water service to approximately 470 customers in the Washington County Towns of Cambridge, White Creek and Jackson, and public fire protection to the Village of Cambridge. Cambridge has experienced significant administrative and operating deficiencies for several years, resulting in inadequate service and uncollected revenues in excess of $10,000 per year (9% of annual revenues).

ASI has committed to correct these problems, operate this system more efficiently and operate under an 11-year price cap plan. Under the plan, rates will be frozen for three years, and in the fourth through eleventh years rates will be increased by an inflation based escalator. The current average annual residential customer bill is approximately $480, which includes a surcharge of approximately $190 for repayment of Environmental Facilities Corporation (EFC) bonds for capital improvements.

Staff has reviewed the ASI proposal, believes that it is in the public interest, and recommends approval of the transfer contingent on the terms discussed herein.

Background

Cambridge has operated for several years with significant administrative and operating deficiencies. Approximately 44% of the customers receive minimum bills because no meters are installed, meters are inoperable, or meters have not been regularly read by the company. Approximately 23% of customers are incorrectly billed or not billed at all.[1] Staff estimates that the company's poor billing practices have resulted in uncollected revenues in excess of $10,000 per year (9% of annual revenues). Cambridge has been repeatedly advised of its obligation to perform leak detection and make the necessary meter replacements and system repairs. However, the company has made little or no effort to reduce its lost and unaccounted for (LAUF) water and high percentage of minimum bills, or carry out other needed repairs and improvements.

As a result, the Commission issued an Order[2] on May 7, 1998, directing Cambridge, its officers and directors to show cause within 10 days why the Commission should not find that Cambridge is not providing safe and adequate service and directed

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[1] Based upon company data, staff estimates that due to incorrect billing, metering inaccuracies, and high leakage, the company's lost and unaccounted for (LAUF) water is over 65%.

[2] Case 98-W-0687, Order Instituting Proceeding and to Show Cause (Order), issued May 7, 1998.

that appropriate remedial actions be taken. The company's reply to the Order was non-responsive but essentially confirmed the problems staff reported. The Commission subsequently directed Cambridge to perform the repairs, installations, and inspections that were identified in an attachment to the Order, within specific timeframes[1/]. To staff's knowledge, practically none of that work has been done.

Cambridge argues that it does not have the financial resources required to improve its service, and a rate surcharge would likely be required to perform the necessary system maintenance and improvements. However, staff believes the company is not collecting the full amount of revenues it is entitled to because of mismanagement, as noted above, and service would continue to deteriorate under the present owner.

By an agreement (contract) dated September 2, 1998, Cambridge agreed to transfer its stock to ASI, a wholly-owned affiliate of DQE[2/]. AquaSource owns water and wastewater utilities, construction and engineering companies, system leasing and fabrication businesses and contract operation services. Since its formation, ASI has acquired 24 water utilities serving about 100,000 customers in two states. ASI intends to become a significant player in the private water business in New York State and elsewhere, and is willing to assume the considerable commitment to make Cambridge a long-term, viable water system. Finally, the local municipalities are not interested in taking over this water system.

The Petition

The petition states that ASI will purchase all outstanding stock of Cambridge for $235,478. The purchase price is about 257% of the current $66,000 rate base for Cambridge.

[1/] Case 98-W-0687, supra, Order Directing Remedial Action (issued July 15, 1998).

[2/] DQE, Inc., (formerly Duquesne Power & Light Company) is a Pennsylvania-based electric, transmission and distribution and energy services company with assets of more than $4.6 billion and annual revenue in excess of $1.2 billion.

However, the level of rate base for small water companies is generally not truly representative of the level of actual plant investment because of the relatively high level of contributed plant from real estate developers. In addition, ASI will assume the debt associated with the company's EFC Bonds totaling approximately $830,000.

ASI has also requested that the Commission extend the compliance dates set forth in the Revised Schedule of the July 15, 1998 Order, to permit for the orderly and efficient transfer of control and operation, and to give ASI time to perform the required work.

ASI contends that it is willing to commit to make Cambridge a viable water system, and projects an immediate cost of approximately $46,000 for necessary operation and capital improvement expenses. ASI stated that it would use equity (and possibly long-term debt) financing to do these projects, which will result in more efficient financing compared to current ownership where rate surcharges would likely be required to finance improvements.

ASI intends to operate this system more efficiently, and has requested that the Commission not take any action to reduce rates and surcharges and allow ASI to retain for itself the efficiencies it attains. ASI states that the retained operating efficiencies will compensate it for the increased investment base.

Customer Notification

In October, Cambridge informed the customers regarding the above proposal. The notice introduced AquaSource and explained that ASI can provide quality water at a lower price than the current owner because it has the resources, expertise, and efficiencies that a larger company can provide. Cambridge informed customers that both companies believe the transfer will help customers by permitting improvements to be implemented quickly with the use of capital at reasonable costs and will ultimately result in stable rates. ASI indicated it will develop an action plan for immediate enhancements and renovations to the distribution system.

The customers were also informed of the need for Commission approval and were asked to contact the Commission's Consumer Services Division to comment on the proposal. Three customer comments were received in 1998. The first two comments were received prior to the customer notification regarding the proposed water company transfer (increased bill and surcharge, and low pressure or no water at all). A third comment related to the proposed stock transfer, and questioned why the EFC financing surcharge would not be paid in full with the sale of the company. An explanation was sent to the customer that the surcharge terms will remain the same after the stock transfer.

Discussion

Many of the approximately 400 Public Service Commission regulated water systems are small and do not have the financial capability to cope with major repairs and other stresses of business. Some of the small companies are in poor condition and long-term service is in jeopardy. Occasionally, municipalities are able to take ownership and operate small troubled companies, but usually only after long periods of poor service and customer anguish. To address this situation, the Commission issued its Acquisition Incentive Policy[1/]. This policy statement indicates the Commission's willingness to encourage consolidation and acquisitions of small companies by non-traditional ratemaking approaches (e.g., a return premium, recognizing acquisition premiums in rate base, bringing rates of the acquired company up to regional rates, and accelerated write-offs of acquisition costs).

ASI intends to use its financial ability to make system improvements at its acquisitions to ensure their long-term viability. In the case of Cambridge, ASI will invest the

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[1/] Case 93-W-0962 -- Statement of Policy on Acquisition Incentive Mechanisms for Small Water Companies ("AIM Policy"), issued August 8, 1994.

premium is a departure from traditional rate of return ratemaking methodology.

ASI's proposal will alleviate the rate impact of high surcharges that customers would likely encounter if Cambridge were to do the system repairs and improvements itself. Moreover, because long-term financing is not an option for Cambridge, ownership by ASI will result in reduced financing costs to customers for any future improvements as compared to current ownership. It should also be highlighted that Cambridge customers are obligated (through a surcharge based on water usage), to repay a loan that the company received in 1995 from the EFC to fund necessary system improvements. ASI will continue paying off the loan balance of approximately $830,000, as required by EFC through the existing capital surcharge.

It appears that ASI should be able to achieve economies of scale in both operations and financing. Accordingly, customers will be paying no more, and most likely less, under ASI's ownership than they would be under the current ownership. Staff believes ASI's pledge to make the required system repairs is credible, and the transfer is in the public interest.

This memo has been reviewed by Nancy Tourville of the Office of Consumer Affairs and David Van Ort of the Office of Counsel.

<u>Recommendation</u>

<u>It is recommended that</u>:

The Commission approve the transfer of the Cambridge Water Works Company stock to AquaSource Utility, Inc., conditioned on the following provisions related to the future ratemaking.

1. Existing base rates shall remain in effect for a minimum of three years (through 12/31/01).

2. After the initial three year rate freeze (through 12/31/01), ASI will be allowed to increase rates by an escalator based upon the increase in the GDP inflator minus 25% of that rate for anticipated productivity savings. However, the 25% GDP productivity factor will be

open to renegotiation as described in the body of this order.

3. If the aggregate of certain unavoidable costs (power, chemicals, taxes, testing costs, and the depreciation and return components of extraordinary capital additions) increase by more than 5% above the escalator, AquaSource Utility, Inc., will be allowed to apply for a rate reopener, subject to the provisions described in the body of this Order.

4. The compliance dates to perform the directed tasks in the Commission Order Directing Remedial Action, dated July 15, 1998, shall be extended to June 1, 1999. AquaSource Utility, Inc., shall submit its timetable for compliance to the Chief of Water Rates by April 1, 1999.

Respectfully submitted,

Sandra D. Reulet

Sandra D. Reulet
Senior Valuation Engineer
Gas & Water Division

Brian Summers
Associate Utility Financial Analyst
Office of Accounting & Finance

APPROVED:

Arthur Gordon

Arthur Gordon
Chief, Water Rates Section
Gas and Water Division

R. A. Ansaldo

Richard Ansaldo
Chief, Office of Accounting & Finance

Appendix A

Rate Plan for AquaSource Acquisition of Cambridge Water Works Company

- Rate Freeze
  - ASI would hold rates constant to 12/31/01 (3 year freeze).
- Improved Service
  - ASI would invest in the repair and maintenance of Cambridge system without increasing current rates, except for the escalator and extraordinary reopener clauses discussed below.
- GDP based Escalator in "Out Years"
  - In the fourth through eleventh years if the GDP inflator is greater than zero, rates would increase by an escalator (the GDP inflator less 25% of the GDP for a productivity offset), e.g., GDP deflator of 2% results in an escalator of 1.5% and 8% GDP results in 6% escalator. Prior year actual GDP will be used to set subsequent year rates.
  - The minus 25% of GDP as a productivity offset will be open to renegotiation upward (e.g., minus 30% of GDP, but no greater than 50% of GDP) in the event that ASI buys additional companies, which provide for added economies to all ASI companies. The intent would be to share some of the additional economies between ratepayers and ASI.
- Rate reopeners for extraordinary expense increases
  - If certain unavoidable costs (power, chemicals, taxes, testing costs, and the depreciation and return component of extraordinary capital additions), increase in aggregate, by more than 5% above the escalator, a rate reopener would be allowed. However one-half of new customer revenues would be netted against the increased costs. If reopener is used, ASI cannot revert to the escalator option in remaining years.
- Ratemaking after Eleven Years
  - The investment base would not include a purchase price premium but would include the capital investments made by ASI since the acquisition. These capital additions will be treated as if traditional rate making had been in place since the acquisition; that is, in the twelfth year the net plant for these capital additions (and all other plant) will reflect the appropriate level of depreciation since the acquisition.

AGENDA DATE: 4/28/99

STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102

IN THE MATTER OF THE JOINT PETITION OF AQUASOURCE UTILITY, INC. AND MAXIM SEWERAGE CORPORATION FOR APPROVAL OF THE SALE OF MAXIM SEWERAGE CORPORATION'S STOCK TO AQUASOURCE UTILITY, INC. AND FOR APPROVAL TO KEEP BOOKS AND RECORDS OUTSIDE THE STATE OF NEW JERSEY	<u>WATER AND WASTEWATER</u> DECISION AND ORDER DOCKET NO. WM98121465

(SERVICE LIST ATTACHED)

BY THE BOARD:

On December 24, 1998, Petitioners Maxim Sewerage Corporation (Maxim), a corporation of the State of New Jersey with its principle offices located in Union, New Jersey, and AquaSource Utility, Inc. (AquaSource), a wholly owned subsidiary of AquaSource, Inc. (which is in turn a wholly-owned subsidiary of DQE, Inc.) with their principal offices located in Houston, Texas filed a joint petition with the New Jersey Board of Public Utilities ("Board") requesting approval, pursuant to <u>N.J.S.A.</u> 48:2-51.1, of the transfer of all of Maxim's stock to AquaSource and for a waiver, pursuant to <u>N.J.S.A</u>. 48:3-7.8, to keep Maxim's books and records outside the State of New Jersey.

AquaSource provides water and wastewater service to customers in portions of seven states: Texas, Rhode Island, Indiana, Missouri, Connecticut, Florida and South Carolina. It currently provides potable drinking water to more than 100,000 customers in these seven states. It has invested or received corporate approval to invest over $300 million in 12 states.

DQE, Inc., the parent company of AquaSource, Inc., is a Pennsylvania based energy services company with assets of more than $4.6 billion and annual revenues in excess of $1.2 billion.

Maxim is a New Jersey corporation and a public utility subject to the Board's jurisdiction that operates a sewage collection and transmission system. Its system serves approximately 2,540 customers within its service territory. Maxim's wastewater service territory consists of a portion of Howell Township in Monmouth County, New Jersey. Maxim does not treat the wastewater. Treatment is provided by the Ocean County Utilities Authority.

AquaSource and Maxim have entered into a Stock Purchase Agreement (SPA) in the amount of $2,653,000 for the sale of Maxim's stock to AquaSource. Upon consummation of the transaction, the shareholders of Maxim will sell, and AquaSource will purchase, one hundred percent (100%) of the outstanding shares of Maxim. After the stock purchase, Maxim will become a wholly-owned subsidiary of AquaSource. Transaction costs to effectuate this stock purchase are currently estimated at $2,000 for accountant services. Other transaction charges have not been determined, and thus not supplied to the Board.

The transaction will result in a change of ownership of Maxim, but will not change the manner in which it provides wastewater service to its customers. The services currently being provided by Maxim will continue to be offered pursuant to Maxim's tariff on file with the Board. There will be no changes in rates, terms or conditions of service provided to customers.

The company has represented that there will be no immediate change in employees. Maxim currently has eight employees. Petitioners reserve the right to reassess staffing needs in the future.

In addition, Maxim's books and records will initially be maintained in New Jersey, but Petitioners seek approval to transfer Maxim's books and records outside the State at a later time. Petitioners have agreed to pay any reasonable expenses or charges incurred by the Board for any investigation or examination of Maxim's books and records if the Board grants permission for Petitioners to keep the books and records outside the State.

The Board <u>FINDS</u> the stock purchase agreement is in accordance with <u>N.J.S.A.</u> 48:2-51.1. The proposed change in control will not adversely impact competition, rates, employment or the provision of safe, adequate and proper utility service at just and reasonable rates.

The Board <u>FINDS</u> the following:

1. <u>Impact on Competition:</u> The change in control will have no adverse impact on competition because Maxim Sewerage Corporation will continue to operate in its current franchise territory, subject to the continuing jurisdiction of the Board, and under the same market conditions as presently exist.

2. Effect on Customer Rates: The rates, rules, regulations, and terms and conditions of service in effect on the date of closing will not change as a result of the change in control. Maxim will continue to operate under its existing Board approved tariff and continue to be subject to the jurisdiction of this Board.

3. Effect on Employees: Maxim currently has eight employees. AquaSource does not intend any staffing changes in the immediate future.

4. Effect on Service: The change in control will not affect the ability of Maxim to provide safe, adequate and proper service, nor will it in any way affect the Board's continuing jurisdiction over rates and service.

Finally, the Board notes that while AquaSource is not seeking, nor has it requested, ratemaking treatment of the acquisition for this stock purchase at this time, the Board NOTICES AquaSource of its acquisition policy set forth in I/M/O Petition of New Jersey-American Water Company for an Increase in Rates for Water and Sewer Service and Other Tariff Modifications at BPU Docket No. WR98010015 and OAL Docket No. PUC 699-98S, issued April 6, 1999. In that Order, the Board stated:

> The Board NOTICES the water and wastewater industry that, in the future, the Board expects proposed acquisitions and contemplated acquisition adjustments, supported by two independent appraisals, to be submitted for Board approval prior to finalization of the acquisition agreement, and that, in the absence of a timely submittal, the acquiring company proceeds at its own risk with respect to rate treatment of those acquisitions and acquisition adjustments. The Board further DIRECTS that individual notice be given to members of the regulated water/wastewater industry of this Board policy.

Accordingly, the Board HEREBY APPROVES the joint petition of AquaSource Utility, Inc. and Maxim Sewerage Corporation for the stock purchase of Maxim by AquaSource with the following conditions:

(1) Petitioners shall not recover from utility customers any transaction costs related to this stock acquisition.

(2) Petitioners' request for a waiver to maintain Maxim's books and records outside the State of New Jersey is HEREBY GRANTED provided that Petitioners shall pay any costs associated with any future review or audit by staff. N.J.S.A. 48:3-7.8 states that, notwithstanding the waiver, upon notice, the books, records, accounts, documents and other writings shall be provided for Board review within this State at a time and place as the Board may designate.

(3) Petitioners shall at all times continue to maintain Maxim's books and records in accordance with the Board approved Uniform System of Accounts or as otherwise prescribed by the Board.

DATED: April 28, 1999

BOARD OF PUBLIC UTILITIES
BY:

HERBERT H. TATE
PRESIDENT

CARMEN J. ARMENTI
COMMISSIONER

FREDERICK F. BUTLER
COMMISSIONER

ATTEST:
MARK W. MUSSER
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities

DOCKET NO. WM98121465

AQUASOURCE UTILITY, INC.
AND MAXIM SEWERAGE CORPORATION
BPU DOCKET NO. WM98121465

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Dante Mugrace
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Division of Water & Wastewater
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Two Gateway Center
Newark, NJ 07102

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of AMFAC PROPERTY INVESTMENT, CORP., KAANAPALI WATER CORPORATION, and AQUASOURCE UTILITY, INC. Requesting Approval of the Sale of the Stock of Kaanapali Water Corporation by AMFAC Property Investment Corp. to AquaSource Utility, Inc., Pursuant to Hawaii Revised Statute, § 269-17.5.	DOCKET NO. 99-0056

DECISION AND ORDER NO. 16993

Filed May 21, 1999
At 9:45 o'clock A .M.

Karon Higashi
Chief Clerk of the Commission

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities Commission, State of Hawaii.
K. Higashi
MAY 21 1999

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of) AMFAC PROPERTY INVESTMENT, CORP., KAANAPALI WATER CORPORATION, and AQUASOURCE UTILITY, INC. Requesting Approval of the Sale of the Stock of Kaanapali Water Corporation by AMFAC Property Investment Corp. to AquaSource Utility, Inc., Pursuant to Hawaii Revised Statute, § 269-17.5.	Docket No. 99-0056 Decision and Order No. 16993

DECISION AND ORDER

I.

By an application filed on March 9, 1999, AMFAC PROPERTY INVESTMENT CORP., (Amfac), KAANAPALI WATER CORPORATION (KWC), and AQUASOURCE UTILITY, INC. (AquaSource) (collectively, Applicants), request that we approve Amfac's sale of all of the outstanding stock of KWC to AquaSource. Applicants' request is made pursuant to Hawaii Revised Statutes (HRS) § 269-17.5 and Hawaii Administrative Rules (HAR), title 6, chapter 61, subchapter 10.

Applicants served a copy of the application on the Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs (Consumer Advocate). On April 6, 1999, the Consumer Advocate served information requests (IRs) on Applicants. Applicants filed responses to the IRs on April 22, 1999. On May 11, 1999, the Consumer Advocate filed a statement of position informing us that it does not object to our approval of the transaction described in the application.

II.

KWC is a Hawaii corporation and a subsidiary of Amfac. Its principal offices are in Honolulu, Hawaii. KWC is a public utility, authorized to provide water service in the Kaanapali area of Maui, Hawaii. It has a customer base of six hotels having a total of 21 meters, eight condominium projects having a total of 42 meters, 344 single-family connections, 11 commercial connections, and 74 other connections. It has six employees. Amfac is a Hawaii corporation with principal offices in Honolulu, Hawaii. It is the sole shareholder of KWC.

AquaSource is a Texas corporation with principal offices in Houston, Texas and is a subsidiary of AquaSource, Inc. It owns 64 water, wastewater, and service-related companies serving approximately 316,245 "living unit equivalents"[1] in ten states.[2] AquaSource's affiliates own design-build companies, system leasing and fabrication businesses, and contract operation services.

AquaSource, Inc. is a subsidiary of DQE, Inc. DQE, Inc. is a Pennsylvania based services company and the parent of Duquesne Light Company. As of December 31, 1997, DQE, Inc. reported assets of more than $4.6 billion and annual revenue in excess of $1.2 billion. It serves approximately 600,000 customers and has 2,670 megawatts of generation capacity.

[1] A "living unit equivalent" is the total gallons consumed by non-residential customers (hotels, condominiums, commercial connections, etc.) divided by the monthly average residential customer usage, divided by 12 months and added to the residential customer base.

[2] Connecticut, Florida, Indiana, Massachusetts, Missouri, Rhode Island, Texas, New York, South Carolina, and Colorado.

On February 12, 1999, Amfac and AquaSource entered into a Stock Purchase Agreement (Agreement). Pursuant to the Agreement, AquaSource will purchase all of the outstanding stock of KWC for approximately $5,500,000 in cash.

Amfac is selling KWC because it needs to raise cash to meet debt obligations due in June 1999. AquaSource is purchasing KWC because it and its direct and indirect parent companies are in the business of owning, operating, designing, building, and leasing water and wastewater systems. AquaSource's ownership of KWC permits these companies to establish a presence in Hawaii.[3]

Applicants maintain that the acquisition will have little discernable effect on KWC's operations and ratepayers. AquaSource intends to retain all of KWC's full-time employees, including KWC's current operations manager. It asserts that rates will remain at current levels for the next several years. The company expects to realize cost savings through the consolidation of administrative functions and upgrading its record keeping and billing systems.

III.

HRS § 269-17.5 requires a foreign corporation to obtain our consent prior to obtaining more than 25 per cent of the issued and outstanding voting stock of a Hawaii corporation that owns, controls, operates, or manages any plant or equipment as a public

---

[3]Since 1997, AquaSource, Inc. has acquired more than 60 water/wastewater utilities in Texas, Florida, South Carolina, and New York.

utility.[4] AquaSource is a foreign corporation and, therefore, its purchase of all of the shares of KWC requires our approval.

Upon review of this docket, we find that AcquaSource is fit, willing, and able to assume KWC's operations and that its acquisition of KWC is not contrary to the public interest. We acknowledge that its parent, AquaSource, Inc., and its ultimate parent, DQE, Inc., are substantial companies, which are capable of supporting AquaSource in the operation of KWC. Therefore, we conclude that AquaSource's acquisition of KWC, as described in the application, should be approved upon the conditions discussed below.

---

[4]HRS § 269-17.5(c) provides:

> No more than twenty-five percent of the issued and outstanding voting stock of a corporation organized under the laws of the State and who owns, controls, operates, or manages any plant or equipment, or any part thereof, as a public utility within the definition set forth in section 269-1 shall be held, whether directly or indirectly, by a single foreign corporation or any single nonresident alien, or held by any person, unless prior written approval is obtained from the public utilities commission, or unless a transaction is exempt. An exempt transaction is:
>
> (1) Any purchase or sale by an underwriter; or
>
> (2) A transaction to acquire shares of a corporation with less than one hundred shareholders and less than $1,000,000 in assets.
>
> Every assignment, transfer, contract, or agreement for assignment or transfer of any shares in violation of this section shall be void and of no effect; and no such transfer shall be made on the books of the corporation. Nothing herein shall be construed to make illegal the holding of stock lawfully held, directly or in directly, prior to June 4, 1977.

Although we conclude that the acquisition should be approved, we acknowledge that the Consumer Advocate has raised legitimate concerns regarding (1) affiliated company transactions and inter-company allocations and (2) the recovery of any acquisition premium and costs related to the acquisition.

With respect to affiliated company transactions, we expect AquaSource to comply with HRS § 269-19.5, where applicable. We further expect the company to support the basis for inter-company cost allocations in any request for a change in rates.

With respect to an acquisition premium and acquisition costs, we note that AquaSource claims there is no premium and that it will not pass on any acquisition costs to KWC's ratepayers. We also note the company asserts that, should an acquisition premium materialize, it may seek recovery upon a showing that, over the long term, its ownership of KWC resulted in rates that are lower than rates would have been under Amfac's ownership. We have traditionally disallowed the recovery of any acquisition premium and have not permitted recovery of acquisition costs. Therefore, we will require Applicants to record all costs directly or indirectly related to the acquisition and any acquisition premium in "below-the-line" accounts and will further require Applicants to continue this separate recording of costs until the next KWC rate case.

IV.

THE COMMISSION ORDERS:

1. AquaSource's acquisition of KWC's stock from Amfac, as described in the application, is approved.

2. Applicants will not recover any acquisition premium or any direct or indirect acquisition costs from KWC's ratepayers, and will record all costs directly or indirectly related to the acquisition and any acquisition premium in "below-the-line" accounts until KWC's next rate case.

DONE at Honolulu, Hawaii this 21st day of May, 1999.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By ____________________
Dennis R. Yamada, Chairman

By ____________________
Rae M. Loui, Commissioner

By ____________________
Gregory G.Y. Pai, Commissioner

APPROVED AS TO FORM:

____
Danise C.H. Nip
Commission Counsel

98-0056.ad

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 16993 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

AMFAC PROPERTY INVESTMENT CORP.
Attn: Chet Richardson, Vice President
P.O. Box 3230
Honolulu, HI 96801

KAANAPALI WATER CORPORATION
Attn: Chet Richardson, Vice President
P.O. Box 3230
Honolulu, HI 96801

AQUASOURCE UTILITY, INC.
Attn: Michael Ashfield
16810 Barker Springs, Suite B215
Houston, TX 77084

ALAN M. OSHIMA, ESQ.
MICHAEL H.Q.L. LAU, ESQ.
OSHIMA, CHUN, FONG & CHUNG
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J. DOUGLAS ING, ESQ.
PAMELA J. LARSON, ESQ.
WATANABE, ING & KAWASHIMA
First Hawaiian Center, 23rd Floor
999 Bishop Street
Honolulu, HI 96813

Catherine Sakato
Catherine Sakato

DATED: May 21, 1999

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

September 24, 1999

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Patrick T. Schmidt
Attorneys for AquaSource Utility, Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

RE: Case No. 99-303

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

Stephanie J. Bell

Stephanie Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

O R D E R

On September 15, 1999, AquaSource Utility filed a letter with the Commission requesting an informal conference with Commission Staff to discuss the issues relating to its application for transfer of ownership rights of Goshen Utilities. AquaSource Utility included in the letter an agreement to grant the Commission an extension of 30 days from October 7, 1999 in which to render a decision in this case.

The Commission, having considered the letter and being otherwise sufficiently advised, finds that an informal conference should be held between the Commission Staff and AquaSource Utility to discuss the issues contained in the petition. It further finds that AquaSource Utility has agreed to extend the time period for a decision on this petition for 30 days from October 7, 1999.

IT IS THEREFORE ORDERED that:

1. An informal conference shall be held September 30, 1999 at 1:00 p.m., Eastern Daylight Time, in Hearing Room 2 of the Commission's offices at 677 Comanche Trail, Frankfort, Kentucky.

2. The time in which the Commission is to render a decision in this case shall be extended to November 5, 1999.

Done at Frankfort, Kentucky, this 24th day of September, 1999.

By the Commission

ATTEST:

Helen C. Helton

Executive Director

TILFORD, DOBBINS, ALEXANDER,
BUCKAWAY & BLACK, LLP

ATTORNEYS AT LAW

1400 ONE RIVERFRONT PLAZA
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PATRICK T. SCHMIDT
JOHN T. EVANS[5]
DANA M. TAYLOR

CAROLYN K. BALLEISEN*[2]
RANDOLPH NOE*[1]
MICHAEL G. KAREM*[4]
* Of Counsel

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PHONE: (812) 738-2100

[1]Also admitted in Indiana
[2]Also admitted in New York
[3]Also admitted in District of Columbia and Maryland
[4]Also admitted in District of Columbia
[5]Also admitted in Florida and Indiana
[6]Also admitted in Georgia and Illinois
[7]Also admitted in South Carolina

RECEIVED
SEP 20 1999
PUBLIC SERVICE COMMISSION

September 15, 1999

RECEIVED
SEP 20 1999
GENERAL COUNSEL

Anita Mitchell
Commonwealth of Kentucky
Public Service Commission
730 Schenkel Lane
Frankfort, Kentucky 40602

RE: AquaSource Utility' s Petition for Transfer of Control of Goshen Utilities, Case No. 99-303

Dear Ms. Mitchell:

Please accept this letter as a request for an informal conference with the PSC to discuss AquaSource Utility's Petition for the Transfer of Ownership Rights of Goshen Utilities, Inc. We propose having this conference on one of the following dates: September 28, 29, 30 or October 1, 1999. AquaSource Utility agrees to grant the Commission a thirty-day extension to their statutory deadline of October 7, 1999. The Commission will now have until November 7, 1999 to respond to our Petition.

I talked to Bill Pfrommer of AquaSource today and he asked if you could fax him an agenda for this conference and the issues that the PSC would like to discuss. He wants to be sure to bring all relevant information and personnel to this conference so that AquaSource can fully answer the Commission's questions and fully comply with their requests. His fax number is 412-393-3610. If you would prefer to discuss this with him personally, his direct line is 412-393-3623.

Thank you for your help and I look forward to hearing from you soon.

Sincerely,

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.

FAX

TILFORD, DOBBINS, ALEXANDER, BUCKAWAY & BLACK, LLP

ATTORNEYS AT LAW
1400 ONE RIVERFRONT PLAZA
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[7]Also admitted in South Carolina

September 15, 1999

RECEIVED
SEP 16 1999
PUBLIC SERVICE COMMISSION

Anita Mitchell
Commonwealth of Kentucky
Public Service Commission
730 Schenkel Lane
Frankfort, Kentucky 40602

RE: AquaSource Utility's Petition for Transfer of Control of Goshen Utilities, Case No. 99-303

Dear Ms. Mitchell:

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I talked to Bill Pfrommer of AquaSource today and he asked if you could fax him an agenda for this conference and the issues that the PSC would like to discuss. He wants to be sure to bring all relevant information and personnel to this conference so that AquaSource can fully answer the Commission's questions and fully comply with their requests. His fax number is 412-393-3610. If you would prefer to discuss this with him personally, his direct line is 412-393-3623.

Thank you for your help and I look forward to hearing from you soon.

Sincerely,

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

AUG 3 0 1999

PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

AMENDED PETITION FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.

Comes now, AquaSource Utility, Inc., by counsel, for its Amended Petition for the Commission and respectfully requests an Order pursuant to KRS 278.020 (4) and (5) and 807 KAR 5:001, Section 8 granting approval of the transfer of all stock in Goshen Utilities, Inc. by the present owners of that stock.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED
AUG 30 1999
PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

AMENDED PETITION FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.

Comes now, AquaSource Utility, Inc., by counsel, for its Amended Petition for the Commission and respectfully requests an Order pursuant to KRS 278.020 (4) and (5) and 807 KAR 5:001, Section 8 granting approval of the transfer of all stock in Goshen Utilities, Inc. by the present owners of that stock.

The Petitioner provides the following information in response to the Commission's Order dated August 12, 1999 and to supplement its Petition heretofore filed with the Commission. The Petitioner is providing names of witnesses that are, at the time of this filing, the best source for the information provided. However, should the need arise, the Petitioner may change the witnesses listed below.

Question 1 **Provide a copy of Goshen Utilities, Inc.'s ("Goshen Utilities") 1998 balance sheet, income statement, statement of retained earnings, and cash flow statement. The statements should be provided separately for the water and sewer divisions.**

Witness: James A. Lahtinen

Company's Response

AquaSource Utility, Inc. ("ASI") used the financial data provided in Goshen Utilities, Inc. ("Goshen") 1997 annual reports to the Public Service Commission of the Commonwealth of Kentucky as part of its evaluation of the acquisition of Goshen. Separate financial data for water and sewer systems is available to the extent it is identified in the annual reports.

Question 2 **Provide a copy of AquaSource Utility's 1998 balance sheet, income statement, statement of retained earnings, and cash flow statement.**

Witness: James A. Lahtinen

Company's Response

Financials for AquaSource Utility are not stated separately. AquaSource Utility reports its financials on a consolidated basis as part of AquaSource, Inc. AquaSource, Inc. reports its financials on a consolidated basis as part of DQE.

Question 3 **Provide the journal entries AquaSource Utility will record to reflect the purchase of Goshen Utilities' water division.**

Witness: James A. Lahtinen

Company's Response

AquaSource will record the investment in Goshen's stock as a charge to the investment account and a credit to cash at the purchase price of $3,550,000 plus the net working capital adjustment at the closing date. The net working capital adjustment (balance of current assets less the balance of current liabilities) is defined in the Stock Purchase Agreement. This entry will not differentiate between water and sewer operations.

Question 4 **Provide the journal entries AquaSource Utility will record to reflect the purchase of Goshen Utilities' sewer division.**

Witness: James A. Lahtinen

Company's Response

Please refer to the response to Question 3.

Question 5 **Provide the journal entries AquaSource Utility will record on Goshen Utilities' books to reflect the purchase of Goshen Utilities' stock.**

Witness: James A. Lahtinen

Company's Response AquaSource proposes to record the acquisition adjustment on the books of Goshen by charging the acquisition adjustment with an offsetting credit to equity (paid in capital).

Question 6 **Provide copies of AquaSource Utility's and Goshen Utilities' balance sheets reflecting the purchase of Goshen Utilities' stock.**

Witness: James A. Lahtinen

Company's Response Please refer to the response to Questions 3, 4, 5 and 13C.

Question 7 **AquaSource Utility is requesting, among other things, that the Commission approve its purchase of Goshen Utilities' stock, "an acquisition adjustment for accounting and future rate-making purposes" and amortizing the plant acquisition adjustment over a 15-year period. Relative to these requests, provide the following:**

A. Relative to AquaSource Utility's purchases which have included acquisition adjustments in other states, provide a chart showing:

1) The utility acquired, the state in which it operates, and if its operations are water, wastewater, or both.

2) Whether the purchase was a stock transfer or asset transfer.

3) The amount of any acquisition adjustment recorded.

4) The amortization period approved by the commission. If the commission did not approve an amortization period, so state.

5) The embedded cost per customer.

6) Copies of any jurisdictional approvals AquaSource Utility was required to obtain in the acquisitions.

7) The net book value of the utility acquired.

Witness: James A. Lahtinen

Company's Response

AquaSource has not received an order that explicitly allows for rate base treatment of the acquisition adjustment. While ASI is negotiating with other regulatory commissions for such treatment, no such adjustment for current or future rate making has been allowed.

ASI has filed numerous petitions to transfer ownership. Each has stated explicitly that ASI has no plans to file for an increase in base utility rates for the next several years, absent extraordinary expenses (e.g. unforeseen requirements imposed by a regulatory agency, changes in taxes, acts of God, etc.). ASI would seek to hold rates at current levels through the rate freeze period while working to recover its investment through O&M cost savings associated with economies of scale, during which the company would amortize the purchase price premium. In the event that circumstances change and ASI is forced to file for a change in base rates, the Company would seek to recover any unamortized acquisition adjustment through an adjustment to rate base or under an alternative rate-making plan. ASI believes that rate base treatment and amortization of the acquisition adjustment as part of the cost of service is reasonable where it can be shown that rates over the long term are lower than they otherwise would have been under current ownership.

As ASI is concerned with recovering its investment, the Company prefers to address the issue of acquisition adjustments now during the request for transfer of ownership rather than defer to a future proceeding. Accordingly, the Company is willing to consider alternative rate making proposals that provide a reasonable opportunity to allow the Company recovery of and on its investment while not burdening ratepayers.

A. Have other regulatory commissions generally allowed AquaSource Utility to record an acquisition adjustment for a stock purchase, as opposed to an asset purchase?

Witness: James A. Lahtinen

Company's Response

Please refer to the response to Question 7A.

B. Have other regulatory commissions generally allowed AquaSource Utility an acquisition adjustment for future ratemaking purposes prior to the filing of a rate case? If so, did those approvals include settlement agreements containing multi-year rate freezes and/or rate cap plans?

Witness: James A. Lahtinen

Company's
Response Please refer to the response to Question 7A.

C. The Commission is aware that AquaSource Utility has purchased small water utilities in New York and has agreed to multi-year rate freezes and subsequent rate cap guarantees for those utilities. In this instance, AquaSource Utility is proposing a rate freeze through the end of 2000 (17 months) and no explicit rate guarantees beyond then. Is AquaSource Utility willing to extend the rate freeze period beyond 2000 and/or agree to some type of rate cap plan subsequent to the end of that year?

Witness: James A. Lahtinen

Company's
Response The Company is willing to work with the Staff toward arriving at a mutually acceptable settlement on rates and the disposition of the acquisition premium. The goal of such a plan would enable ASI to allow for the recovery of and on its investment and provide tangible benefits to rate payers in the form of rates lower than they might otherwise have been under current ownership.

Question 8 **In Case No. 9059, the Commission determined that, the burden of proof is upon the utility to justify its investment at the price in excess of the net original cost based on economic and quality of service criteria. To meet this burden of proof, the Commission established the criteria a utility must meet in order to recover any investment in excess of the net original cost ("plant acquisition adjustment"). Provide evidence to show that AquaSource Utility's proposed purchase of Goshen Utilities meet the following criteria:**

A. The purchase price was established upon arms-length negotiation.

Witness: James A. Lahtinen

Company's
Response The purchase price ASI will pay for Goshen is "arms-length" because: a) ASI has no prior or past affiliation with Goshen or any of its principal employees or shareholders; b) ASI mailed a letter of intent to Goshen and negotiated the potential transaction; and c) the shareholders approved the sale to ASI. ASI would not have been selected as the buyer under these circumstances unless it had made a competitive arms-length offer to purchase Goshen stock.

B. The initial investment, plus the cost of restoring the facilities to required standards, will not adversely impact the overall costs and rates of the existing and new customers.

Witness: James A. Lahtinen

Company's Response

ASI expects that its projected investment for near term capital improvements would be incurred regardless of the owners of the system. Thus there is no adverse impact in overall costs as a result of the acquisition. ASI has also committed to a rate freeze through the end of 2000 and possibly longer if O&M savings are greater than anticipated, absent unforeseen capital expenditures.

C. Operational economies can be achieved through the acquisition.

Witness: James A. Lahtinen

Company's Response

ASI projects cost savings through operational efficiencies in areas such as professional fees, insurance, and office operations. Over time, additional savings are anticipated through regionalized operations. Please refer to the response to Question 16C for more detailed information.

D. The purchase price of utility and non-utility property can be clearly identified.

Witness: James A. Lahtinen

Company's Response

In evaluating and negotiating a purchase price for Goshen, AquaSource attributed zero value to a dam owned by the current owners. While this dam is understood to be part of utility assets, it is not included as a component of Goshen's rate base.

E. The purchase price will result in overall benefits in the financial and service aspects of the utility's operations.

Witness: James A. Lahtinen

Company's Response

AquaSource and AquaSource's parent, DQE, have the financial backing and access to financial markets to attract capital at lower costs than otherwise achievable by a smaller company. AquaSource, the immediate parent of ASI, has assembled a skilled, experienced staff to manage its regulated utilities as well as its other operations. DQE's extensive experience in utility operations, maintenance, and customer service renders it well suited to support AquaSource's mission. These resources and experience demonstrate AquaSource's commitment to ensure high levels of customer satisfaction, comply more efficiently and more expeditiously with federal and state requirements, and support future growth in the region.

Question 9 **Will AquaSource Utility issue any form of evidence of indebtedness or stock to fund its proposed purchase of Goshen Utilities?**

Witness: James A. Lahtinen

Company's Response

No. This transaction as will be a cash purchase.

Question 10 **Provide the embedded cost per customer of Goshen Utilities' sewer division to AquaSource Utility, including the plant acquisition adjustment.**

Witness: James A. Lahtinen

Company's Response

In a conversation on August 25, 1999 with Staff, it is AquaSource's understanding that Staff defines embedded cost as the net plant invested to serve a customer. Specifically, gross plant in service less accumulated depreciation less the customer contributions in aid of construction (CIAC).

ASI's purchase price is \$3,550,000. A simple estimate of the acquisition adjustment is the purchase price less net plant less CIAC. (Please refer to the response to Question 13C for additional calculations). Thus, the embedded cost per customer would be the purchase price divided by the total number of customers. Absent an audit of the books and records of Goshen, the following table provides the calculations to estimate the embedded cost per customer using the financials and customer counts stated in the 1998 annual reports.

	Water and Sewer Combined
Gross Plant	3,988,827
Less Depreciation	(1,696,003)
Plant Less Depreciation	2,292,824

Less CIAC	(2,453,284)
Net Plant	(160,460)
Estimated Acquisition Adjustment – Purchase Price Less Net Plant	\$3,710,460
Embedded Cost Including Acquisition Adjustment	\$3,550,000
Total Customers – Water and Sewer Combined	2901
Average Embedded Cost	\$1224/Customer

Question 11 **Provide the embedded cost per customer of Goshen Utilities' water division to AquaSource Utility, including the plant acquisition adjustment.**

Witness: James A. Lahtinen

Company's Response: Please refer to the response to Question 10.

Question 12 **Is AquaSource Utility aware of any jurisdictions in which it currently has no operations that allow the recovery of a plant acquisition adjustment when a utility is acquired in a stock purchase? If yes, provide copies of the orders granting the approval.**

Witness: James A. Lahtinen

Company's Response: Attached as Exhibits A through C are copies of the following orders where rate base and cost of service treatment of a plant acquisition adjustment were allowed.

A. Reorganization of Public Service Company of New Hampshire, DR 89-244, Order No. 19,889
B. Louisiana Public Service Commission re Louisiana Power and Light 65 PUR (NS) 23 (La. 1946) Docket No. 4271, Order No. 4346
C. Tennessee Public Service Commission re United Inter-Mountain Tel. Co. 79 PUR 3rd 499 (Tenn. 1969) Docket No. U-5175

Question 13 **In paragraph 10 of its application AquaSource Utility stated that, "The purchase price will be compared to the book value of Goshen when the**

transaction is consummated with the difference reflected as an acquisition adjustment on the books and records of ASI and Goshen Utilities."

A. Explain how the purchase of Goshen Utilities' stock would impact Goshen Utilities books and records.

Witness: James A. Lahtinen

Company's Response: Please refer to the response to Question 5.

B. Should AquaSource Utility's stock purchase be recorded as an investment and, therefore, the stock purchase would not impact the value of Goshen Utilities' utility plant.

Witness: James A. Lahtinen

Company's Response: Please refer to the response to Questions 3 and 5.

C. Explain why AquaSource Utility is comparing the book value of Goshen Utilities to the stock purchase price, rather than Goshen Utilities' existing stock value.

Witness: James A. Lahtinen

Company's Response: First, the purchase of stock is an arms length transaction. Therefore, the purchase price is at the fair value of the stock and also the underlying fair value of Goshen's assets. Acquisition adjustments are defined as the difference between the purchase price of an operating system or unit and the net book value (original cost less accumulated depreciation and unamortized contributions in aid of construction). As stated in the answer to Question 3, the purchase price is $3,550,000 plus the balance of current assets less current liabilities at the closing date. The following table shows two ways to calculate the acquisition adjustment using year-end 1998 financials. Note that the actual purchase price represents a purchase of the net working capital at settlement date (current assets less current liabilities) plus the $3,550,000, which is essentially the purchase price of the operating system. Note that in the calculations below, the acquisition adjustment equals the acquisition premium.

Method 1

Purchase Price of Net Utility Plant	$3,550,000
Current Assets	424,615
Less Current Liabilities	(294,615)
Adjusted Price	3,680,000
Less Long Term and Other Liabilities	(5,988)
Market Equity-Actual Purchase Price	3,674,012
Book Equity	(36,448)
Acquisition Premium	$3,710,460

Method 2

Purchase Price of Net Utility Plant	$3,550,000
Net Plant	2,292,824
Less Contributions In Aid of Construction	(2,453,284)
Net Book Value	(160,460)
Acquisition Adjustment	$3,710,460

Question 14 **AquaSource Utility intends to record the utility plant acquisition adjustment on its books as an asset, but include the unamortized balance in Goshen Utilities' rate base. Explain how an asset recorded on the books of the Parent Corporation, AquaSource Utility, will be recovered in the rate base of its subsidiary, Goshen Utilities.**

Witness: James A. Lahtinen

Company's Response: Please refer to the response to Question 5.

Question 15 **Goshen Utilities has separate water and sewer divisions. Does AquaSource Utility intend to maintain the water and sewer operations in separate divisions?**

Witness: William Reynolds

Company's Response: Water and wastewater operations will be provided by AquaSource Service and Technology, Inc.

Question 16 The following questions relate to paragraph 9 of the application:

A. Provide a detailed description of the immediate repairs ($50,000) that AquaSource Utility intends to make to Goshen Utilities' system.

Witness: William Reynolds

Company's Response AquaSource estimates capital expenditures as follows:

Sand-blast and paint a ground storage tank	$25,000
Construct a chlorination building	10,000
Replace a mechanical aerator	12,000
Replace an effluent monitoring unit	3,000
Total	$50,000

B. AquaSource Utility anticipates that it will spend $3 million to $5 million over the next 5 years should the need of Goshen Utilities require such expenditure. Provide a detailed description, including the time line, for AquaSource Utility's anticipated expenditures.

Witness: William Reynolds

Company's Response The $3 million to $5 million figure is an estimated range for a new regional sewage plant to serve the surrounding area of Goshen Utility in Oldham County. A detailed description and time line are not available at this time.

C. Provide a detailed analysis of AquaSource Utility's expected cost savings that will be achieved through greater efficiencies and economies. AquaSource Utility should provide separate analyses for the sewer and water divisions.

Witness: William Reynolds

Company's Response Over time and with the consolidation of services for AquaSource subsidiaries, cost savings will be realized. Typically, when purchasing new companies, ASI projects eventual savings in some or all of the following categories: professional fees, office salaries, insurance, interest charges and office operations (primarily in accounting and billing).

In evaluating the operating costs of Goshen, ASI expects cost savings for water and sewer operations as described in the following tables. These figures are based on the 1997 annual report for each system and only show the areas where cost savings are anticipated. Future cost savings beyond the most recent year as a result of consolidations are not provided.

Water	Current Owner O&M	Projected ASI O&M	Basis for Adjustment
Purchased water	29,044	0	Non-recurring expense
Purchased Power	49,338	25,000	Reduced system flushing as a result of refurbished well
Materials & Supplies	41,093	21,093	Elimination of charges for another company
Contractural Services	24,231	14,231	Reduction in accounting & legal expenses
Salaries - Employees	146,548	90,180	Reduction in the number of operators
Salaries – Officers	54,185	0	Positions eliminated
Employee Benefits	21,912	27,956	DQE benefits at 31% loader
O&M Expense	366,351	178,460	
Estimated Savings		187,891	

Sewer	Current Owner O&M	Projected ASI O&M	Basis for Adjustment
Admin. & General Salaries	64,820	0	Positions eliminated
Outside Services	24,113	14,113	Reduction in accounting & legal for rate case expenses
Employee Benefits	9453	13,312	DQE benefits at 31% loader
Rent	1977	0	Eliminate current office
O&M Expense	100,363	27,425	
Estimated Savings		72,398	

ASI also expects operating cost reductions in the following areas of water and sewer operations. However, since direct cost allocations for these expenses are not expected to be complete until the end of the year, projected ASI expenses are not provided.

Water	Current Owner O&M
Legal & Accounting	8471
Bad Debt Expense	145
Insurance – Vehicle	3896
Insurance – General	3438
Insurance – Worker's Comp	6965
Insurance – Other	2004
Advertising	85
Miscellaneous	1659
Total	26,663

Sewer	Current Owner O&M
Misc. Supplies and Expenses	1872
Misc. Customer Accounts	1365
Insurance	8105
Misc. General Expenses	94
Total	11,436

D. AquaSource Utility intends to use Goshen Utilities as "a platform for future growth in Kentucky." Provide a detailed narrative of AquaSource Utility's plans for future growth in Kentucky.

Witness: William Reynolds

Company's Response

AquaSource was formed specifically to acquire and operate water and wastewater utility systems throughout the country. AquaSource intends to increase operating efficiencies and provide better service than smaller systems can afford through regionalized operations. Strategically, these operating efficiencies and improved service levels are more achievable, and sustainable, if acquisitions are concentrated in a particular area within each state, and expanded from there.

By example, Goshen is located in close proximity to the Louisville area. AquaSource can achieve efficiencies with existing operations. Through additional acquisitions targeted in areas surrounding the Louisville area, acquisition and regionalization of other water and/or wastewater systems will enable AquaSource to it's achieve its desired economies and ultimately a return on its investment.

AquaSource is ready to work with the Commonwealth of Kentucky in a public/private partnership to accomplish the goals of the Commonwealth and the Governor to provide safe, clean drinking water and environmentally sound wastewater services both at reasonable prices.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

DR 89-244

REORGANIZATION OF PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE

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O R D E R N O. 19,889

Based on the foregoing Report, which is made a part hereof, it is hereby

ORDERED, that NUSCO's requests for findings of facts, dated June 8, 1990, are consistent with the commission analysis in the foregoing report, are consistent with the public good, and are hereby granted; and

FURTHER ORDERED, that the requested approvals filed by NUSCO on June 8, 1990, are consistent with the commission analysis in the foregoing report, are consistent with the public good, and are hereby granted; and

FURTHER ORDERED, that, as set forth in the foregoing report, our approval of the Twenty Year Load and Resource Plan filed by NU pursuant to Section 3(d) of the agreement does not relieve NU from its obligation to implement least cost planning as specified by the commission, or limit, in any way, the right of the commission to set just and reasonable rates; and

FURTHER ORDERED, that NU/PSNH shall comply with all existing and any future least cost integrated planning or any other resource planning requirements of the commission; and

FURTHER ORDERED, that the requested findings of the State of New Hampshire for an Order Approving the Rate Agreement, filed on June 18, 1990, are consistent with the

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commission analysis in the foregoing report and are hereby approved with the exception of (1) the state's third requested finding of fact which asked the commission to accept the Annotated Rate Agreement and the accompanying glossary as the "authoritative reference guide to the rate agreement," which is denied insofar as the commission cannot ascribe the same weight to the annotations as is ascribed to the explicit wording of the agreement itself; and (2) the state's supplementary request for a finding of fact regarding NU's fees, expenses and obligations incurred prior to the first effective date which will be determined when NU files its detailed accounting of net book value and the acquisition premium; and

FURTHER ORDERED, that the Hydro Intervenors' requests for findings of facts are denied, for reasons set forth in the foregoing report and analysis, with the following three exceptions:

1. The Hydro Intervenors' Third Request for Finding of Fact that "NU does not assign the acquisition premium either to the Seabrook assets or to the non-Seabrook assets," is consistent with the record and with the foregoing report and analysis and is granted.

2. The Hydro Intervenors' First Request for Finding[1] is granted insofar as the record indicates that, from an investor's standpoint, the Rate Agreement, when considered as a whole, reflects in effect recovery $1.5 billion or the equivalent of slightly more than fifty percent of PSNH's

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[1] The Hydro Intervenors' First Request for Finding was: "in effect, implementation of the Rate Agreement will result in recovery of $1.5 billion, or slightly more than fifty percent, of PSNH's Seabrook investment of approximately $2.9 billion.

Seabrook investment. The request is denied in that the value assigned to Seabrook under the Rate Agreement is $700 million, not $1.5 billion. Treatment of the Acquisition Premium as part of the recovery of PSNH's Seabrook investment is not supported by the record, is inconsistent with the intent of the parties and would jeopardize the 5.5 percent rate projections set forth in the Rate Agreement.

3. Hydro Intervenors' Fourth Request for Findings of Fact, that the "$800 million 'acquisition premium' is not related to and not justified by the 'synergies' that NU claims will result from the acquisition of PSNH," is granted in that the acquisition premium was not calculated based on the aggregate savings attributable to synergies. This requested finding is denied insofar as it is inconsistent with the foregoing report and our finding that the savings attributable to the synergies are of paramount importance to the ability of the projected 5.5 percent annual rate increases to support $2.3 billion dollar cumulative value of PSNH; and

FURTHER ORDERED, that the Hydro Intervenors' First Request for a Ruling of Law[2] is granted for reasons cited in the foregoing report; and

FURTHER ORDERED, that the Hydro Intervenors' Second Request for a Ruling of Law[3] is denied for the reasons set forth in the foregoing report; and

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[2] The Hydro Intervenors' First Request for a Ruling of Law is that the "commission is required to employ some rational method and to identify fully and accurately its method for determining reasonable rates, including its calculation of rate base and rate of return.

[3] The Hydro Intervenors' Second Request for a Ruling of Law is: "...the statutory basis for calculation of rate base is 'the cost of the property of the utility used and useful so in the public service less accrued depreciation.' RSA 378:27, 28; Appeal of Public Service Company, 130 N.H. 748, 751 (1988)."

FURTHER ORDERED, that the Hydro Intervenors' Third Requested Ruling of Law provides that the special statute enacted by the Legislature that governs this case, RSA Ch. 362-C, does not supercede traditional rate-making principles under New Hampshire law, is granted in part and denied in part. It is granted to the extent that the commission can authorize said implementation of the Rate Agreement consistent with traditional rate-making principles under New Hampshire law. It is denied to the extent that implementation of the Rate Agreement is not possible under traditional rate-making principles under New Hampshire law, as may be the case in the application of the so-called anti-CWIP statute, RSA 378:30-a; and

FURTHER ORDERED, that pursuant to RSA 362-C:3, the commission hereby finds that the implementation of the agreement would be consistent with the public good and the levels of rates, fares or charges and the fuel and purchased power adjustment clause shall be placed into effect as appropriate in accordance with, and during the time period set forth in, the agreement; and

FURTHER ORDERED, that the commission findings above, granting various requested findings of fact and approvals by the parties, were made in the context of the commission analysis and interpretation set forth in the foregoing report and are not necessarily consistent with the position of the party making the request; and

By order of the Public Utilities Commission of New Hampshire this twentieth day of July, 1990.

John N. Nassikas
John N. Nassikas
Special Commissioner

Bruce B. Ellsworth
Bruce B. Ellsworth
Commissioner

Linda G. Bisson
Linda G. Bisson
Commissioner

Attested by:

Wynn E. Arnold
Wynn E. Arnold
Executive Director and Secretary

Louisiana Public Service Commission

v.

Louisiana Power & Light Company

Docket No. 4271, Order No. 4346
July 29, 1946

INVESTIGATION *of rates and practices of electric utility; revised rate schedules established.*

Return, § 9 — Fair value basis.

1. Use of the fair value theory in public utility rate making is not required in order to meet Federal or state requirements of due process, and no state statutes direct its use, p. 21.

Return, § 11 — Prudent investment basis.

2. The prudent investment theory in public utility rate making is permissible under Louisiana law and should be adopted, p. 21.

Valuation, § 69 — Prudent investment — Excess over original cost.

3. Money is prudently invested, even though it is in excess of the original cost of property purchased, if the excess was paid as the result of arm's-length bargaining between nonassociated buyer and seller, if it was necessary for integration of property into a larger and more efficient system, and if the purchase necessitating the excess did or reasonably should have resulted in public benefit by improvement of service or in lowered rates, p. 21.

Accounting, § 32 — Purchase price — Excess over original cost — Amortization.

4. The integration cost or excess of purchase price over original cost, termed in the prescribed system of accounts as Utility Plant Acquisition Adjustments, should remain a part of the prudent investment during the life of the physical property to which it was applied, and its extinguishment from investment when and if required by the Commission should be accomplished by amortization through annual charges to operating revenue deductions during the life of the property remaining after the date of the purchase which created the excess, p. 21.

Valuation, § 36 — Rate base determination — Prudent investment basis.

5. The rate base should be original cost of property in useful service, plus allowable Utility Plant Acquisition Adjustments not amortized, plus a reasonable allowance for materials and supplies and cash working capital, less the amount of capital secured from customers as contributions and construction advances, p. 21.

Return, § 24 — Reasonableness.

6. The allowable rate of return is such a percentage of the rate base as will yield enough money (after all reasonable operating expenses, main-

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tenance, taxes, annual retirement or depreciation appropriations and amortization of Utility Plant Acquisition Adjustments have been paid or set aside) to pay bond interest and sufficient dividends to maintain credit, attract new capital, reward good management, and enable the investor to recoup at any time the money he has prudently invested, p. 23.

Valuation, § 86 — Accrued depreciation — Prudent investment theory.

7. An undepreciated rate base should be used where return is allowed on the money prudently invested in property used and useful, since the investment still exists and the property is used and useful until the day it is removed from service, when it should be removed from the property account at original cost and the investor should receive the amount of his investment in this property from the reserve accumulated by charges to operating revenue, p. 23.

Depreciation, § 10 — Nature of annual charge.

8. The annual depreciation charge is an advance payment by the public to provide future return of investors' money when equipment which has been used up is retired from useful service; creation of a depreciation reserve is necessary to maintain the integrity of the investment and to distribute the cost evenly, p. 23.

Depreciation, § 32 — Sinking-fund basis.

9. Any sinking fund based on a fixed depreciation rate and fixed period of time would be unsatisfactory and subject to serious infirmities, owing to the fact that from time to time interest rates change and scientific progress changes the foreseeable useful life expectancy of material and equipment, p. 23.

Depreciation, § 32 — Straight-line basis.

10. Any fixed service life basis for straight-line annual depreciation would ignore the possibility and probability of technological changes which will have substantial bearing on length of useful life of material and equipment, p. 23.

Depreciation, § 39 — Annual charge — Size of reserve — Periodical revision.

11. Both the amount of the annual depreciation charge and the size of the depreciation reserve should be determined by the best judgment available, based on consideration of all factors involved, but both should be examined periodically by a consideration of all new facts and foreseeable changes in conditions and revisions should be made when their necessity is apparent, p. 23.

Depreciation, § 40 — Reserve — Ownership — Customers' interest.

12. Legal title to money collected from customers to cover depreciation and set aside in a reserve is in the utility, but the utility does not have unconditional unrestricted ownership but contributing customers have an equitable interest in this reserve and some of the elements of the trust apply; the customer is entitled to have this money used for his benefit until such time as it is actually required to reimburse the owners for investment extinguished by retirement of property from useful service, p. 23.

Depreciation, § 41 — Reserve — Income.

13. Interest earned by the invested depreciation reserve should be applied as a deduction from net operating revenue in computing the allowable return, as the customer is entitled to receive whatever interest can be earned by judicious use of the money, p. 23.

LOUISIANA PUBLIC SERVICE COMMISSION

Valuation, § 307 — Working capital — Electric utility.

14. A reasonable allowance for cash working capital of an electric utility was held to be approximately two months' operating expenses, p. 26.

Return, § 87 — Electric utility.

15. A rate of return of 6 per cent on the rate base of an electric utility was held to be fair, equitable, and adequate to compensate the owners and to attract the capital necessary to maintain the soundness of investment, p. 26.

Depreciation, § 41 — Reserve — Interest.

16. An interest rate of 5¼ per cent on money represented by the amount of retirement or depreciation reserve used in the utility's business was considered fair, p. 26.

By the COMMISSION: On December 14, 1945, the Louisiana Public Service Commission, on its own motion, started an investigation of the rates, charges, and practices for electric service in the state of Louisiana of all electric public utilities in the state subject to its jurisdiction by issuance of citation and an order to each utility to show cause why such investigation should not be made and to show cause why rates, charges, and practices should not be required to be changed and revised if found to be excessive or unreasonable and to show cause why such changes or revisions should not be made effective as of the date of the citation. In response to this citation and show cause order, the Louisiana Power & Light Company, hereinafter referred to as "Respondent" filed an answer and appeared at a formal hearing before the Commission in Baton Rouge, Louisiana, on January 15, 1946.

Respondent's answer conceded the authority of the Commission to make the investigation and to require revision of rates and practices if found to be excessive or unreasonable, and offered its books and records for examination and inspection, but entered an exception to the authority of the Commission to require any changes or modifications which would become effective before the issuance of a final order. The Commission reserved the ruling on this exception. Since this order does not require any changes or modifications of the Respondent's rates or practices to be made effective prior to the date of this order, the rights of the Respondent will not be harmed and a ruling on the question is pretermitted.

After preliminary conferences with officials of Respondent, the Commission sent members of its staff to New Orleans to make an investigation and examination of the books and records of Respondent, and to study its operations. This investigation and examination has been completed, the staff has compiled its working papers and has submitted its report and recommendations to the Commission. Officials and employees of Respondent have been coöperative and helpful during the examination and several meetings have been held between officials of Respondent and the Commission for the purpose of discussing the staff reports and for the purpose of reaching agreement upon stipulations to be entered in the record of this proceeding. Agreement between officials of

Respondent and members of the Commission's staff has been reached as to the reasonableness of conflicting estimates and several other questions of fact and the stipulations have been entered in the record. This proceeding as to Respondent is now ready for conclusion.

Before setting out our findings and order as to the Respondent, however, it is both desirable and necessary that this Commission give some consideration to general principles of public utility regulation and make some readjustment and realignment of its policies and practices. Setting out of these policies and practices as standards will benefit the Commission in carrying on its work in the future and will serve as a guide for the regulated utilities in their relations with the Commission.

Growth and development of the several types of utility business in Louisiana, change and realignment in the economic and financial organization of the public utility business and changes in the legal approach to the regulatory process have imposed added responsibility on this Commission which requires that the supervision and regulation of the utilities be made a more continuing and consistent process. The legislature has recognized the need for this increased continuity and consistency in utility regulation by providing for the setting up of an organization by the Commission to carry on this work.

[1-5] For many years the rule of Smyth v. Ames (1898) 169 US 466, 42 Led 819, 18 S Ct 418 required that regulatory Commissions must give consideration to three factors in making determinations in rate-making proceedings in order to comply with the due process provisions of the Federal Constitution. These three factors were original cost of the physical property used and useful in carrying on the service, the reproduction cost new as of the date of the proceeding and the amount of the capitalization of the utility corporation. The theory behind these requirements, as confirmed by the subsequent practice of requiring finding of reproduction cost new less accrued depreciation as the rate base, was that the owners of the utility were entitled to a fair return on the *current value of the property* used and useful in performing the public service. The *value* of the property was the thing required to be preserved in order to avoid a finding of confiscation by the courts.

Determination of the *positive aspects* of this *value*, requiring expensive and time consuming appraisals, almost endless controversy over guesses of present cost necessary to reproduce and install materials and equipment under imaginary conditions, together with the ever present arguments concerning overheads and intangibles become a burdensome, inconclusive, and unsatisfactory process. Also the determination of *negative aspects* of this value; namely, *depreciated condition or accrued depreciation* was no less complicated, expensive, and inconclusive.

In 1923 Mr. Justice Brandeis wrote his famous concurring opinion in the Southwestern Bell Telephone Company Case, and there launched his theory of "prudent investment" later further expounded and advocated in the O'Fallon and other cases, and thus made a beginning for a public utility regulatory process which would not be subject to the enormous expense, interminable delays, and final inconclusiveness of the old process. This theory contained the basic elements for the development of an approach to the problem of utility regulation which could be both expeditious from the standpoint of the regulatory body and also fair and equitable from the standpoint of both the rate-paying public and the utility investor and owner.

Fundamentally, the "prudent investment" theory was based on the two concepts that (1) the thing which is required to be protected in order to avoid confiscation under the Constitution is the *money invested* in used and useful property and not the ever changing and illusory *value of the property* and (2) that so long as the investor is allowed to earn a rate of return which will attract purchasers for his interest and allow him to sell his interest and *recoup his money invested*, there will not be any Constitutional confiscation. Naturally, these concepts were based upon the assumptions that the public interest in the public utility business is of sufficient importance and that the economic necessity for actual freedom from wasteful competition in the public utility business is sufficiently well-founded as to justify the elimination of the possibility of capital gain by increase of the *value of the investment*. But the theory also assumes that the investment is made freely and without compulsion, so that if the investor desires to put his money into some other business where there is the probability of capital increase, so long as the rate of return available is sufficient to attract purchasers for his interest, he cannot claim confiscation.

Although the Massachusetts version of "prudent investment" regulation of public utilities had been in use there for many years, this Brandeis "prudent investment" theory suffered many defeats at the hands of the courts during the succeeding years. But the acceptance of its validity and usefulness made some progress and finally, in 1944, the United States Supreme Court in the Hope Natural Gas Company Case (1944) 320 US 591, 88 Led 333, 51 PUR(NS) 193, 64 S Ct 281, laid the ghost of Smyth v. Ames, *supra*, to rest and left regulatory Commissions free to build the rate regulation process on "prudent investment," as far as the Federal Constitution is concerned. Commissions are left free to make pragmatic adjustments within the statutory (and judicial) ambit of their authority.

Although this Commission has in the past followed the "fair value" theory in rate-making proceedings, and although this process has been approved by the supreme court of this state, this approval was *required by* the former United States Supreme Court jurisprudence on *Federal due process*. Since there are no Louisiana decisions requiring use of the "fair value" theory in public utility rate making to meet *state requirements of due process*, and since there are no state statutes directing use of the "fair value" theory, it is the opinion of this Commission that the supreme court of Louisiana is free to allow the use of the "prudent investment" theory in public utility rate making by this Commission. Therefore, being desirous of simplifying the rate-making process by eliminating the necessity for and the use of the cumbersome, expensive, time-wasting, and inconclusive reproduction appraisals and studies used in the past, we herewith adopt the "prudent investment" theory of rate making for the public utilities and set out below our application of this theory.

The owners of a public utility are entitled to earn and receive a fair rate of return upon the money prudently invested in property used and useful in rendering public service. Money is prudently invested, even though it is in excess of the original cost of the property purchased, if the excess of purchase price over original cost was paid as the result of arm's-length bargaining between nonassociated buyer and seller, if the excess was necessary for the integration of the property into a larger and more efficient system, and if the purchase necessitating the excess did or reasonably should have resulted in public benefit by improvement of service to customers or in lowered rates or both better service and lowered rates. This integration cost or excess of purchase price over original cost termed in prescribed system of accounts as "Utility Plant Acquisition Adjustments" should remain a part of the prudent investment during the life of the physical property to which it was applied, and its extinguishment from the investment when and if required by the Commission, should be accomplished by amortization through annual charges to Operating Revenue Deductions during the life of the property remaining after the date of the purchase which created the excess.

The rate base to be used in determining a fair return shall be the total original cost of the property in useful service plus the allowable amount of Utility Plant Acquisition Adjustments not amortized through charges to Operating Revenue Deductions plus a reasonable allowance for materials and supplies and for cash working capital, less the amount of capital secured from customers as contributions and construction advances.

[6] The rate of return to be allowed shall be such a percentage of the rate base which will yield enough money after all reasonable operating expenses, maintenance, taxes, annual retirement, or depreciation appropriations and amortization of Utility Plant Acquisition Adjustments have been paid or set aside, to pay bond interest and sufficient stock dividends to maintain the credit of the utility, attract new capital, reward good management, and to enable the investor to recoup at any time the money he has prudently invested. The rate of return is a question to be determined in each individual case from evidence as to efficiency of the operation of the subject utility, market prices, and ratio of earnings to market value of the stocks and bonds of similar enterprises operating under similar conditions, and any other relevant facts.

Few questions of the reasonableness of operating expenses and taxes will arise as the matter is rather well-settled by both customary utility practice and also by the requirements of applicable systems of accounts. Therefore, no extended discussion of this matter is required.

[7–13] The next factor for consideration is depreciation. Much has been written about this subject and much time and expense has been devoted to determining accrued or observed depreciation in past rate proceedings, and tremendous engineering and accounting efforts have sought to show that loss of service life is an evenly proceeding process and can be accounted for exactly and scientifically. It seems to us that this entire process, although theoretically desirable, is unrealistic, and is overstressed and unduly complicated by too great a desire for mathematical exactness and certainty. Also the current approach to the problem of depreciation seems to be a hangover of the old "fair value" process. As mentioned before, the "depreciated condition," "accrued depreciation" or the "observed depreciation" under the old Smyth v. Ames, *supra*, doctrine was merely a *negative* aspect of *value* used as a deduction in determining the rate base. It seems reasonable and consistent that if "fair value" is to be abandoned, then it necessarily follows that *all* of the process would be abandoned and the hybrid concept of depreciation handling should be brought up to date.

As stated above, the owners of a public utility are entitled to earn and receive a fair rate of return upon the money prudently invested in property used and useful in rendering public service. This means that investment still exists and the property is used and useful until the day it is removed from service when it should be removed from the property account at original cost and the investor should receive the amount of his investment in this piece of property back from the reserve which has been previously accumulated by charges to operating revenue. This is the so-called "undepreciated rate base."

Under this theory and procedure the annual depreciation charge and the depreciation reserve are the two parts of a method which has as its purpose (1) the providing of sufficient money (2) from charges to the public, which will be adequate to always reimburse the investor as property is retired. The two requirements applicable to the annual charge for depreciation are (1) that the annual amount be sufficient to create and maintain a reserve which will be adequate for any foreseeable retirement, and (2) that the annual amount set aside be as nearly uniform as practicable in order to distribute the charge equitably and without discrimination between users of the service. In addition to the two requirements set out above, the necessity for providing for replacement of worn out equipment out of this charge and fund has generally been considered necessary. However, replacements are almost always made by installation of better, more modern, differently arranged and larger units.

Also, replacements are handled under prescribed systems of accounts in the same manner as extensions and it seems more realistic certainly in a growing property, to consider retirement as the end of investment.

The annual depreciation charge is an *advance* payment by the public to provide future return of the investors' money, when equipment which has been used up is retired from useful service. The creation of the reserve by use of the annual charge is necessary to maintain the integrity of the investment and to distribute the cost evenly.

Due to the fact that general interest rates for money change from time to time and due to the fact that scientific progress changes the foreseeable useful life expectancy of material and equipment from time to time, any sinking fund based on a fixed rate and a fixed period of time would be unsatisfactory and subject to serious infirmities. For the same two reasons, any fixed service life basis for straight-line annual depreciation would be inflexibly ignoring the possibility and probability of technological changes which will have substantial bearing on length of useful life of material and equipment.

It is our opinion that both the amount of the annual depreciation charge and the size of the depreciation reserve should be determined by the best judgment available based on consideration of all the factors involved but that both should be examined periodically by a consideration of all new facts and foreseeable changes in conditions and when the necessity for revisions are apparent, they should be made. The judgment of the management of each utility when properly supported by estimates of future conditions and records of past performance of depreciable property should be accorded considerable weight. Therefore, we propose to allow an annual depreciation allowance based on a fixed percentage of the cost of property, but with the understanding that this fixed percentage will be subject to revision when facts appear or are presented which would indicate the equitableness of such revision.

Legal title to the money collected by a utility from its customers to cover depreciation and set aside in a depreciation reserve is by authoritative jurisprudence held to be in the utility. However, the utility owner does not have unconditional unrestricted ownership and the contributing customers have an equitable interest in this reserve and some of the elements of the trust apply. Certainly the customer is entitled to have this money used for his benefit until such time as it is actually required to reimburse the owners for investment extinguished by retirement of property from useful service. The customer is entitled to receive whatever interest can be earned by judicious use of the money. This annual interest earned by the invested reserve should be applied as a deduction from allowable net operating revenue in computing the allowable return. The amount of this reduction of interest earned by this reserve is a question to be settled in each individual case by facts as to available uses for the money and other relevant evidence. The rate of interest to be applied will never be greater than the allowed rate of return, but may be less upon a showing by the utility that a lesser rate is justified.

Having set out our views as to general principles and policies which we propose to follow, we now proceed with a consideration of Respondent's operations and the application of these principles to the case.

Description and History of Respondent

Respondent, whose principal executive office is located in 142 Delaronde Street, New Orleans 14, Louisiana, was incorporated under the laws of Florida on June 25, 1927. It is a public utility company operating in the state of Louisiana, where it qualified to do business on July 2, 1927. Respondent is engaged in the generation, transmission, purchase, and distribution of electricity; purchase and distribution of natural gas; transportation of passengers, and activities incidental to such operation.

Respondent supplies electric and certain other public utility services in communities in a wide area in northern Louisiana, in eastern Louisiana, in the southeastern part of the state north and west of New Orleans and in a district along the Mississippi river south of that city. The territory served extends north and south for a distance of about 350 miles and its east and west limits are approximately 175 miles apart.

Respondent furnishes electric service to approximately 86,000 urban and rural customers of all classes. Of these customers 63,000 are rural customers (as defined by U. S. Bureau of the Census) of which more than 15,-800 are farm customers.

The major portion of the electrical energy sold by Respondent is generated at its steam electric generating station at Sterlington, Louisiana, which has a name plate capacity of 120,000 kilowatts. The fuel used in this station is natural gas purchased under a contract which is effective until 1958. Other energy is obtained from connecting companies in this and adjoining states.

The more important industries in the territory served with electricity include pulp and paper milling, production of building and insulating material, oil drilling, pumping and refining, manufacture of containers and boxes, cotton oil milling and refining, dry docks ship repairing, ice, cold storage and packing plants, carbon black and gas compressor stations, quarries and gravel pits.

The electric system of Respondent as described above was formed by the purchase of many small operating properties and the integration of these properties into an efficient operating system by the building of transmission lines and the making of many improvements and extensions. This process of integration is described in the report of the Federal Power Commission staff in its original cost study and in the Louisiana Power & Light Company report in the same proceeding. Both of these reports have been made a part of the record in this case.

The Record

The record in this proceeding consists of pleadings and facts as stipulated by Respondent and the staff of the Commission.

Findings by the Commission

[14–16] Upon consideration of the record herein and application of the principles discussed above to that record, the Commission finds:

1. The amount of Respondent's Gross Electric Plant Account as of June 30, 1946 is $37,113,175
   The amount of Respondent's Gross Electric Plant Account as of June 30, 1947, is estimated to be $39,813,175
   The average amount of Respondent's Gross Electric Plant Account for 12 months June 30, 1946, to June 30, 1947, from the above estimate will be $38,463,175
2. A reasonable allowance to Respondent for cash working capital is approximately two months operating expenses and is $875,000
3. A reasonable allowance to Respondent for Materials and Supplies for the year under consideration is $650,000

4. The average amount of capital used by Respondent which has been contributed or advanced by customers is estimated for the 12 months June 30, 1946, to June 30, 1947, to be		$613,640
5. The total amount of Utility Plant Acquisition Adjustment is		$3,844,727
Of this total amount the cost to Respondent in acquiring its electric properties in transactions based on arm's-length bargaining and because of the many advantages accruing to the customer found to be justified as a part of its Prudent Investment and included in gross electric plant account as set out in Finding 1 above, is		$3,493,594
The rates charged by this utility are lower than those charged in Louisiana towns municipally owned and operated and by Rural Electric Coöperatives financed by the Federal government. The respondent has been a pioneer in the development of electric service to its largely rural territory and has been very active in extending service on an area-wide basis.		
6. The total amount of this Electric Plant Acquisition Adjustments should be amortized over a 15-year period by making equal annual charges to Amortization of Electric Plant Acquisition Adjustments—Account 505 beginning with the year 1946 in the amount of		$232,906
7. The amortization charge provided for in item 6 above will result in a deduction from amount of Gross Electric Plant in determining a rate base for the 12 months from July 1, 1946, to June 30, 1947, in the amount of		$232,906
8. The total amount of Respondent's Depreciation of Retirement Reserve for all property at June 30, 1946, is reasonable and adequate to meet any and all demands for the purposes for which it was accrued and is		$9,396,762
The part of this Reserve which should be allocated to Electric Plant as of June 30, 1946 is		$8,306,904
The amount of this Reserve for Electric Plant as of June 30, 1947 is estimated to be		$9,231,904
The average amount of this Depreciation Reserve for the 12 months from June 30, 1946, to June 30, 1947, will be		$8,769,404
9. Applying the principles previously set out in this opinion to the findings above results in a rate base for the 12 months from July 1, 1946, to June 30, 1947		
Average of Gross Electric Plant Account		$38,463,175
Plus: Cash Working Capital	$875,000	
Materials and Supplies	$650,000	$1,525,000
		$39,988,175
Less: Contributions and Construction Advances	$613,640	
Reserve for Amortization of Electric Plant Acquisition Adjustments	$232,906	$846,546
Electric Rate Base		$39,141,629
10. A rate of return of 6 per cent on the rate base is fair and equitable and is adequate to compensate the owners and to attract the capital necessary to maintain the soundness of Respondent's investment and will result in substantial rate reductions to the customers.		
11. Applying a rate of return of 6 per cent to the rate base found above would yield Respondent Net Operating Revenue for the 12 months period from July 1, 1946, to June 30, 1947, in the amount of		$2,348,498
12. Respondent can and should be able to use in its business the money represented by the amount of the Retirement or Depreciation Reserve to the extent that it will earn 5½ per cent. This rate of interest is considered fair to both the customer and the Respondent and its application during the twelve months from July 1, 1946, to June 30, 1947, will result in an earning of		$467,409
13. This earning of the Reserve money should be deducted from the Net Operating Revenue as shown in item 11 above to determine the Allowable Return to Respondent. Making this deduction we determine the Allowable Return for the 12 months from July 1, 1946, to June 30, 1947, to be		$1,881,089

14. A conservative estimate of Respondent's Electric Operations for the 12 months period from July 1, 1946, to June 30, 1947, with due consideration given to actual figures for the past year and based on existing rates follows:

Operating Revenues—Electric		$11,168,000
Operating Revenue Deductions—Electric		
Operating Expenses	$5,348,800	
Property Retirement Reserve Appropriations	925,000	
Amortization of Electric Plant Acquisition Adjustments	232,906	
Taxes	2,360,489	8,867,195
Estimated Net Operating Revenues		$2,300,805

15. The estimated Net Electric Operating Revenue of Respondent for the 12 months period from July 1, 1946, to June 30, 1947, will exceed the Allowable Return by the amount of $419,716. After considering the effect of income taxes, the elimination of this excess will necessitate a reduction in Respondent's rates and charges in the amount of approximately $700,000

Order of the Commission

After consideration of the findings made above, the Commission, therefore, *orders* as to Respondent herein:

(1) The electric rate base is $39,141,629 for the twelve months ending June 30, 1947, and shall in the future from time to time be computed in accordance with the principles hereinbefore adopted.

(2) The allowable rate of return is 6 per cent per annum.

(3) For the purpose of determining the allowable return, earnings on the entire amount of the retirement or depreciation reserve at 5½ per cent per annum shall be deducted from the amount derived from applying the "rate of return" to the "rate base."

(4) Annual allowance for electric plant retirement or depreciation appropriations shall be $925,000 for the year ending June 30, 1947, and for subsequent years, unless later changed, the allowance will be an amount of $925,000 plus 3 per cent of net additions thereafter made.

(5) Reserves for retirement of depreciation of utility plant shall hereafter be maintained for each utility department of Respondent and shall be set up on the basis of the allocation found reasonable in "Finding" No. 8.

(6) The amount of $3,844,727.52 in account Utility Plant Acquisition Adjustments at June 30, 1946, shall be allocated between the electric and gas departments in accordance with Finding No. 5.

(7) Respondent shall amortize the amount of $3,493,593.95 allocated to Electric Plant Acquisition Adjustments by equal annual charges to Account 505—Amortization of Electric Plant Acquisition Adjustments over a 15-year period beginning with the year 1946.

(8) Not later than August 20, 1946, Respondent shall file, to be applied on bills rendered on and after September 1, 1946, for electric service revised electric rate schedules designed to reduce gross electric operating revenue in an amount not less than $700,000 annually, including changes now being made affecting revenues from municipalities.

(9) The terms used in the Commission's opinion and findings, and this order, are for the purpose hereof, those currently in use by the company, and are adopted without prejudice to the right of the Commission to amend such terms in connection with any or-

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der it may issue under Docket 4350 prescribing accounts to be kept by Respondent.

It is *further ordered* that this proceeding, as to this Respondent only and as to its electric utility operations only, be now concluded and dismissed subject to compliance of Respondent with this order and subject to the continuous jurisdiction of this Commission under the Constitution and statutes of the state of Louisiana.

SECURITIES AND EXCHANGE COMMISSION

Re Middle West Corporation

File No. 70-1213, Release No. 6560
April 17, 1946

DECLARATION *filed by holding company regarding sale of entire interest in subsidiary holding company; declaration denied effectiveness.*

Consolidation, merger, and sale, § 33 — Sale of holding company interests — Integration of holding company system.

A declaration filed by a registered holding company regarding the sale of its entire interests in its subsidiary holding company, which owns approximately 40 per cent of the common stock of another holding company, which in turn owns substantially all the outstanding securities of eleven electric and gas utility companies, should be denied effectiveness where the several utility subsidiaries, upon acquisition by the purchasers, would be incapable of interconnection or integration and where the acquisition would not tend toward the efficient and economical development of an integrated public utility system.

APPEARANCES: Ove B. Dendtler, for The Middle West Corporation; Sydney K. Schiff, for Harold C. Mayer, Salim L. Lewis, and Donald C. Lillis, prospective purchasers; Herbert David, for the Public Utilities Division of the Commission.

By the COMMISSION: The Middle West Corporation (Middle West), a registered holding company, has filed a declaration pursuant to § 12(d) of the Public Utility Holding Company Act of 1935, 15 USCA § 79l (d) (Act) and Rule U-44 promulgated thereunder, proposing to sell its interest in United Public Service Corporation (UPS), a subsidiary registered holding company, consisting of 172,393 shares of capital stock (56.3 per cent of total capital stock outstanding)[1] to Harold C. Mayer, Salim L. Lewis, and Donald C. Lillis (Purchasers), in equal amounts, for a total cash consideration of $215,491.25 or

[1] The remaining 43.7 per cent of such stock is held by the public.

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from subscribers outside the municipality.

I further believe that the majority opinion is based in part on irrelevant material. Counsel for General Telephone in his brief discusses at length the differences in a franchise tax (imposed on the utility) and a consumer tax (imposed on the ultimate consumer); yet all the cases cited as pertinent discussed the franchise tax. The tax in question is instead a sales tax.

Therefore it is my opinion that this commission should issue a final order in this proceeding, together with suitable findings, upholding that portion of Ordering Paragraph No. 1 of the order issued April 4, 1969, which requires General Telephone Company to cease the charging and collecting of sales tax imposed by the city of Wrangell on telephone service rendered to subscribers residing outside the corporate limits of the city.

TENNESSEE PUBLIC SERVICE COMMISSION

Re United Inter-Mountain Telephone Company

Protestants: Carter County, Johnson County, Towns of Elizabethton and Greeneville, Washington County Utility District

Docket No. U-5175
August 1, 1969; rehearing granted September 12, 1969

PETITION *by telephone company for authority to increase rates; granted in part.*

Valuation, § 25 — Average figures — End-of-period figures — Telephone.

[TENN.] The monthly average of plant in service for the first six months of a calendar year was used rather than end-of-period figures in calculating the rate base of a telephone company. [1] p. 505.

Valuation, § 19 — Attrition.

[TENN.] A telephone company was denied a claim for attrition to be allowed in a depreciated original cost rate base. [2] p. 507.

Valuation, § 224 — Construction work in progress.

[TENN.] Construction work in progress is excluded from the rate base where interest is capitalized during construction. [3] p. 509.

Valuation, § 213 — Property for future use — Telephone.

[TENN.] Property held for future use should be included in the rate base if it can reasonably be expected to be placed in service within two years from the time of the rate proceeding and if the amount in-

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vested in such property is reasonable. [4] p. 511.

Valuation, § 68 — Acquisition adjustment.

[TENN.] An acquisition adjustment, subject to amortization over a 16-year period, and as reduced by the amount that should have been amortized from the date of purchase to the end of a current rate proceeding test period if the purchase had been handled according to the Uniform System of Accounts, was included in a telephone company's rate base where the purchase appeared to be in the best interest of the public. [5] p. 511.

Expenses, § 37 — Acquisition adjustment amortization.

[TENN.] An acquisition adjustment which was allowed in the rate base of a telephone company was permitted to be amortized over a 16-year period where the purchase appeared to be in the best interest of the public. [6] p. 511.

Valuation, § 98 — Depreciation reserve — Calculation.

[TENN.] Where the rate base was calculated on the basis of average plant in service, the depreciation reserve would be calculated on the same basis rather than on an end-of-period basis. [7] p. 515.

Valuation, § 104 — Depreciation reserve — Intrastate-interstate allocation.

[TENN.] Where 82 per cent of a telephone company's depreciation expense on certain property used in intrastate and interstate service was allowed in intrastate operating expense, the same percentage consistently would be required to reduce the rate base through the depreciation reserve. [8] p. 515.

Expenses, § 114 — Investment tax credits — Flow-through.

[TENN.] Interest-free funds resulting from service life flow-through accounting for investment tax credits do not inure to the benefit of the investors of the company; the funds are to be flowed through gradually to the consumer. [9] p. 518.

Valuation, § 192.1 — Investment tax credits.

[TENN.] Unamortized investment tax credits resulting from "service life flow-through" accounting should be deducted from the rate base. [10] p. 518.

Valuation, § 317 — Cash working capital — Telephone company.

[TENN.] One-eighteenth of operating expenses of a telephone company was allowed for cash working capital, though the commission observed that a "lead and lag" study would more accurately determine adequate cash requirements and that the one-eighteenth of operating expenses would not necessarily be a precedent to be followed in the future. [11] p. 520.

Valuation, § 300 — Materials and supplies.

[TENN.] A telephone company was allowed an amount for materials and supplies equal to the average for the test period in the materials and supplies accounts; this was consistent with the commission's use of average plant in service in the rate base. [12] p. 521.

Valuation, § 192.1 — Income tax deferrals.

[TENN.] The income tax deferral account of a telephone company, resulting from the normalization of the tax effects of accelerated depreciation, should be excluded from the rate base. [13] p. 521.

Rates, § 120.1 — Test period — Post-test-period changes.

[TENN.] Where the first half of 1968 was used as a test period for a telephone company, the commission allowed pro forma 1968 expenses under certain apportionment procedures, but 1969 pro forma expenses were not considered; the commission pointed out that future rates are set on the basis of test-period experience and that going too far outside the test period in adjusting for known increased costs creates a highly speculative and distorted earnings position for setting future rates unless due consideration is given to revenue growth for the same period. [14] p. 523.

Expenses, § 114 — Tax effects of accelerated depreciation — Normalization.

[TENN.] Normalization of the tax effects of accelerated depreciation under § 167

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of the Internal Revenue Code is equitable and fair for both the consumer and the company since the use of accelerated depreciation results in a tax deferral rather than a tax saving and the company should be allowed rates sufficient to cover what the taxes would be on a straight-line basis. [15] p. 529.

Return, § 111 — Telephone.

[TENN.] A rate of return of 7.5 per cent was allowed a telephone company on an average depreciated original cost rate base. [16] p. 531.

By the COMMISSION: This matter is before the Tennessee Public Service Commission upon the petition of United Inter-Mountain Telephone Company filed December 31, 1968, and amended March 4, 1969, wherein the company seeks to increase its existing rates and charges for intrastate telephone service. The amount of increase in rates and charges proposed by the company is designed to produce an increase in annual net operating income of $937,437.79, or an increase of gross revenue before taxes of $2,052,212.

This matter was set for public hearing and heard on May 6, 7, and 8, 1969, at Johnson City, Tennessee, at which time the following appearances were entered:

APPEARANCES: Lon P. MacFarland, MacFarland, Colley, Blank & Jack, Columbia, and James H. Epps, Jr., Epps, Powell, Weller, Taylor & Miller, Johnson City, for the petitioner; Walter A. Curtis, Elizabethton, Counsel for Carter County, Tom Grayson, Mountain City, Counsel for Johnson County, Dan Laws, Jr., Elizabethton, Counsel for the town of Elizabethton, O. C. Armitage, Greeneville, Counsel for the town of Greeneville, Mark C. Hicks, Jr., Jonesboro, Counsel for Washington County Utility District, protestants; Kenneth Atkins, Assistant General Counsel, Nashville, for the commission.

History of Proceeding

The United Inter-Mountain Telephone Company filed a petition with this commission on December 31, 1968, requesting a rate increase stating that due to changing conditions and circumstances the rates established by this commission in its order in Docket No. U-4752 dated December 17, 1965, do not provide sufficient revenue to enable the company to pay its operating costs, including wages, taxes, and other expenses, and to earn a reasonable return of the fair value of its property used and useful in the company's intrastate operations. The commission placed the requested increase under investigation and set the matter for public hearing on May 6, 1969.

Prior to the hearing on this matter the Federal Communications Commission in FCC 60-65 24148 Docket No. 17975 ([1969] 78 PUR3d 479) issued an order changing, to some extent, the procedures used in apportioning plant investment, expenses, and reserves between interstate and intrastate operations. The said order affected this proceeding in that the United Inter-Mountain Telephone Company's plant is used, generally speaking, for intrastate toll and exchange operations and for interstate communications. This commission has jurisdiction only over intrastate toll and exchange operations, therefore, it is necessary to apply some method to separate the revenues, expenses, and plant used for both interstate and intrastate operations. Officials of the company and the commission agree that the separation between intrastate and interstate operations should be accomplished in accordance with the procedures set forth in the Separations Manual.

The Separations Manual had never been formally prescribed by this commission or by the FCC until January of 1969, although the FCC had from time to time approved, on an interim basis, various modifications made in the manual. In the most recent rate proceeding involving this company the commission proposed to set rates based on the combined operations interstate and intrastate. This was held, by the chancery court of Davidson county, to be improper and in Rule 88067 the chancellor held that separations between interstate and intrastate operations should be made according to the Separations Manual as proposed by the company.

The net effect of the order issued by the FCC in January of 1969 on the company in this proceeding was to shift approximately $3,100,000 in investment from intrastate operation to interstate. The order also had the effect of increasing net operating income by approximately $140,000 on intrastate operations by shifting operating expenses formerly charged to intrastate operations to interstate.

The original petition and exhibit filed on December 31, 1968, referred to above, reflected an investment or rate base of $44,956,773 and operating expenses of $6,370,204 as adjusted before taxes.

The staff in investigating the proposed rate increase, after the December 31st filing, discussed with company management the order of the FCC amending the Separations Manual. The staff took the position that the intrastate operations should be derived by following the prescriptions set forth in the manual as amended by the FCC decision. The company undertook another separations study employing the new procedure adopted by the FCC and subsequently filed an amended petition and exhibits on March 4, 1969, which reflected the effects, among other things, of the new separation procedures.

The amended petition and exhibits reflected little change in the proposed rate base from that of the original petition and exhibits since the company proposed to include an additional $2,765,306.26 in the rate base for an attrition allowance. This proposed attrition resulted in the rate base remaining approximately the same as it was before the January FCC order.

The amended petition and exhibits also included additional wages contracted for in 1969 but not proposed to be included in the original petition and exhibits. To a large extent this resulted in canceling out the effect on earnings of the shift in operating expense from intrastate to interstate which came out of the FCC order.

Subsequent to the filing of the amended petition and exhibits, the

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staff examined the separation work papers of the company and found that certain adjustments were necessary to conform the company separation procedures to the Separations Manual. In addition to the separation adjustment, the staff also made adjustments which are termed accounting adjustments. It prepared exhibits that reflected the separation adjustment and accounting adjustment. After a review of these adjustments the company conceded that the same were proper and filed an additional amended exhibit on the morning of the hearing. In this amended exhibit the company proposed to increase its test period property tax by an additional \$76,891.36. The requested increase in revenue of \$2,052,212 was never altered or changed in any way from the original petition and exhibits. The company has insisted that its proposed increase in revenue remain the same throughout all the amendments and adjustments referred to above.

In order for this commission to make a decision concerning the company's petition for increased rates it is necessary to establish a fair and reasonable cost of service. It is a historic concept that a utility should be authorized to charge for its services under schedules of rates which, on an anticipated volume of business, will produce total revenues about equal to the cost of service. The cost of service is, of course, the sum of (1) operating expenses, (2) depreciation expenses, (3) taxes, and (4) a reasonable return on the net valuation of the property devoted to the public service commonly referred to as a rate base. As the rate base is a very important aspect of this case the commission at this point will make its findings concerning the rate base items.

Rate Base

General Comments

The rate base is composed principally of the net (or depreciated) valuation of the public utility's tangible property, comprising the plant and equipment used and useful in serving the public. Historically this commission has followed the practice of using the depreciated original cost rate base concept in determining the investment on which the utility is entitled to earn a fair rate of return.

In this case there is a difference of \$8,684,534.08 between the respective Tennessee intrastate rate bases proposed by the staff and by the petitioner for the test year ending June 30, 1968. The following tabulation sets out the rate bases proposed by the staff and by the petitioner:

Tennessee Intrastate Rate Base
Test Period Six Months Ending June 30, 1968

Item	TPSC Staff Ex. 21	Petitioner Ex. 4C	Petitioner Exceeds TPSC Staff
Plant	\$45,106,462.37	\$49,555,598.35	\$4,449,135.98
Construction Work in Progress		3,128,244.62	3,128,244.62
Property Held for Future Use		25,952.79	25,952.79
Plant Acquisition Adjustment		456,552.61	456,552.61
Total	\$45,106,462.37	\$53,166,348.37	\$8,059,886.00

TENNESSEE PUBLIC SERVICE COMMISSION

Tennessee Intrastate Rate Base
Test Period Six Months Ending June 30, 1968

Item	TPSC Staff Ex. 21	Petitioner Ex. 4C	Petitioner Exceeds TPSC Staff
Less: Depreciation Reserve	$ 9,550,497.68	$ 9,467,081.63	$ (83,416.05)
Unamortized Investment Credit	512,784.76		(512,784.76)
Total	$10,063,282.44	$ 9,467,081.63	$ (596,200.81)
Allowance for working capital 1/18 of Operating Expenses	$ 200,588.60	$ 220,592.06	$ 20,003.46
Materials & Supplies	653,587.81	662,031.62	8,443.81
Total	$ 854,176.41	$ 882,623.68	$ 28,447.27
Rate Base	$35,897,356.34	$44,581,890.42	$8,684,534 08

The staff proposed a rate base which varied substantially from that proposed by the company. The staff's prepared rate base is reflected in the following table:

United Inter-Mountain Telephone Company
Rate Base
For Test Period Six Months Ended June 30, 1968

Average	Per Books	TPSC Staff Adjustments	TPSC Staff Adjusted Books
Plant	$45,227,196.97	$(120,734.60)	$45,106,462.37
Depreciation	8,793,161.21	757,336.47	9,550,497.68
Unamortized Investment Credit	512,784.76		512,784.76
Net Investment	$35,921,251.00	$(878,071.07)	$35,043,179.93
Allowance for Working Capital One-eighteenth of Operating Expenses	$ 202,820.22	$(2,231.62)	$ 200,588.60
Materials & Supplies	653,587.81		653,587.81
Rate Base	$36,777,659.03	$(880,302.69)	$35,897,356.34

The first column shows the average per books of items comprising the rate base for the test period, the second column shows the adjustments to the test period, and the third column shows the staff's proposed adjusted rate base. This rate base reflects average plant in service computed on a monthly basis for the test period less depreciation reserve and unamortized investment credit, plus an allowance for working capital. The allowance for working capital includes both materials and supplies and cash requirements. The cash requirements were computed by taking one-eighteenth of operating expenses less taxes and depreciation.

The company proposed a rate base which is reflected in the table on page 505.

The first column shows the balance per books at June 30, 1968, the second column shows the adjustments proposed to the June 30th balances, and the third column reflects the adjusted rate base as proposed by the company. This rate base reflects plant investment, construction work in progress, property held for future use, plant acquisition adjustment, depreciation reserve, and allowance for working capital.

United Inter-Mountain Telephone Company
Tennessee Adjusted Intrastate Rate of Return Based On Operations
For the Six Months Period Ended June 30, 1968

	Per Books	Adjustments	Per Books After Adjustments
Plant Investment	$46,899,932.98	$2,655,665.37	$49,555,598.35
Construction Work in Progress	3,128,244.62		3,128,244.62
Property Held for Future Use	25,952.79		25,952.79
Plant Acquisition Adjustment		456,552.61	456,552.61
Less: Depreciation Reserve	9,102,479.99	364,601.64	9,467,081.63
Net Investment	$40,951,650.40	$2,747,616.34	$43,699,266.74
Allowance for Working Capital One-eighteenth of Operating Expense	$ 202,820.22	$ 17,771.84	$ 220,592.06
Material & Supplies	662,031.62		662,031.62
Rate Base	$41,816,502.24	$2,765,388.18	$44,581,890.42

The above illustrations have been set out in this order for the purpose of stating in figures the positions taken by the staff and by the company. Each item comprising the rate base, on which there is a difference in the above illustration, will be commented on and a ruling given separately below.

Average versus Period End Figures

General Comments

[1] The staff proposed an average for plant in service based on monthly averages for the test period whereas the company took the position that an end-of-the-period balance as of June 30th was the appropriate figure to use in evaluating the earnings for the test period.

Following is a table that sets out the difference in dollar valuation based upon both methods of calculating net plant in service:

	TPSC Staff Ex. 21	Petitioner's Ex. 4-C	Petitioner's Exceeds TPSC Staff
Plant in Service	$45,227,196.97	$46,899,932.98	$1,672,736.01
Less: Depreciation Reserve	8,793,161.21	9,102,479.99	309,318.78
Net Plant in Service	$36,434,035.76	$37,797,452.99	$1,363,417.23

Staff's Testimony

The staff proposed an average for plant in service, depreciation reserve, materials and supplies, and unamortized investment credit. Reference to the above table discloses a difference of $1,363,417.23 in net plant in service which is the primary difference dollarwise in using average versus period end.

The staff took the position that use of average plant in service is proper because in evaluating the company's earnings in the test period certain revenues and expenses were a result of plant added and retired throughout the test period. It is proper to match the period earnings with the average of the plant in service for that period, but it is not appropriate to include additions to plant made during the test period in the rate base for testing operating results which do not include revenues and expenses generated from providing the service for which these additions are made.

An illustration as to why it would not be proper to use period-end balance was as follows: If a unit of plant costing $2 million were added on the day immediately before the end of the test period and period-end figures are used, this results in virtually no revenues and expenses attributable to this plant being reflected while a rate of return would be allowed on this addition for the entire test period.

Company's Testimony

The company testified that it is correct in using the period-end figures for plant in service due to the fact that it has used a 6-month test period and annualized the figures, thereby doubling the growth in the test period. It maintains that as the test period was doubled or annualized its figure is actually a mid-point or average and is proper to be used.

Mr. Sexton, testifying for the company, stated: "There is a growth in the test period in revenue and that growth is doubled over in, going into December 31st, so we have in effect shown an increase, a growth factor in our revenue as well." To explain the company's position it is necessary to look at another excerpt from Mr. Sexton's testimony on page 550 of the transcript: "We haven't added anything else in, just projected the first-half growth over to a full-year basis, and there again we come up with the mid-point. We maintain we have the right figure and Mr. Burcham does not have the right figure." (Mr. Burcham is director of the accounting division of the commission.)

The company takes the position that the commission's staff by using the average over the 6-month test period ending June 30th has actually arrived at an approximate rate base in effect as of March 31, 1968.

Commission's Findings and Conclusions

Since the valuation of the plant in service is the largest component of the rate base it necessarily follows that the greater the valuation of the company's property, the greater the rate base and, therefore, the higher the total cost of service. In order to rule on the proper figure to use in the question of average or period end, it is necessary first to examine the purpose and reasons behind establishing a test period in a rate proceeding such as this.

The commission, in setting rates, is obligated to do so for an indefinite period into the future. Consequently, we must rely upon the record of costs of service in a test period. The company established January 1, 1968, through June 30, 1968, as the test period in this proceeding. Known changes that will occur after the test period are usually taken into consideration if they will make the test-period data more representative of future earnings.

A "test period" with appropriate adjustments to evaluate the future earnings can most effectively be accomplished by using the average monthly rate base for the test period. The matching of revenues and expenses, resulting throughout the test period from additions and retirements of plant, to the corresponding plant averaged over that same period will reflect the most representative earnings picture to use in establishing rates.

Witness Sexton testified that revenues and expenses for the 6-month test period ended June 30, 1968, were annualized and thereby reflected growth in both revenues and expenses. It would appear from the testimony that since the company is maintaining that these growth factors were reflected it is in effect using the twelve months ending December 31, 1968, as a test period and, therefore, it was proper to use the June 30th figures because they represent an average or mid-point of the calendar year 1968.

The commission cannot accept the rationale that the annualized amounts for six months ended June 30, 1968, represent the revenues and expenses for the calendar year 1968. Revenues and expenses for the latter six months of 1968 would depend upon the actual growth experienced. If the company continues to grow, revenue and expenses would increase and, consequently, would be larger for the latter six months of 1968 than those reflected in the annualized test period ending June 30, 1968. The company by annualizing has merely doubled the results of the 6-month test period and, consequently, its use of the plant in service as of June 30, 1968, does not properly match the revenues and expenses which resulted throughout the test period.

Therefore, the commission finds the monthly average of plant in service for the test period ending June 30, 1968, should be used to establish rates in this proceeding.

It is significant to note at this point what positions other regulatory agencies take in regard to the use of an average or period-end rate base. The Federal Power Commission's 1967 booklet entitled "Federal and State Commission Jurisdiction and Regulation—Electric, Gas & Telephone Utilities," introduced in this proceeding as Exhibit 22, shows that the Federal Communications Commission and Federal Power Commission both require the use of an average rate base in setting rates; thirty state or territory commissions require the use of an average rate base, while eighteen state or territory commissions use a period-end rate base; two states use both methods, one has no experience, one no general prescription, and one does not regulate telephone companies. The above statistics include the District of Columbia, Puerto Rico, and the Virgin Islands.

Attrition

General Comments

[2] As indicated in the history of the proceeding, the company first maintained that an attrition allowance should be added to the rate base in its amended petition and exhibits of March 4, 1969. It is significant to note that the company did not propose to include an attrition allowance in the rate base until the FCC in 69-65 24148 Docket No. 17975 ([1969] 78 PUR3d 479) issued an order changing the procedures used in apportion-

ing plant investment, expenses, and reserves between interstate and intrastate operations. The net effect of the FCC ruling was that approximately $3,100,000 of the company's rate base were shifted from intrastate to interstate and the net operating income on intrastate operations was increased by approximately $140,000.

The amended petition and exhibits filed by the company on March 4, 1969, included a write-up on the rate base of approximately $2,765,306.26 for attrition and proposed additional projections in operating expenses not pertinent here. This had the effect of nullifying the shift brought about by the FCC ruling on apportionment between interstate and intrastate operations.

Staff's Testimony

The staff is of the opinion that an attrition figure should not be allowed in the development of the company's rate base. It maintains that such an attrition allowance in the rate base would, in effect, permit a return on an investment that was not actually made by the company, and that the customer should not be required to pay rates that would yield sufficient revenues to compensate the company for an attrition factor of $2,765,306-.26.

The use of an attrition figure arbitrarily added to the rate base would completely disregard the original cost concept of rate making. A policy of permitting write-up of plant or attrition could result in the commission's having to revamp its entire rate-making philosophy, thus requiring adjustments of all utilities' property in service depending on the inflationary or deflationary trends in the economy.

Company's Testimony

The company insists that its rate base should be increased above the original depreciated cost by approximately $2,765,306.26 due to inflation causing replacement cost to be considerably higher than the original cost. The company's position can probably best be determined by Witness Sexton's testimony. When asked on direct examination to explain what he meant by attrition, Witness Sexton stated: "That is the replacement of our plant by erosion of earnings through higher costs."

Witness Sexton stated that as of June 30, 1964, the average investment in each telephone was $367.33 compared with the average investment of $454.13 at June 30, 1968, or an increase of 23.63 per cent. This is an average increase of 5.91 per cent per year. Witness Sexton stated generally that the attrition factor of $2,765,-306.26 proposed to be included in the rate base had been determined by the increase in its investment per phone. In his testimony Witness Sexton did not explain or show in detail how the company arrived at the figure used. However, the company did furnish the staff with working papers showing the computation of its proposed attrition factor.

Commission's Findings and Conclusions

The commission would first state in regard to attrition that it takes official judicial notice of all rate cases which it has decided and it has never allowed a write-up or attrition factor to be used in the rate base.

The commission is of the opinion that by virtue of the monopolistic characteristics of a utility such as the company involved here it should not be authorized to charge rates that will provide a return on an investment not actually made by the company. To allow such attrition to be added to the rate base would permit the company to earn a return on an amount which it did not invest.

It seems extremely coincidental that the company found it appropriate to include attrition in the amount of $2,765,306.26 only after the new separation procedures shifted approximately $3,100,000 from the intrastate to interstate operations on its rate base.

In reviewing Witness Sexton's testimony on cross-examination we find that he stated the separation procedure is almost entirely disregarded by the fact that the company added the attrition. He also indicates in this cross-examination that intrastate ratepayers receive no benefit from the separation changes, stating: "We don't intend for them to. We need the money we are asking for there." When asked, "Then after these separation procedures, you are saying that this would have benefited the intrastate ratepayer, had you not increased your rate base again, is that what you are saying?" He answered, "Yes, it will work down to that." Witness Sexton seemed to take the position that the company had to follow the recent FCC separation procedure changes but that it did not agree with them and the attrition factor was used in order for the company to recover a major part of the $3,100,000 transferred by the new separation changes.

The commission finds that the attrition or write-up proposed to be added to the rate base by the company in the amount of $2,765,306.26 should not be allowed. It appears that the company has used this attrition to offset the shifting of a portion of the intrastate rate base to interstate as a result of the January FCC ruling. As indicated earlier in this order this commission has jurisdiction only over intrastate toll and exchange operations, therefore, it is necessary to apply some method for separating the revenues, expenses, and properties of the company used for both interstate and intrastate operations. This commission and the companies under its jurisdiction make the separations in accordance with the procedures set forth in the Separations Manual as approved and modified by the FCC. We cannot see the rationale in separating operations according to the manual and then turning around and completely negating these effects by allowing a write-up to the company's rate base.

Construction Work in Progress

Staff's Testimony

[3] The staff proposed to exclude construction work in progress from the rate base which totaled $3,128,244.62 and the interest capitalized during construction from the company's income for rate-making purposes.

The company is earning a return on this plant through the accounting process of capitalizing interest during construction at the rate of 7 per cent. The staff maintains that the rate at which interest is capitalized would in effect provide a return on capital which is dedicated to construction programs.

Company's Testimony

The company included in its rate base computation, construction work in progress totaling $3,128,244.62. Its position is best stated by Witness Sexton when questioned by Mr. MacFarland as follows:

"Q. Mr. Sexton, the item that you have put in the rate base for construction work in progress, have you commented on that, why in your opinion that is necessary?"

"A. Well, we feel that that is what is contributed by the investors in the company and it ought to be in the rate base and certainly as long as we grow, as far as we can see, in other words, some newsmen say it is going to double here by the year 2000. This construction work in progress will grow rather than decrease. It will always be in our books. We will have it on the books. It is money that has been expended, obtained from investors in the company."

The above answer was the extent of the elaboration by Witness Sexton on the merits of the inclusion of construction work in progress in the rate base. He contends that the investors are required to furnish this capital and that it would be required indefinitely because construction would be constantly taking place.

On cross-examination the company's witness, Mr. Gleason, testified generally that the company earns a return on construction work in progress through the accounting mechanics of capitalizing interest during construction. It was his position that interest capitalized during construction might not be a full and fair return and he felt the stockholders would be treated more fairly if construction work in progress were included in the rate base and the interest capitalized included in revenue. He further stated that in the long run there is no difference in the result of the two choices.

Commission's Findings and Conclusions

Generally this commission has excluded construction work in progress from the rate base, however, in the last proceeding with this company construction work in progress was included in the rate base. At that time, the commission specifically noted that this was done because the company was not capitalizing interest on construction.

The company is now earning a return on construction work in progress through the capitalization of interest. We see no basis for including the construction work in progress in the rate base and the interest capitalized in revenue; the interest capitalized is in itself a return on the construction work in progress.

The Uniform System of Accounts provides in § 31.2-22 that the company can capitalize interest on all moneys, including the company's own funds, used in the acquisition or construction of telephone property. This in effect provides for a rate of return on the construction work in progress and the commission finds that construction work in progress should be excluded from the rate base in this case.

Property Held for Future Use

General Comments

[4] The company proposed to include in its rate base $25,952.79 as property held for future use. The staff did not include this in its proposed rate base, stating that it was not a policy of the commission to include property in the rate base not used or useful in providing telephone service. An investigation reveals that the property is of such physical nature that it will be used in providing telephone service in the near future.

Commission's Findings and Conclusions

The commission is of the opinion that if property held for future use can reasonably be expected to be placed in service within two years from the time of the rate proceeding, certainly it should be considered as a part of the company's rate base. The commission would qualify this finding by stating that the amount invested in the property held for future use should be reasonable, and would further state that each case shall be considered on its own merits.

We find that the present property held for future use should be allowed in the rate base. However, it is to be noted that the amount will be less than that proposed by the company since it advocated a period-end figure and we have ruled above that average plant in service for the test period is proper. The period-end investment proposed by the company is $25,952.79; an average investment for the test period would be $14,372.02. The investment of $14,372.02 will be used in this proceeding by the commission in setting the rates.

Plant Acquisition Adjustment

General Comments

[5, 8] The commission feels it proper at this point to explain how the acquisition adjustment account arises and then consider the staff's testimony and the company's testimony prior to making a determination.

The acquisition adjustment in this case occurred as the result of the company purchasing plant from the Bell System. The purchase was made in February, 1966. The purchase price on the plant was $3,516,534.74. Of this amount it appears that roughly $1,281,000 would be placed in the acquisition adjustment account which will be explained later.

The acquisition adjustment is provided for in the Uniform System of Accounts adopted by this commission. The commission requires all utilities under its regulation to comply with the Uniform System of Accounts. The Uniform System of Accounts sets out that when property comprising a substantially complete telephone system, exchange, or toll line is acquired from predecessors, the amount of money actually paid for the property shall be charged to Account 276, Telephone Plant Acquired. The system of accounts then requires the original cost (cost to the predecessors) to be charged to the telephone plant accounts, Account 100:3, Property Held for Future Use, and Account 100:2, Telephone Plant under Construction, whichever is appropriate, and credited to Account 276 mentioned above. The proper reserve requirements for depreciation and amortization should then be debited to Account 276 and credited to Accounts 171 and 172, Depreciation Reserve and Amortization Reserve. The amount remaining in Account 276, Telephone Plant Acquired, applicable to the plant acquired should then be debited or credited as appropriate to Account 100:4, Telephone Plant Acquisition Adjustment.

In this case we are considering an amount that could vary from roughly $400,000 to $475,000 in the telephone plant acquisition adjustment account, depending on calculations that will be explained later.

Apparently the company did not follow the above-described procedure set out in the Uniform System of Accounts in recording the Bell purchase. The original petition and exhibit filed by the company did not provide for the acquisition adjustment account and it is apparent from the exhibits and records that the entire purchase price on the Bell acquisition had been placed in the plant accounts. After discussions with the commission's staff, the company revised its exhibits and in its amended petition filed on March 4th the exhibits reflected $456,552.61 in plant acquisition adjustment which will substantially comply with the procedure established in the Uniform System of Accounts.

Staff's Testimony

The commission's staff did not include the acquisition adjustment in its development of a rate base as can be seen in the foregoing tables. This acquisition adjustment balance represents generally the difference between the original depreciated cost and the purchase price paid to Bell. An exchange such as this creates an investment (or acquisition adjustment) over and above the original depreciated cost and if the acquisition adjustment is included in the rate base of the purchasing company it results in the company earning a rate of return on a higher investment than depreciated original cost. An allowance of acquisition adjustments in the rate base could encourage companies to exchange property to inflate their rate base.

The staff proposes it to be fair in this case to allow the company to recoup this excess cost (acquisition adjustment) through amortization charges of $29,737.53 per year over a period of sixteen years. The company did not seek to include these amortization charges in its cost of service until it discovered that the staff had proposed to include them in its exhibits on cost of service.

The staff took the position that both the subscriber and the stockholder should share in the costs incurred by the company as a result of this acquisition adjustment since it was maintained by the company that the purchase benefited the subscriber as well as the stockholder. The staff testified that both the stockholder and subscriber would share in the cost by allowing the company to recoup the annual amortization charges in operating expenses and by precluding the company from earning a return on the investment or, in other words, by excluding the acquisition adjustments from the rate base.

Company's Testimony

The company proposes to include $456,552.61 in the computation of the rate base. The company's position is shown in Witness Sexton's testimony. He testified generally that this was a good purchase on the part of the company. He stated that the company's engineers had priced out the plant purchased and compared it to their cost and the engineers were of the opinion that it was a good buy. He further testified that the purchase was in the best interest of the subscriber and the stockholders.

Witness Sexton pointed out in his testimony that the company had requested the original cost data from Bell but had not been able to obtain that information. Mr. Sexton testified that the following calculation had been used to determine the acquisition adjustment:

Southern Bell Purchase

Amount Included in Rate Base Purchase Price	$3,516,534.74		
Original Cost as Supplied by Southern Bell	$3,085,867.00		
Plus Payment Made for Addition at 100% Condition	135,459.00		
	$3,221,326.00		
	Total	Inter	Intra
Overstatement on Books	$ 295,209.74	$ 185,568.85	$ 109,640.89
Bell Purchases Divided Inter-Intrastate per Cost Study Information			
	Total	Inter	Intra
C. O. Plant	$2,454,963.00	$1,446,581.35	$1,008,381.65
O. S. Plant	628,968.12	491,848.34	137,119.78
	$3,083,931.12	$1,938,429.69	$1,145,501.43
		62.86%	37.14%
Bell Purchase Reserve Requirement	$ 933,230.04	$ 586,628.40	$ 346,601.64
Acquisition Adjustment	$1,229,274.66	$ 772,722.05	$ 456,552.61
Payments Made on Bell Purchase	$3,085,867.00		
	135,459.00		
To Southern Bell	$3,221,326.00		
To A. T. & T.	$ 292,564.00		

Witness Sexton testified that the information relative to the Bell purchase was acquired from the commission's staff who, in turn, had obtained it from Southern Bell. (The commission would note at this time that the staff stated at the hearing that the $3,085,867 used in the exhibit was not the amount furnished by Bell to the commission's staff as being its original cost.) This matter will be taken up in the commission's conclusion.

Commission's Findings and Conclusions

The commission has carefully considered the merits of including the acquisition adjustment in the company's rate base for rate-making purposes and feels that it is proper to be included and that the company should be allowed to earn a return on this investment, the amount of which will be qualified later. The purchase appears to have been in the best interest of the public, and we feel the company should be allowed to earn a return on the acquisition adjustment and also should be allowed to recoup the cost of acquisition adjustment by amortizing this amount over a 16-year period from the date of acquisition.

The commission is aware that transactions such as this could under certain circumstances lead to utilities exchanging plant to inflate their rate base and certainly a transaction that appeared to do this would not be tolerated. However, it does not appear that the transaction we are concerned with here could be construed to have been made for the purpose of inflating the rate base.

The commission in allowing the acquisition adjustment to be included in the rate base and allowing it to be amortized is not overlooking the fact that the company failed to abide by the requirements established in the Uniform System of Accounts in reporting this transaction to the commission. It is apparent that a great deal of confusion could have been avoided in this matter had the company properly reported the transaction as required by the Uniform System of Accounts. The commission does not intend to permit companies under its jurisdiction to violate rules established for the companies' regulation.

There is an apparent discrepancy in the company's Exhibit 4-B-1 presented above. Reference is made to the "Original Cost as Supplied by Southern Bell" on Exhibit 4-B-1 in which the company represents the original cost to be $3,085,867. The title "Payment Made on Bell Purchase," $3,085,867, is exactly the same amount as the represented original cost. This $3,085,867 was used to arrive at the overstatement on books and the acquisition adjustment. Since this represented original cost reflected on Exhibit 4-B-1 does not agree with the original cost reflected in our records it is apparent that the overstatement on the books and the acquisition adjustment would not be correctly stated. It seems that an error was made when the company assumed that the payment made on the Bell purchase was the same as the original cost.

The commission's records reveal the following data relative to the purchase price, original cost, acquisition adjustment and depreciation reserve on the Bell System purchase shown on page 515.

The schedule above will serve to explain other differences in the staff's position and the company's position, some of which will be discussed later in this order.

Reference to the above schedule on Line 10 will reflect total original cost of $3,191,931.04, whereas Exhibit 4-B-1 reflects an original cost of $3,221,326 or an overstatement of $29,394.96 for the entire system. Furthermore, the depreciation reserve requirement of $956,020.17 on Line 13 of our schedule when compared to the reserve requirement of $933,230.04 on Exhibit 4-B-1 reflects an understatement of the depreciation reserve of $22,790.13. These two discrepancies account for the difference

RE UNITED INTER-MOUNTAIN TELEPH. CO.

Southern Bell Purchase

Line No.		Intra	Inter	Total
	Purchase Price			
1	AT&T			$ 292,564.00
2	Bell Plant			3,085,867.00
3	Custom Work			135,459.00
4	Legal Expense			3,120.74
5	Total			$3,517,010.74
	Original Cost			
6	AT&T			$ 346,408.75
7	Bell Plant			2,700,849.29
8	Custom Work			135,459.00
9	Spare Parts			9,214.00
10	Total			$3,191,931.04
11	Overstatement on Books	$120,734.60	$204,345.10	$ 325,079.70
12	% Allocation Factors	37.14%	62.86%	100%
13	Depreciation Reserve Requirement			$ 956,020.17
14	Less: Depreciation Reserve on Overstatement .			(33,451.69)
15	Total	$757,336.47	$165,232.01	$ 922,568.48
16	Allocation Factors	82.09%	17.91%	100%
17	Acquisition Adjustment	$475,800.49	$805,299.38	$1,281,099.87
18	Less: Amortization of Acquisition Feb. 1, 1966, thru June 30, 1968 ..	71,866.69	121,635.43	193,502.12
19	Total	$403,933.80	$683,663.95	$1,087,597.75
20	% Allocation Factors	37.14%	62.86%	100%

in the acquisition adjustment as shown by the company and in our files. We accept the acquisition adjustment balance of $475,800.49 before giving consideration to the amount of amortization that would have been otherwise written off since the acquisition of the plant in February, 1966. We are of the opinion that the amortization that should have been taken since the date of the purchase should be subtracted from the $475,800.49. The above schedule reflects intrastate amortization reserve of $71,866.69 through June 30, 1968, which when netted out against the $475,800.49, leaves a balance of $403,933.80 which is shown on Line 19.

Based on the record and the above calculations made from exhibits presented at the hearing and from our official files we find the proper acquisition adjustment to be $475,800.49 less $71,866.69, the amount that should have been amortized from February 1, 1966, to June 30, 1968, had the purchase been properly handled according to the Uniform System of Accounts and past procedures of this commission.

Depreciation Reserve

General Comments

[7, 8] A summary of the differences in the depreciation reserve presented by the staff and by the company is shown in the table on page 516.

The staff's per book balance of $8,793,161.21 before adjustments represents the average depreciation reserve

	TPSC Staff Ex. 21	Petitioner Ex. 4-C	Petitioner Exceeds TPSC Staff
Per Books	$8,793,161.21	$9,102,479.99	$ 309,318.78
Adjustments	757,336.47	364,601.64	(392,734.83)
Adjusted Total	$9,550,497.68	$9,467,081.63	$ (83,416.05)

where the company's $9,102,479.99 is the end-of-the-period balance. The company's depreciation reserve exceeds the staff's by $309,318.78 as a result of its using the period-end balance and the staff using the average balance. The use of average or period-end figures on depreciation is, of course, subject to the same arguments and conclusions as the average and period-end figures on plant in service. As indicated in the commission's conclusion on use of average versus period-end plant in service, an average for the test period seems to be the most appropriate to use and we therefore adopt the same conclusion on the depreciation reserve.

Our decision that the average of plant in service and reserve for depreciation for the test period should be used would obviously mean that we adopt the per book figure of $8,793,161.21. We must also determine depreciation reserve adjustments, i.e., whether to use $757,336.47 proposed by the staff or the $364,601.64 proposed by the company. Both are set out in the above table.

In addition, the staff adjusted the depreciation the company had taken on overstated plant, mentioned heretofore in the acquisition adjustment section. This adjustment would amount to roughly $27,000 which will be a reduction in the amount calculated by the staff.

Staff's Testimony

The staff adopted the same argument on the use of average depreciation reserve as it applies to average plant in service and did not elect to elaborate further.

The staff proposed an adjustment of $757,336.47 to the average depreciation reserve. It contends that this adjustment results from two items: (1) Depreciation accrued in the amount of $33,451.69, on the overstatement of the Bell plant from Feb. 1, 1966, through June 30, 1968; and (2) depreciation reserve applicable to the original cost of the Bell plant not established in the records of the company. This amounted to $956,020.17 and the staff proposed to reduce this by the accrual of depreciation on the overstatement of plant of $33,451.69 mentioned above, leaving a balance of $922,568.48. This is a total of both intrastate and interstate operations in Tennessee and has to be apportioned between the two. The staff proposed to apportion this balance between interstate and intrastate operations on the same basis that total depreciation reserve related to intrastate which amounts to 82.09 per cent. Using this percentage the staff calculated $757,336.47 to be the proper adjustment.

The company used the total depreciation allocation of 82.09 per cent for apportioning the depreciation expense on the Bell plant and then maintained that it should use 37.14 per cent for the purposes of apportioning the depreciation reserve on this same plant. The staff maintains this allocation procedure should not be followed.

Company's Testimony

The company did not go into any lengthy comments on its depreciation reserve adjustments. It maintains that the adjustment on the depreciation reserve of $364,601.64 on the Bell purchase is made on the basis of the actual usage of plant. For the purpose of stating as clearly as possible the company's position on this matter, we feel it would be well to insert Mr. Sexton's direct testimony in regard to this:

Redirect Examination

"By Mr. MacFarland:

"Q. Mr. Sexton, relative to depreciation figures yesterday, Mr. Atkins asked you that we were speaking specifically about the depreciation reserve for the Bell acquisition. Would you make a statement in regard to that at this time, please?"

"A. I want to say at the outset that we feel that the purchase was a good one for the company, earningwise and, of course, that works right on down to it is good for our subscribers, too.

"Now the depreciation reserve amounts, the way we spread that was based on the usage as to inter- and intrastate. Tennessee, all the properties, of course, being located in Tennessee. We came up then on our 4–C exhibit with depreciation for intrastate of $364,601.64.

"Now if we were to relate that and put that on the basis of our other plants, then the factor, of course, works down to a different spread. Calculated, it would be a reduction in our rate base of the difference between what all of the depreciation, that is, on that from 700, from our figure of—in other words, we have reduced our rate base by $392,734.83. That would change then our rate base that we show on 4–B from $44,581,-890.42 to $44,189,155.59."

"Q. Let me see if I understand you, Mr. Sexton, in an effort to make it clear. When you purchased this property, you have testified that you were not able to get the original cost from Bell, although it was requested?"

"A. We had just an engineering figure on that, that is right."

"Q. In your treatment of it, you applied the 32 per cent factor because you knew the use in your treatment of the depreciation?"

"A. That is the use that that plant was put to."

"Q. The commission staff has requested, has suggested that 82 per cent, the overall factor should be applied, applying that would make a difference in the treatment of three hundred and how many thousand?"

"A. $392,734.83. A reduction in rate base."

"Q. That is the commission's judgment, if they decide to treat it the way you treated it, or the way the staff has suggested that it be treated?"

"A. That is the difference."

"Q. That is the effect of it?"

"A. Yes."

Mr. Sexton did agree on cross-examination that the company used one basis to allocate depreciation reserve and another for depreciation expense on the Bell purchase. This can be seen on page 109 of the transcript as follows:

"Q. (By Mr. Atkins) Now for the basis of reducing your rate base, by virtue of the depreciation reserve you have used 37 per cent. Now by the basis,—for the basis of establishing expense, you have used 82 per cent, is that not correct?"

"A. (By Mr. Sexton) That is right, yes sir."

Commission's Findings and Conclusions

It is apparent from the record in this cause and from the commission's official files that the company has used inconsistent percentages in apportioning its depreciation reserve and expense on the Bell acquisition.

The ratepayers are required to pay rates that will compensate the company for its expenses and allow a rate of return on its investment as mentioned in the beginning of this order. Depreciation expense is, of course, one of these expenses the rates must cover. On the other hand, the depreciation reserve reduces the rate base on which the company is entitled to earn a return. To follow the company's procedure in this instance would be to allow it to charge 82.09 per cent of the depreciation expense on this Bell purchase to the intrastate operations while reducing the rate base through the depreciation reserve by only 37.14 per cent on the same plant, which is highly inconsistent and inequitable to the intrastate ratepayer.

The commission is of the opinion and finds that the 82.09 per cent should be applied in this instance to both the depreciation expense and the depreciation reserve. We believe that an adjustment should be made in the depreciation reserve for the excess depreciation which resulted from the overstatement of the cost of the Bell plant on the company's books and records, therefore, we find the staff's proposed depreciation reserve adjustment proper to use in establishing the rate base.

Unamortized Investment Credit

General Comments

[9, 10] The unamortized investment credit account on the books of the company represents funds that have been made available through the rate structure by virtue of using the "service life flow-through" method of accounting for the benefits of investment credit on federal income taxes. Section 38 of the Internal Revenue Code, 26 USCA § 38, permits nonregulated companies to offset their tax liability by 7 per cent of the cost of tangible property fitting certain qualifications. Utilities such as the company herein are permitted to offset their tax liability by 3 per cent of the cost of the qualifying tangible property.

This commission issued an order on August 6, 1965, in Docket No. G-4557 (60 PUR3d 450), to the effect that each utility subject to the jurisdiction of this commission could elect to adopt either the "service life flow-through" or the "initial year flow-through" methods for the treatment of the investment tax credit as provided by § 38 of the Internal Revenue Code. The company has elected and is using the "service life flow-through" method for the investment tax credit in its operations.

The company by using said method reflects the federal income tax expense at an amount greater than its actual federal income tax liability. The difference is then reflected in the unamortized investment credit account, which is written off to income over the life of the property giving rise to the investment credit. The balance not amortized is the amount we are concerned with here.

Staff's Testimony

The staff takes the position that the amount of $512,784.76 in the company's unamortized investment credit account should be deducted from the rate base, because it is actually capital which has been supplied by the ratepayer.

It states the unamortized investment credit account results from federal income tax expense charged to operations which were greater than the actual tax liability and since the rates paid covered this additional income tax expense, not actually paid, it results in capital contributed by the ratepayer rather than the investors. The staff contends that the ratepayers should not be required to pay a rate of return on capital which they have contributed to the company, and that this can be prevented in this situation by deducting the amount in the unamortized investment credit account from the rate base.

Company's Testimony

The company does not propose to reduce its test-period rate base by the amount in the unamortized investment credit account. Witness Sexton stated he felt that this amount is not a contribution by the ratepayers. The company left this in the rate base, because it feels this is money belonging to its investors rather than the ratepayers.

Witness Gleason appearing for the company did not testify on the use of the unamortized investment credit account, however, he did in Exhibit No. 17, Schedule 3, include the unamortized investment credit at a zero weight in calculating his projected earnings.

Commission's Findings and Conclusions

As indicated above the company has elected to use the "service life flow-through" treatment of the investment credit. This treatment gives rise to funds made available by this provision of the Internal Revenue Code. These funds are temporarily retained by the utility and provide means for the company to acquire additional plant and equipment or to use interest-free in any manner it so desires.

Under the "service life flow-through" method the capital resulting from the investment credit gradually flows through to the subscriber. This commission approves of this method as indicated in the above-mentioned order, therefore, our problem herein is to reach a conclusion as to the treatment of the funds temporarily retained and being used by the company, that is, should the company be allowed to earn a rate of return on these funds.

We are of the opinion that the company should not be allowed to earn a return on the temporarily retained funds in the unamortized investment credit account. These funds are made available by the Internal Revenue Code and are actually received through the rate structure from the ratepayers, consequently, we do not feel the ratepayer should be required to pay the company a return on these funds. We do not agree with Witness Sexton's theory that these interest-free funds should inure to the benefit of the investors of the company. The purpose of the "service life flow-through" method is to require the funds to be gradually flowed through to the consumer. This method merely provides that it be done gradually as opposed to the "initial year flow-through" method which required the benefits to flow through in the year received.

The commission would point out that even Mr. Gleason, the company's rate of return witness, included these retained funds in his cost-of-capital determination at a zero cost, although he did not testify directly on this point. By including the retained funds at zero cost he is in essence saying the company should not be allowed to earn a return on these retained funds.

We would point out that most jurisdictions allowing or providing for the "service life flow-through" method, under discussion here, do not allow a utility to earn a return on these temporarily retained funds. In denying the utilities a return on these temporarily retained funds the jurisdictions usually take one of two alternatives: (1) The accumulated deferrals are deducted in computing the rate base, (2) the funds are included in the cost-of-capital determination as interest-free money to which there is assigned a zero cost rate.

It is noteworthy to mention that Exhibit 22, presented in this hearing, at pages 38 and 39, reveals that out of 31 jurisdictions permitting or requiring the "service life flow-through" method of accounting, 28 have established rate-making treatments for the accumulated deferrals and 3 have not decided. Of the 28 that have established treatment 18 require the accumulated deferrals (unamortized investment credit account) to be deducted in computing the rate base, 8 do not require the deduction, and 2 consider the deferrals in the cost of capital such as Mr. Gleason did in his Exhibit 17, Schedule 3.

The commission is of the opinion and finds that it is proper to deduct these accumulated deferrals referred to herein as unamortized investment credit from the rate base which in this case is $512,784.76.

Allowance for Working Capital

General Comments

[11] The allowance for working capital includes both cash requirements and materials and supplies. The cash requirements in this case were proposed by both the staff and the company to be one-eighteenth of the operating expenses before depreciation expenses and operating taxes. The difference by which the company's exceed the staff's of $20,003.46, in the foregoing table, is the result of the company proposing to make adjustments to the test period in operating expenses not considered by the staff. The difference in materials and supplies is that the staff proposes to use

the average monthly balance for the test period while the company uses the figure on hand at the end of the test period. The company's figure using test period end exceeds the staff's average figure by $8,443.81.

Commission's Findings and Conclusions

The commission is of the opinion that one-eighteenth of operating expenses will be a reasonable allowance for working capital in this case. Although one-eighteenth of operating expenses will be used herein, we would point out that the use of a "lead and lag" study would more accurately determine adequate cash requirements, and the use of one-eighteenth of operating expenses herein will not necessarily be a precedent we will follow.

We do not accept in total the position taken by either the company or the staff on operating expenses and for that reason the figure of $215,033.39 adopted by the commission as one-eighteenth of operating expenses will not be consistent with that of either the company or the staff in the foregoing table. We find operating expenses, less depreciation and taxes, of $3,870,601.07 to be proper in this proceeding. The total used in this finding is explained fully under the expense section of the order and for cash requirements we find one-eighteenth of these expenses or $215,033.39 is proper to use herein as cash requirements in working capital.

[12] The average for the test period in materials and supplies is the proper figure to use. This is consistent with our use of average plant in service and is adopted for basically the same reasons.

The commission has now commented and ruled on each item comprising the rate base according to the company's and the staff's proposals and will set out below the rate base resulting from our conclusions. However, by virtue of our findings on the matter of accelerated depreciation it is first necessary to make another adjustment to the rate base not proposed by either the staff or the company and that is an adjustment for the federal income tax deferral account.

Deferred Income Taxes

General Comments

[13] It is the conclusion of this commission to permit the company to normalize the tax effects of accelerated depreciation.

Normalization of the tax effects of accelerated depreciation results in a deferral account for deferred income taxes similar to that discussed above in unamortized investment credit. However, the difference in the two is that theoretically the unamortized investment credit will flow through to the consumer over the life of the property, while income tax deferrals, as the name implies, will be used to pay future taxes. The two are similar in that they both give rise to funds made available by the applicable provisions of the Internal Revenue Code. These funds arising by virtue of the company normalizing the tax effects of accelerated depreciation, like those from the unamortized investment credit account, are temporarily retained by the utility and do, in effect, provide means for the company to acquire additional plant and equipment or to use interest-free in any manner as it determines to be proper.

Staff's Testimony

The staff did not deduct the tax deferral from its computation of the rate base. However, Mr. Burcham testifying for the staff stated, in his opinion, that if the commission allowed normalization of the tax effects of accelerated depreciation then the deferral account should be deducted in arriving at a rate base.

Company's Position

The company's witnesses did not testify concerning their position on these tax deferrals. However, they did, in their exhibits, normalize the tax effects of accelerated depreciation but did not calculate or propose to deduct the deferred income tax account from the rate base, nor did they propose to use this at zero weight in their cost-of-capital computation.

Commission's Findings and Conclusions

This commission is of the opinion, for the same reasons set forth in its decision on unamortized investment credit, that the company should not be allowed to earn a return on the temporarily retained funds in the income tax deferral account.

Most jurisdictions allowing or providing for normalization do not permit a utility to earn a return on these temporarily retained funds. For a comparison we would refer to Exhibit 22, pp. 38, 39, which shows that out of the 22 jurisdictions allowing normalization of the tax effects of accelerated depreciation 12 require the accumulated deferrals to be deducted in computing the rate base, 6 do not require the deduction, 2 consider the deferrals in the cost of capital at zero weight, and 2 have not decided.

Based on the foregoing reasons and those set out in the unamortized investment credit section of this order the commission finds that the income tax deferral account in the amount of $124,669.88 should be deducted in calculating the rate base herein.

Summary of Rate Base

From the evidence and matters related in the foregoing conclusions, the commission finds a depreciated rate base of $36,205,437.07 to be fair and reasonable for the test period.

This figure is derived as follows:

Average Plant in Service	$45,106,462.37
Property Held for Future Use	14,372.02
Plant Acquisition Adjustment	403,933.80
Subtotal	$45,524,768.19
Less: Depreciation Reserve	$ 9,550,497.68
Unamortized Investment Credit	512,784.76
Federal Income Tax Deferrals	124,669.88
Subtotal	$10,187,952.32
Add Allowance for Working Capital:	
One-eighteenth of Operating Expenses	$ 215,033.39
Materials & Supplies	653,587.81
Subtotal	$ 868,621.20
Rate Base	$36,205,437.07

Revenues and Expenses

General Comments

[14] As indicated previously the company chose the operating six months ended June 30, 1968, as its test period for this proceeding. The company as well as the commission's staff proposed to make certain adjustments to the actual six months' operations ended June 30, 1968, for the purpose of creating a more representative picture of the anticipated future earnings condition.

Shown in the following comparative table is the proposed "adjusted test period" of the commission's staff and the company, respectively, shown before any proposed rate adjustments:

	TPSC Staff Ex. 25	Petitioner's Ex. 4-C	Petitioner's Exceeds TPSC Staff
Local Service Revenue	$ 7,771,350.42	$ 7,771,350.42	
Toll Service Revenue	1,829,583.04	1,829,583.04	
Misc. Operating Revenue	748,930.50	748,930.50	
Less: Uncollectible Revenue	23,558.02	23,558.02	
Total Operating Revenue	$10,326,305.94	$10,326,305.94	
Current Maintenance	$ 1,297,123.14	$ 1,407,636.35	$ 110,513.21
Depreciation Expense	2,202,663.85	2,202,663.85	
Traffic Expense	812,460.72	876,550.73	64,090.01
Commercial Expense	621,971.44	649,128.66	27,157.22
Operating Rents	91,874.24	91,874.24	
Executive and Legal	71,241.88	84,274.19	13,032.31
Accounting and Treasury	431,533.52	453,770.67	22,237.15
Provision for Service Pensions	136,612.02	245,752.08	109,140.06
Employee Benefits	99,811.90	113,704.33	13,892.43
Other General Expense	154,628.46	154,628.46	
Acquisition Adjustment Amortization	29,737.53	29,737.53	
Less: Expense Charged Construction	136,400.12	136,400.12	
Total Operating Expense	$ 5,813,258.58	$ 6,173,320.97	$ 360,062.39
Net Operating Revenue	$ 4,513,047.36	$ 4,152,984.97	$(360,062.39)
Federal Tax on Income, Reduced by Investment Credit	$ 1,006,968.51	$ 948,446.63	$ (58,521.88)
Other Taxes	1,113,377.32	1,201,846.12	88,468.80
Total Operating Taxes	$ 2,120,345.83	$ 2,150,292.75	$ 29,946.92
Plus: Interest on Const.		$ 227,482.64	$ 227,482.64
Net Operating Income	$ 2,392,701.53	$ 2,230,174.86	$(162,526.67)
Other Income	229,924.50	2,441.86	(227,482.64)
Misc. Income Deductions	6,827.76	6,827.76	
Total Income	$ 2,615,798.27	$ 2,225,788.96	$(390,009.31)
Interest Deductions	1,143,131.70	1,143,131.70	
Net Income	$ 1,472,666.57	$ 1,082,657.26	$(390,009.31)

The above table discloses no difference in revenue between the staff and the company as neither has proposed any adjustments in revenue, except both have considered the effect of toll settlement contracts with Bell. The adjusted test-period figures proposed by the company exceed those proposed by the staff in certain operating expenses and taxes. These differences resulted generally from anticipated increased wages, pension benefits, social security taxes, and property taxes. The federal income tax balance as reflected by the staff's calculation exceeds the company's by $58,521.88. This is because the company's proposed expenses exceed the staff's and because the staff proposed to reflect the tax effects of accelerated depreciation on the basis of "flow through," while the company advocated "normalization."

Staff's Testimony

The staff's position is that future increases in wages, pension benefits, and taxes should not be included in the test-period operating expenses for the purpose of fixing rates because revenue growth and operating economies will be sufficient to maintain the level of earnings experienced in the test period. The staff did propose an adjustment increasing depreciation expense in the test period due to recent changes in the company's depreciation rates. Both staff and company agreed to include these increased depreciation expenses in the test period.

Concerning its position on wages, pension benefits, and taxes, the staff testified that it had made a study of the trends of system revenues and expenses from 1964 through 1968. Following is page 1 of Collective Exhibit 27 presented by the staff on the year-to-year increases in revenues and expenses:

United Inter-Mountain Telephone Company
Trends of Revenues and Expenses
System Total

Year	Total Operating Revenue	Year-to-year Increase	Total Operating Expenses	Year-to-year Increase	Net Operating Revenue	Year-to-year Increase
1964	$12,856,034	$1,033,304	$10,020,257	$ 846,178	$2,835,777	$187,126
1965	14,103,440	1,247,406	10,833,508	813,251	3,269,932	434,155
1966[1]	16,640,950	2,537,510	12,462,104	1,628,596	4,178,846	908,914
1967	18,111,310	1,470,360	13,693,277	1,231,173	4,418,033	239,187
1968	20,071,653	1,960,343	15,773,296	2,080,019	4,298,357	(119,676)

[1] First full year at rates authorized by Docket No. U-4752 except for the following exchanges: Bluff City, Jonesboro, Mosheim, Baileyton, Blountville, Roan Mountain, and Limestone.

Source: Company's annual report.

The staff noted that revenue growth since 1964 was sufficient to offset the growth in operating expenses except for 1968. A number of factors could have caused the downturn of earnings in 1968. Some of these are increased wages and pension benefits and the 10 per cent surtax imposed on corporations for the calendar year 1968. The staff contends that the growth in revenues and expenses would have to be considered in conjunction with the growth in plant to evaluate the effects on the company's rate of return.

The staff presented the following charts on page 525 which show an analysis of the percentages of wages that were capitalized and expensed from 1964 through 1968.

These charts indicate that the percentage of wages charged to expense has increased substantially in the test period over preceding periods. The charts also reveal that 75.94 per cent of the wages was expensed for

United Inter-Mountain Telephone Company
Trends of Wages and Percentages Charged Construction, Removals, and Expense System Total

Total Wages Charged
Construction, Removals, and Expenses

Year	Amount	Percentage of total	Year-to-year Increase
1964	$4,037,196	100%	$ 291,393
1965	4,374,901	100%	337,705
1966	5,059,677	100%	684,776
1967	5,719,069	100%	659,392
1968	6,975,085	100%	1,256,016

Wages Charged Construction and removals			Wages Charged Expense		
Amount	Percentage of Total	Year-to-year Increase	Amount	Percentage of Total	Year-to-year Increase
$1,086,526	26.91%	$ 56,595	$2,950,670	73.09%	$ 234,798
1,207,953	27.61%	121,427	3,166,948	72.39%	216,278
1,390,220	27.48%	182,267	3,669,457	72.52%	502,509
1,517,927	26.54%	127,707	4,201,142	73.46%	531,685
1,678,017	24.06%	160,090	5,297,068	75.94%	1,095,926

Source: Page 72 of the company's annual report

Trends of Year-to-year Increases in Revenues and Wages Charged Expense
System Total

Year	Annual Increase in Revenues	Annual Increase in Wages Charged Expense	Annual Increase in Revenues Less Wages Charged Expense
1964	$1,033,304	$ 234,798	$ 798,506
1965	1,247,406	216,278	1,031,128
1966[1]	2,537,510	502,509	2,035,001
1967	1,470,360	531,685	938,675
1968	1,960,343	1,095,926	864,417

[1] First full year at rates authorized by Docket No. U-4752 except for the following exchanges: Bluff City, Jonesboro, Mosheim, Baileyton, Blountville, Roan Mountain, and Limestone.

the year 1968, whereas for 1967, 73.46 per cent of the wages was expensed or approximately 2.5 per cent increase for 1968 over 1967. The year-to-year percentage from 1964 through 1968 remained relatively constant. It is further noted that the hiring of additional employees and the substantial increase in wages appeared to account for the 1968 increase in wages charged expenses of $1,095,926, which were extraordinary when compared to past experience. Exhibit 27, page 3, shows that the growth in revenues was more than enough to offset the growth in wages charged expenses.

Page 4 of Exhibit 27 shows the amount of revenue per average main station, the wages charged expense per average main station, and the revenue less wages charged expense per average main station. The staff contends that the increase or growth in revenue per station has been sufficient to offset the increases in wages charged expense per station. The increase in revenue per station for 1968 over 1967 was $6.69 and the increase in wages per station was $6.65, leaving a balance of 4 cents of increased revenue after increased wages. Page 5 of Exhibit 27 contains an analysis similar to the one discussed on page 4 in that it reflects the pensions charged expense per average main station. This schedule reveals that the pension expense per average main station had decreased 16 cents in 1968 over 1967 and that a comparison of the increase in wage and pension expense with the increase in revenue reflects that the growth of revenue has offset the increase in both wages and pensions.

Page 6 of Exhibit 27 demonstrated the effect the August, 1967, wage increase had on 1968 operations. Following is a table taken from page 6 of Exhibit 27:

United Inter-Mountain Telephone Company
System Trends of Wages Per Average Employee
For the Six Months Ending June 30, 1964, 1965, 1966, 1967, and 1968

Year	Total Wages	Average Number of Employees*	Semiannual Wages Per Average Employee	Six Months-to-Six Months' Increase: Amount: Employees	Amount: Wages	Percentage: Employees	Percentage: Wages
1964	$1,968,678	951	$2,070	54	26	6.02	1.27
1965	2,125,635	987	2,154	36	84	3.79	4.06
1966	2,410,036	1,044	2,308	57	154	5.78	7.15
1967	2,679,695	1,126	2,380	82	72	7.85	3.12
1968	3,297,029	1,241	2,657	115	277	10.21	11.64

* Average computed on a monthly basis.
Source: Company's annual report and monthly statement.

This table isolates more fully the effects the August, 1967, wage increase had on 1968 operations. Since said wage increase was granted, a comparison of the first six months of the calendar year 1967 with the first six months (test period) of 1968 can be more reasonably relied on to evaluate the impact the wage increase had on the test-period operations. The number of employees percentagewise had increased substantially over preceding periods. This is significant because the number of employees increased 10.21 percent for 1968 over 1967; whereas the increases from 1964 through 1967 ranged from a low of 3.79 per cent in 1965 to a high of 7.85 per cent for 1967. It was reasoned that the increase in wages when compared to past experience is accounted for in part by larger increases in the number of employees. The 11.64 per cent increase in wages per average employee for the test period over the same period in 1967 clearly emphasized the extraordinary effects of the 1967 wage increase. Since the effects of the wage increase were included in the test-period operating expenses, the inclusion of additional wage and pension contracted for in August of 1968 and 1969 would be unjustified unless the growth in revenues was also considered.

In making its analysis of the test-period results of operations the staff concluded that regularly occurring changes in revenue and expenses tend to be offsetting against each other, and, accordingly, made neither an adjustment for the increased wage rates nor for the increased revenue per telephone.

Following is part of Exhibit 29 presented by the staff which clearly illustrates the foregoing statement:

United Inter-Mountain Telephone Company
Comparison of Six Months-to-Six Months Rates of Return
For the period January 1, 1964, to December 31, 1968
System Total

	1967		1968	
	June 30	December 31	June 30	December 31
Operating Revenues	$ 8,841,500	$ 9,269,810	$ 9,747,162	$10,324,491
Operating Expenses	6,703,883	6,989,394	7,683,009	8,090,288
Net Operating Income	$ 2,137,617	$ 2,280,416	$ 2,064,153	$ 2,234,203
Net Operating Income[1]	$ 4,275,234	$ 4,560,832	$ 4,128,306	$ 4,468,406
Plant in Service	$71,479,725	$78,272,515	$83,311,710	$90,230,531
Depreciation Reserve	14,532,301	15,130,805	16,137,950	16,959,381
Net Plant in Service	$56,947,424	$63,141,710	$67,173,760	$73,271,150
Average Net Plant*	$55,840,379	$60,044,567	$65,157,735	$70,222,455
Rate of Return on Average Net Plant	7.66%	7.59%	6.34%	6.36%

[1] Annualized.
* Average is computed on the beginning and ending period balance.
Source: Company's monthly statements.

The last six months of 1968 included the effects of the 1968 increase in wages and pension from August 25th through December and while these increases were felt in the period succeeding the test period they did not depress the earnings as was maintained by the company. Again the staff stated that it was apparent that increased revenues and operating economies were sufficient to maintain the level of earnings without including the effects of these increases in wages and pensions in the test period because the rate of return on average net plant in service for the system was slightly higher in the last six months than the first six months (test period) of 1968.

Company's Testimony

Witness Sexton testified that the minimum wage had increased since the last rate order in 1965 from $1.25 per hour to the present $1.60 per hour. He stated that the company had fully complied with the Fair Labor Standards Act in raising minimum wages and that the rise in minimum wages resulted in a need to raise the wage rates of other levels of employment.

Witness Sexton testified that additional wage increases were scheduled to be made in August of 1968 and 1969. The effect of these wage increases was included in the company's pro forma adjustments on its exhibits. He stated that the August, 1969, general wage increase would be $295,417, and since 1964 the expenses had increased by $163,494 due to increased insurance benefits and $282,741 due to increased pension provisions.

Witness Sexton testified that ad valorem taxes had increased since 1964 and that the property tax rates of the cities and counties had increased as is reflected in Exhibit 1 to the petition. The composite county tax rates, he stated, had increased from $3.85 to $4.19 and that the city composite rate had increased from $2.60 to $2.80, resulting in a combined composite rate increase from $5.91 to $6.40. Mr. Sexton stated these rates were the 1968 rates and that the 1969 tax rates had not been fixed. In the third revision of Exhibit 4—C he proposed to include additional ad valorem taxes of $76,891.36 applicable to intrastate operations.

Witness Sexton testified that in arriving at the $76,891.36 adjustment to ad valorem taxes he used the formula developed by the commission for assessing utility property. He entered said formula as Exhibit 5. It was his position that the property tax assessment made by the commission would increase because the rate increase would generate more income. In turn, this increase in income, reflected in the formula, would cause the assessment level to increase. It appears that Mr. Sexton is testifying that as his gross revenue increases, his property tax assessment level increases. Following is a question and answer from Mr. Sexton's direct testimony:

"Q. (By Mr. MacFarland) Mr. Sexton, is this what you wanted?

In regard to Exhibit No. 5, in making assessments, the amount of revenue you used in the net operation?"

"A. It is used in that formula by the commission, yes sir. We find this, that in 1965, our Tennessee gross revenue, $9,642,198. Our taxes for that year, our ad valorem taxes for that year in 1965, $716,262.78. Then we worked that on up to 1968, when our gross revenue was $13,776,706, and our gross receipt—not our gross receipts, but our ad valorem taxes are about $923,872.65.

"So we see there that our revenues went up, ad valorem taxes, about $207,000. So we have taken this figure, used the formula in working it down and came up with this figure of $76,891.36."

Witness Sexton stated the 10 per cent surtax raised the effective corporate tax rate from 48 per cent to 52.8 per cent and he was of the opinion that it would continue indefinitely. He also testified that social security taxes increased on January 1, 1969.

Commission's Findings and Conclusions

The commission would point out at the outset that its objective is to make a finding as to the reasonableness of the expenses included in the test-period operations for the purpose of fixing rates. We recognize from the exhibits and testimony that revenue growth has been prevalent. Although both the staff and the company recognize and admit that expenses are increasing rather substantially, the question is whether expenses and revenue growth will be such as to maintain the level of earnings in future periods. This depends not only on revenue and expense growth but upon the technologies, operating economies, and a multitude of other factors. It is an established fact that the company will experience the expense of 1968 and 1969 wage and pension increases.

The commission would note here that the company did not propose to include the 1969 pro forma adjustments until the separation procedures changed, as set out in the beginning of this order. We cannot help but feel that these 1969 pro forma expenses were inserted by the company to offset the shifting of a portion of the operating expenses from the intrastate to interstate operations.

We have already pointed out that future rates are set on the basis of the experience shown from the test period. We feel that going too far outside this test period in adjusting for known increased costs creates a highly speculative and distorted earnings position for setting future rates unless due consideration is given to revenue growth for the same period.

Due to an abundance of caution the commission is of the opinion that the 1968 pro forma expenses reflected on the original exhibit should be included in the test-period operating expenses for the purpose of setting rates. It is our conclusion that these 1968 pro forma expenses should be apportioned on the basis of the procedures employed in the company's amended exhibits (4–A, 4–B, and 4–C). In our considered opinion the 1969 pro forma expenses should not be considered in establishing rates based on the conclusions stated above.

In reference to taxes the commission would note that Witness Sexton related the growth in gross revenue to the growth in the property taxes, but we are fully cognizant that gross revenue is not a part of the formula used by the commission's staff in assessing utility property. An examination of Exhibit 5 introduced by Witness Sexton will reveal that net operating income is the factor used rather than gross revenue. We are aware of the changing property tax situation which apparently will benefit the utilities in that the effective tax rate is likely to decline substantially due to the increase in the assessment level of locally assessed property. In connection with this we would mention the recent decline of the tax rates in Sullivan county from $4.35 per hundred dollars to $2.40 per hundred dollars. A substantial amount of the company's property is located in Sullivan county.

The commission is of the opinion and finds that the following operating results reflecting the conclusions set out in this order are fair and reasonable and should be used for the purpose of fixing the company's future rates:

United Inter-Mountain Telephone Company

Local Service Revenue	$ 7,771,350.42
Toll Service Revenue	1,829,583.04
Misc. Operating Revenue	748,930.50
Less: Uncollectible Revenue	23,558.02
Total Operating Revenue	$10,326,305.94
Current Maintenance	$ 1,360,648.77
Depreciation Expense	2,202,663.85
Traffic Expense	850,208.51
Commercial Expense	637,704.92
Operating Rents	91,874.24
Executive and Legal	78,844.94
Accounting and Treasury	443,914.77
Provision for Service Pensions	245,744.39
Employee Benefits	113,694.66
Other General Expense	154,628.46
Acquisition Adjustment Amortization	29,737.53
Less: Expense Charged Construction	136,400.12
Total Operating Expense	$ 6,073,264.92
Net Operating Revenue	$ 4,253,041.02
Federal Tax on Income Reduced by Investment Credit	1,041,752.79
Other Taxes	1,125,185.97
Net Operating Income	$ 2,086,102.26
Other Income	$ 229,924.50
Misc. Income Deductions	6,827.76
Total Income	$ 2,309,199.00
Interest Deductions	1,143,131.70
Net Income	$ 1,166,067.30

"Normalization" versus Flow-through Treatment

General Comments

[15] The commission has indicated in preceding sections its intention concerning the tax effects of accelerated

depreciation. We will now comment fully on this item.

As pointed out above the rates charged by a regulated utility should be sufficient to cover the cost of service plus a specified rate of return on the utility's investment or rate base. Taxes, of course, are part of the utility's cost of service. The amount of taxes paid in a given year will depend on whether or not the utility elects to take accelerated depreciation provided in § 167 of the Internal Revenue Code, 26 USCA § 167. When considering single items of property the use of accelerated depreciation will result in a decrease in income tax payments during the early part of the useful life of the property and an increase in such payments during the remaining period of the useful life of the property.

When the tax effects of this accelerated depreciation are normalized, the ratepayers pay in sufficient rates to cover what the taxes would have been on a straight-line depreciation basis rather than what is actually paid due to the decrease resulting from accelerated depreciation. The difference between the actual taxes paid and the larger hypothetical amount based on straight-line depreciation is accumulated in a deferred tax account to be used when taxes are higher during the later life of the property.

Under the flow-through treatment of the tax effects of accelerated depreciation, the ratepayers reimburse the utility for federal income taxes actually paid. The utility does not accumulate a deferral account and the cost of service reflects only the actual liability for federal income taxes on a year-to-year basis.

The controversy that arises between the exponents of the respective methods centers around the question of whether or not accelerated depreciation results in a permanent tax saving or a tax deferral.

Staff's Testimony

The staff took the position in this matter that the accelerated depreciation results in a tax saving and that, in effect, the amounts accumulated in the deferred income tax accounts are enforced contributions from the ratepayers. It maintained that the ratepayers should be charged for only the actual liability for federal income taxes.

It also insisted that if the utility is stable or expanding, requiring the utility's continued reinvestment in plant equal to or in excess of plant retirement, a program of accelerated depreciation produces true tax savings because there will never be a reduction in the deferral accounts.

Company's Testimony

The company stated that its treatment of accelerated depreciation results merely in a tax deferral. It contended it would be required to pay higher taxes in the later life of the property on which it took accelerated depreciation and that, consequently, the deferred accounts would be used at that time.

Commission's Findings and Conclusions

The commission has engaged in extensive conferences and studies concerning the tax effects of accelerated

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depreciation and finds numerous authorities supporting both the normalization theory and the flow-through theory. Both sides present arguments that can result in endless debates and we will not herein attempt to expound on these arguments for either side.

After careful study it appears to us that the use of accelerated depreciation provided for in § 167 of the Internal Revenue Code will result in a tax deferral rather than a tax saving and, consequently, the company should be allowed rates sufficient to cover what the taxes would be on a straight-line basis. This will allow the company to accumulate in a deferred tax account amounts to be used when taxes are higher during the later life of the property.

We are of the opinion that normalization is equitable and fair for both the consumer and the company in this proceeding.

The commission is aware that the accumulated reserve funds that will be established by the company as deferred income taxes are, in effect, interest-free capital that can be used by the company as it sees fit. We do not feel that the company should be entitled to earn a return on this amount and, consequently, we have provided for the deduction of deferred income taxes from the rate base in the rate base section of this order.

Capitalization—Rate of Return

General Comments

[16] Testimony and exhibits with respect to rate of return were submitted by both the staff and the company.

Basically the staff witness recommended a 9.50 per cent return on common equity, and based upon the capital structure at December 31, 1968, a cost of capital of 7.15 per cent was recommended to be adequate on a rate base of $35,897,356.

The company's witness indicated a fair rate of return should not be less than 7.50 per cent but should be in the range of 7.50 per cent to 8 per cent. The company proposed that an 11 to 12 per cent return on common equity is needed in order for United Inter-Mountain to maintain earnings on common equity consistent with those of the other United Utilities companies.

Staff's Testimony

The staff developed cost of capital of 7.15 per cent as set forth in the following table:

	Capital Obligation	Return	Earnings
Equity capital	$32,898,260	9.50%	$3,125,335
Long-term Debt	35,303,000	4.88	1,722,786
Other Notes Payable	8,900,000	7.50	667,500
Total	$77,101,260		$5,515,621
Cost of Capital			7.15%

Such cost of capital was computed using the capital structure of the company at December 31, 1968. It was calculated to be 7.15 per cent using a 9.50 per cent allowance on equity capital, 4.88 per cent allowance on long-term debt, and 7.50 per cent on other notes payable.

The staff's witness testified that the 9.50 per cent allowance on equity capital was a judgment determination and that he had determined this percentage after considering the ability of the company to support its credit position, the ability to attract additional capital for expansion, and comparison of rates of return for other companies.

The 4.88 per cent allowance on the long-term debt is the embedded cost of debt at December 31, 1968. This computation was consistent with that of the company. The 7.50 per cent allowance on other notes payable reflected the prime rate of interest at that time, although the company was actually paying less than 7.50 per cent on some of its short-term notes.

The staff's witness prepared exhibits to show the effect on the cost of capital using the consolidated capital structure of United Utilities, Inc. (United Utilities is the parent corporation of United Inter-Mountain Telephone Company). The exhibits showed that United Utilities has consistently maintained a debt ratio of approximately 60 per cent of its total capital, while United Inter-Mountain had a debt ratio ranging from a low of 37.95 per cent in 1962 to a high in 1967 of 52.06 per cent and in 1968 it dropped back to 51.76 per cent. These comparisons are particularly significant because the capital structure has a substantial effect upon the cost of capital and the cost of service.

The staff's witness stated that the 7.15 per cent rate of return is a fair and reasonable return for United Inter-Mountain to earn on its original cost rate base and that it should move toward a capital structure of 60 per cent debt and 40 per cent equity.

Company's Testimony

The company parallels its study on rate of return with the principles set forth in the Bluefield Water Works case decided in 1923 (262 US 679, PUR1923D 11, 20, 21, 67 L Ed 1176, 43 S Ct 675). Mr. Gleason in his testimony referred to the holding in this case that states: ". . . A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks . . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties . . . ."

The company maintained that the principles stated in the above-cited case express the controlling law. It pointed out that the application of these principles to measure the adequacy of a rate of return is usually not easy or exact. Witness Gleason stated that the process requires a review of rates of return earned by or allowed to other companies, a knowledge of the capital requirements of the company under study, informed judgment as to the costs of any new capital needed, a knowledge of the terms on

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which securities may be issued, and several other factors.

He further stated that he had applied these principles to measure the adequacy of the rate of return earned by United Inter-Mountain Telephone Company and found the rate of return to be much too low. He took the position that a fair rate of return for the company is not less than 7.50 per cent and should be in the range of 7.50 per cent to 8 per cent.

Witness Gleason commented on the following principles set out in the Bluefield Water Works case:

Comparable earnings test—Rate orders in the last few months in the Southeast United States have allowed rates of return to telephone companies from 7.18 per cent to nearly 7.50 per cent.

Capital attraction test—The rate of return must be high enough to enable the company to attract the permanent capital needed now and in the future.

Mr. Gleason testified it was becoming more difficult to attract the permanent capital the company needs because of conditions in the present bond market of high interest rates. For a comparison he discussed the recent sales he had completed for United Telephone Company of the Northwest, United Telephone Company of Missouri, and Capitol City Telephone Company of Jefferson City, Missouri.

He further stated that the short-term debt of the company now exceeds $11 million and that this short-term borrowing is expected to continue in order to finance operating and construction requirements. When the short-term borrowings accumulate to an amount which makes it economic to do so, the company refinances with permanent types of capital. The company herein plans to sell $8 million of bonds in the second quarter of 1969 and issue $4,500,000 in common stock to United Utilities, these funds to be used to pay off the short-term borrowing.

On December 31, 1968, the company had a debt equity ratio of 51.5 per cent to 48.5 per cent. According to the 1969 budget, the sale of bonds and stock will result in the long-term debt representing about 51 per cent of invested capital, short-term debt 4 per cent, and common equity 45 per cent.

He further elaborated that the cost of new equity capital to United Inter-Mountain is related to the cost of new equity to United Utilities due to the fact that all of the outstanding stock of United Inter-Mountain is owned by United Utilities and all future issues of United Inter-Mountain common stock will be purchased by United Utilities. The cost of new equity capital cannot be determined from United Inter-Mountain's own market experience as it has no public market for its stock.

His testimony and exhibits showed United Utilities' average return on common equity over the past few years and he compared these with United Inter-Mountain's experience for the test period, adjusted test period before the proposed rate increase, and the adjusted test period after the proposed rate increase.

Commission's Findings and Conclusions

The commission is aware that the proper rate of return to be allowed this company is one of the most important determinations it has to make in this proceeding. A return which is too low could impair the ability of the company to raise additional needed capital and also have adverse effects on its existing investment, which in turn would hinder the service rendered to the public. By the same token a rate of return which is too high would result in charges to the public exceeding the just and reasonable level.

We are cognizant of the generalizations presented by the company that the rapidly expanding economy of the area which it serves requires utilities financially healthy enough to be able to finance investments for additions to plant necessitated by said expanding economy. We would point out that the financial health of the company depends not only on the rate of return allowed by the commission but also the determination of a price for the service which will create a demand, and be fair and reasonable to both the company and the public.

We have reviewed thoroughly the testimony of all the witnesses and at this point would mention some of the conclusions drawn by Witness Gleason in his testimony and exhibits. Mr. Gleason presented exhibits on the determination of earnings on common equity, showing (1) the earnings for the actual test year (actually the 6-month test period doubled or annualized), (2) the earnings considering the pro forma expense adjustments before the proposed rate increase, and (3) the earnings considering both the pro forma expense adjustments and the proposed rate increase. The earnings on common equity in the first instance were calculated to be 7.935 per cent, in the second 5.964 per cent, and in the third 9.953 per cent. Mr. Gleason contended the 9.953 per cent to be inadequate because it was not comparable to returns being earned on equity in other United Utilities subsidiaries. We would point out that these calculations were based on the financial exhibits and proposals presented by the company on operating expenses and taxes. The same calculations taken on what we have found reasonable and fair in the foregoing portions of this order for operating expenses and taxes would produce something quite different than the 9.953 per cent Mr. Gleason has used in his calculations and comparisons. The return on common equity calculated by Mr. Gleason here and used in his comparisons represents the United Inter-Mountain Telephone Company system's totals which obviously reflect the earnings on system equity which would result from rates established by various jurisdictions, i.e., Virginia, the FCC, and this commission. It is, accordingly, noted that the rate of return on equity devoted to Tennessee intrastate properties is what we should concern ourselves with here. We believe this can be accomplished by ascertaining the respective costs of each class of capital in the system's total capital structure. By the application of the respective costs or rates to the proportion of each class of capital the weighted cost for the total capital can then be determined and applied to the intrastate investment or rate base found to be proper.

Another significant point is that the earnings of 9.953 per cent presented by

Mr. Gleason were apparently based on Witness Sexton's pro forma adjustments along with certain staff adjustments which were accepted and incorporated into the exhibits of the company while certain other adjustments which would have affected the 9.953 per cent were not reflected by Mr. Gleason in his calculations.

The commission has reviewed thoroughly the testimony of all the witnesses and considered the evidence of record fully as it relates to a rate of return. Since the hearing in this matter the prime interest rate has increased to 8.50 per cent and the cost of bonded indebtedness has increased. We have also taken into consideration the effects this higher cost of debt will have on embedded debt cost in the future. We have also considered current business and economic conditions, and all other relevant factors. We have considered the company's earnings and financial experience currently as well as for several prior years. We have also taken into account the returns allowed telephone companies in numerous other formal proceedings and the returns being realized by these other companies. On the basis of the foregoing, the entire record in this matter and applying its considered judgment, having in mind the lawful interests of the ratepayer and the utility, the commission finds that a fair rate of return for the company herein should be 7.50 per cent when applied to the test-period rate base of $36,205,437.07 herein found to be reasonable.

Summary of Findings on Intrastate Operating Results

A summarization of the conclusions reached by this commission in the foregoing indicates the following for the test period at the present rates:

Operating Revenue	$10,326,305.94
Operating Expenses	$ 8,240,203.68
Net Operating Income	$ 2,086,102.26
Rate Base	$36,205,437.07
Rate of Return	5.76%

The evidence is clear, as the above tabulation indicates, that the company's intrastate rate of return is 5.76 per cent. It is apparent that the present rate schedule will not produce the rate of return found proper in our foregoing conclusions.

A rate of return on 7.50 per cent on the fair and reasonable intrastate test-year rate base of $36,205,437.07, indicates the need for approximately $2,715,440.78 in net operating income, or $629,338.52 more than the net operating income produced at present rates. The commission has determined that the additional gross revenue necessary to produce this $629,338.52 will be $1,377,741.45.

We would note at this point that numerous complaints have been received concerning the company's present service. The commission strongly feels that the additional revenues which we have allowed the company in this proceeding should be used by it to the full extent necessary to provide adequate and satisfactory service to its subscribers and to correct promptly the service deficiencies which gave rise to said complaints.

The company in its original petition proposed and requested authority to reclassify each exchange as soon as facilities are available. This proposal indicates the company would offer only one-party and 2-party service inside the base rate area and 4-party service outside the base rate area. The proposal on the 4-party service outside the base rate area indicated this was to be without mileage charges, but with an additional $2 per month above the proposed 4-party rate in lieu of mileage.

The commission welcomes any proposal to eliminate multiparty service but realizes that a project of this magnitude requires much planning and study before the project is approved, especially since approximately 26 per cent of all main stations of the company in Tennessee have multiparty service. The commission is of the opinion that before approval is granted for such a project that a detailed plan should be submitted setting forth a proposed schedule of elimination of multiparty service by exchanges and the estimated date the elimination in each exchange will take place. This plan should also contain details regarding extensions of base rate areas and the substitution of zone rates for mileage charges for one- and 2-party service outside the base rate area. The commission points this out as it has found it necessary in past experience to consider these items when approval is given to elimination of multiparty service.

Numerous complaints have been received and testimony was offered at the hearing from certain subscribers residing in Carter county and served by the Johnson City exchange relative to the existing toll charges for calls to and from Elizabethton, the county seat of that county. The commission feels that some of these complaints are valid and well founded, but is of the opinion that a final and satisfactory disposition of same cannot be made at this time and by this order. However, we insist that the company submit plans calculated to eliminate the existing toll charges for Carter county residents served by the Johnson City exchange, in accordance with Section 3 of our order below.

It is therefore *ordered:*

1. That the petition of United Inter-Mountain Telephone Company to change and increase certain rates and charges for intrastate telephone service in Docket No. U-5175 be, and the same is hereby, granted in part, and the United Inter-Mountain Telephone Company is hereby authorized to increase rates to produce additional annual revenue not to exceed $1,377,741.45.

2. That the petitioner, United Inter-Mountain Telephone Company, file a proposed rate schedule or tariff designed to produce additional annual revenue not to exceed $1,377,741.45 with this commission for its approval.

3. That United Inter-Mountain Telephone Company file a plan for elimination of multiparty service and certain toll charges on or before December 31, 1969, said plan to contain the items discussed in the preceding section of this order concerning such elimination of multiparty service, together with any other items the commission deems pertinent to this project.

4. That Rule 401.6, part (d) of the Rules and Regulations of this commission concerning the effective date of a tariff filing, is hereby waived.

5. That the tariff to be filed by United Inter-Mountain Telephone Company shall become effective on and after August 1, 1969, subject to the approval of this commission.

FLORIDA PUBLIC SERVICE COMMISSION

Re Florida Power Corporation

Docket No. 9981-EU, Order No. 4700
June 24, 1969

APPLICATION *by power utility for approval of territorial agreement and establishment of service area boundaries; granted.*

Monopoly and competition, § 29 — Division of territory or service field — Territorial agreements.

[FLA.] Where two or more power utilities serve the same general area, this is indicative of overlapping and duplication of facilities, and a separation of service areas is then called for so that each utility may realize its full growth potential while providing full-quality service to the affected area. [1] p. 538.

Monopoly and competition, § 17 — Commission jurisdiction — Territorial agreements with municipalities.

[FLA.] Although a state commission has no jurisdiction over a municipality, it does have the power and authority to examine a territorial agreement to which a regulated public utility is a party. [2] p. 538.

Monopoly and competition, § 29 — Division of territory or service field — Territorial agreements.

[FLA.] Territorial agreements involving a regulated public utility and a municipality, when properly presented to the commission in the proper circumstances, are advisable and are in the public interest. [3] p. 538.

Monopoly and competition, § 16 — Jurisdiction and powers — State commissions — Severance of service areas.

[FLA.] Where a public utility and a municipality apply for permission to establish service area boundaries in order to avoid overlapping and duplication of service, the state commission is justified in attaching a condition to the application which would assure that new customers entering the certificated area would be served by the appropriate utility. [4] p. 539.

APPEARANCES: B. Kenneth Gatlin of the firm of Parker, Foster & Madigan, Tallahassee, and Harry A. Evertz, III, St. Petersburg, for the petitioner; Roy T. Rhodes, Tallahassee, for the city of Tallahassee; Prentice P. Pruitt, Chief Staff Counsel and Director of Legal Department, Florida Public Service Commission, for the commission staff and the public generally.

By the COMMISSION: By application in this docket, Florida Power Corporation seeks approval of a terri-

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
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August 25, 1999

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Honorable Terrell L. Black
Attorney for AquaSource Utility, Inc
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Louisville, KY. 40202

RE: Case No. 99-303

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

Stephanie Bell

Stephanie Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

<u>O R D E R</u>

On July 9, 1999, AquaSource Utility, Inc. ("AquaSource Utility") applied to the Commission for authority to transfer ownership rights of Goshen Utilities, Inc. to AquaSource Utility. KRS 278.020(5) requires the Commission to grant, modify, refuse or prescribe terms and conditions to such application within 60 days after the filing or on a later date mutually acceptable to the Commission and the acquirer – in this case, AquaSource Utility.

Upon review of the application, the Commission determined that additional information was required before a decision could be rendered. Therefore, on August 12, 1999, the Commission ordered AquaSource Utility to file additional information by August 23, 1999. In addition, the Commission scheduled an informal conference for August 23, 1999.

On August 23, 1999, AquaSource Utility filed a motion for an extension of time to and including August 30, 1999, to comply with the Commission's request for additional information. Due to the requested extension of time, AquaSource Utility agreed to grant the Commission a 30-day extension on its statutory 60-day period.

The Commission having considered the motion and being otherwise sufficiently advised, finds that the motion should be sustained and the time within which AquaSource Utility is to file the information extended to the close of business August 30, 1999. The Commission further finds that the informal conference scheduled for August 23, 1999 should be cancelled.

IT IS THEREFORE ORDERED that:

1. AquaSource Utility is granted an extension to and including August 30, 1999 to comply with the Commission's Order of August 12, 1999.

2. The informal conference scheduled for August 23, 1999 is cancelled.

3. The time in which the Commission is to render a decision in this case shall be extended to October 7, 1999.

Done at Frankfort, Kentucky, this 25th day of August, 1999.

By the Commission

ATTEST:

Executive Director

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

August 16, 1999

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Attorney for AquaSource Utility, Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

RE: Case No. 99-303

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

Stephanie J. Bell

Stephanie Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

ORDER

The Commission, on its own motion, HEREBY ORDERS that an informal conference shall be held August 23, 1999 at 9:00 a.m., Eastern Daylight Time, in Conference Room 1 of the Commission's offices at 730 Schenkel Lane, Frankfort, Kentucky.

Done at Frankfort, Kentucky, this 16th day of August, 1999.

By the Commission

ATTEST:

Helen C. Helton
Executive Director

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

August 12, 1999

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Attorney for AquaSource Utility, Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

RE: Case No. 99-303

We enclose one attested copy of the Commission's Order in the above case.

Sincerely,

Stephanie Bell
Stephanie Bell
Secretary of the Commission

SB/sa
Enclosure

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

ORDER

IT IS ORDERED that AquaSource Utility, Inc. ("AquaSource Utility") shall file with the Commission the original and 11 copies of the following information, with a copy to all parties of record. 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 along with the original application, in the format requested herein, reference may be made to the specific location of said information in responding to this information request. The information requested herein is due no later than 10 days from the date of this Order. When applicable, the information requested herein should be provided for total company operations and jurisdictional operations, separately.

1. Provide a copy of Goshen Utilities, Inc.'s ("Goshen Utilities") 1998 balance sheet, income statement, statement of retained earnings, and cash flow statement. The statements should be provided separately for the water and sewer divisions.

2. Provide a copy of AquaSource Utility's 1998 balance sheet, income statement, statement of retained earnings, and cash flow statement.

3. Provide the journal entries AquaSource Utility will record to reflect the purchase of Goshen Utilities' water division.

4. Provide the journal entries AquaSource Utility will record to reflect the purchase of Goshen Utilities' sewer division.

5. Provide the journal entries AquaSource Utility will record on Goshen Utilities' books to reflect the purchase of Goshen Utilities' stock.

6. Provide copies of AquaSource Utility's and Goshen Utilities' balance sheets reflecting the purchase of Goshen Utilities' stock.

7. AquaSource Utility is requesting, among other things, that the Commission approve its purchase of Goshen Utilities' stock, "an acquisition adjustment for accounting and future rate-making purposes" and amortizing the plant acquisition adjustment over a 15-year period. Relative to these requests, provide the following:

a. Relative to AquaSource Utility's purchases which have included acquisition adjustments in other states, prόvide a chart showing:

(1) The utility acquired, the state in which it operates, and if its operations are water, wastewater, or both.

(2) Whether the purchase was a stock transfer or asset transfer.

(3) The amount of any acquisition adjustment recorded.

(4) The amortization period approved by the commission. If the commission did not approve an amortization period, so state.

(5) The embedded cost per customer.

(6) Copies of any jurisdictional approvals AquaSource Utility was required to obtain in the acquisitions.

(7) The net book value of the utility acquired.

b. Have other regulatory commissions generally allowed AquaSource Utility to record an acquisition adjustment for a stock purchase, as opposed to an asset purchase?

c. Have other regulatory commissions generally allowed AquaSource Utility an acquisition adjustment for future rate-making purposes prior to the filing of a rate case? If so, did those approvals include settlement agreements containing multi-year rate freezes and/or rate cap plans?

d. The Commission is aware that AquaSource Utility has purchased small water utilities in New York and has agreed to multi-year rate freezes and subsequent rate cap guarantees for those utilities. In this instance, AquaSource Utility is proposing a rate freeze through the end of 2000 (17 months) and no explicit rate guarantees beyond then. Is AquaSource Utility willing to extend the rate freeze period beyond 2000 and/or agree to some type of rate cap plan subsequent to the end of that year?

8. In Case No. 9059,[1] the Commission determined that, the burden of proof is upon the utility to justify its investment at the price in excess of the net original cost based on economic and quality of service criteria. To meet this burden of proof, the Commission established the criteria a utility must meet in order to recover any

[1] Case No. 9059, An Adjustment of Rates of Delta Natural Gas Company, Inc., Order issued September 11, 1985.

investment in excess of the net original cost ("plant acquisition adjustment"). Provide evidence to show that AquaSource Utility's proposed purchase of Goshen Utilities meets the following criteria:

a. The purchase price was established upon arms-length negotiation.

b. The initial investment, plus the cost of restoring the facilities to required standards, will not adversely impact the overall costs and rates of the existing and new customers.

c. Operational economies can be achieved through the acquisition.

d. The purchase price of utility and non-utility property can be clearly identified.

e. The purchase price will result in overall benefits in the financial and service aspects of the utility's operations.

9. Will AquaSource Utility issue any form of evidence of indebtedness or stock to fund its proposed purchase of Goshen Utilities?

10. Provide the embedded cost per customer of Goshen Utilities' sewer division to AquaSource Utility, including the plant acquisition adjustment.

11. Provide the embedded cost per customer of Goshen Utilities' water division to AquaSource Utility, including the plant acquisition adjustment.

12. Is AquaSource Utility aware of any jurisdictions in which it currently has no operations that allow the recovery of a plant acquisition adjustment when a utility is acquired in a stock purchase? If yes, provide copies of the orders granting the approval.

13. In paragraph 10 of its application AquaSource Utility stated that, "The purchase price will be compared to the book value of Goshen when the transaction is consummated with the difference reflected as an acquisition adjustment on the books and records of ASI and Goshen Utilities."

a. Explain how the purchase of Goshen Utilities' stock would impact Goshen Utilities' books and records.

b. Should AquaSource Utility's stock purchase be recorded as an investment and, therefore, the stock purchase would not impact the value of Goshen Utilities' utility plant.

c. Explain why AquaSource Utility is comparing the book value of Goshen Utilities to the stock purchase price, rather than Goshen Utilities' existing stock value.

14. AquaSource Utility intends to record the utility plant acquisition adjustment on its books as an asset, but include the unamortized balance in Goshen Utilities' rate base. Explain how an asset recorded on the books of the parent corporation, AquaSource Utility, will be recovered in the rate base of its subsidiary, Goshen Utilities.

15. Goshen Utilities has separate water and sewer divisions. Does AquaSource Utility intend to maintain the water and sewer operations in separate divisions?

16. The following questions relate to paragraph 9 of the application:

a. Provide a detailed description of the immediate repairs ($50,000) that AquaSource Utility intends to make to Goshen Utilities' system.

b. AquaSource Utility anticipates that it will spend $3 million to $5 million over the next 5 years should the need of Goshen Utilities require such expenditure. Provide a detailed description, including a time line, for AquaSource Utility's anticipated expenditures.

c. Provide a detailed analysis of AquaSource Utility's expected cost savings that will be achieved through greater efficiencies and economies. AquaSource Utility should provide separate analyses for the sewer and water divisions.

d. AquaSource Utility intends to use Goshen Utilities as "a platform for future growth in Kentucky." Provide a detailed narrative of AquaSource Utility's plans for future growth in Kentucky.

Done at Frankfort, Kentucky, this 12th day of August, 1999.

By the Commission

ATTEST:

Helen C. Helton

Executive Director

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

July 27, 1999

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Attorney for AquaSource Utility, Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

RE: Case No. 99-303
GOSHEN UTILITIES, INC.

The Commission staff has reviewed your application in the above case and finds that it meets the minimum filing requirements. Enclosed please find a stamped filed copy of the first page of your filing. This case has been docketed and will be processed as expeditiously as possible.

If you need further assistance, please contact my staff at 502/564-3940.

Sincerely,
Stephanie Bell

Stephanie Bell
Secretary of the Commission

SB/sa
Enclosure

FILED
JUL 09 1999
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

APPLICATION OF AQUASOURCE UTILITY, INC.)
TRANSFER OF OWNERSHIP RIGHTS IN) CASE NO. 99-303
GOSHEN UTILITIES, INC.)

RECEIVED
JUL - 9 1999
PUBLIC SERVICE COMMISSION

PETITION FOR TRANSFER OF OWNERSHIP

OF GOSHEN UTILITIES, INC.

Comes now, AquaSource Utility, Inc. for its verified Petition for the Public Service Commission of the Commonwealth of Kentucky ("Commission") and respectfully requests an Order pursuant to KRS 278.020 (4) and (5) and 807 KAR 5:001, Section 8 granting approval of the transfer of all stock in Goshen Utilities, Inc. by the present owners of that stock.

1. Goshen Utilities, Inc. ("Goshen") is a utility serving approximately 1700 water and 1200 wastewater customers in Oldham County. Goshen is a public utility organized under the laws of the State of Kentucky and authorized to provide water and wastewater services. The principal mailing address for Goshen is 1001 Riverside Drive, Goshen, Kentucky 40026. The shareholders of Goshen are Lloyd Eades (500 shares) and The Nance Realty Company, Al Schneider President (500 shares).

2. AquaSource Utility, Inc. (ASI) is a wholly owned subsidiary of AquaSource, Inc. ("AquaSource"). ASI and AquaSource are located at 411 Seventh Avenue, Pittsburgh, Pennsylvania 15230.

COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION
730 SCHENKEL LANE
POST OFFICE BOX 615
FRANKFORT, KY. 40602
(502) 564-3940

July 16, 1999

Annemarie Beach
Administrative Manager
Goshen Utilities, Inc.
1001 Riverside Drive
P. O. Box 36
Goshen, KY. 40026

Honorable Terrell L. Black
Attorney for AquaSource Utility, Inc
1400 One Riverfront Plaza
Louisville, KY. 40202

RE: Case No. 99-303
GOSHEN UTILITIES, INC.
(Transfer/Sale/Purchase/Merger) TO AQUASOURCE UTILITY, INC.

This letter is to acknowledge receipt of initial application in the above case. The application was date-stamped received July 9, 1999 and has been assigned Case No. 99-303. In all future correspondence or filings in connection with this case, please reference the above case number.

If you need further assistance, please contact my staff at 502/564-3940.

Sincerely,

Stephanie Bell
Secretary of the Commission

SB/jc

FILED
JUL 09 1999
PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

APPLICATION OF AQUASOURCE UTILITY, INC.)
TRANSFER OF OWNERSHIP RIGHTS IN) CASE NO. 99-303
GOSHEN UTILITIES, INC.)

RECEIVED
JUL - 9 1999
PUBLIC SERVICE COMMISSION

PETITION FOR TRANSFER OF OWNERSHIP

OF GOSHEN UTILITIES, INC.

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1. Goshen Utilities, Inc. ("Goshen") is a utility serving approximately 1700 water and 1200 wastewater customers in Oldham County. Goshen is a public utility organized under the laws of the State of Kentucky and authorized to provide water and wastewater services. The principal mailing address for Goshen is 1001 Riverside Drive, Goshen, Kentucky 40026. The shareholders of Goshen are Lloyd Eades (500 shares) and The Nance Realty Company, Al Schneider President (500 shares).

2. AquaSource Utility, Inc. (ASI) is a wholly owned subsidiary of AquaSource, Inc. ("AquaSource"). ASI and AquaSource are located at 411 Seventh Avenue, Pittsburgh, Pennsylvania 15230.

3. A copy of ASI's Articles of Incorporation, including all Amendments thereto, is attached hereto and designated Exhibit "A".

4. DQE, Inc., the parent company of AquaSource, Inc., is a Pennsylvania-based energy services company and parent of Duquesne Light Company. As of December 31, 1998, DQE, Inc. had assets of more than $5.2 billion and annual revenues in excess of $1.2 billion. It serves almost 600,000 electric customers and has 2,670 megawatts of generation capacity. ASI and AquaSource report their financial data on a consolidated basis with DQE, Inc. DQE, Inc.'s 1998 Annual Report to Shareholders is provided as Exhibit "B ".

5. AquaSource is an investor-owned water utility company formed on April 1, 1997, as a subsidiary of DQE, Inc. AquaSource not only owns water and wastewater utilities but also owns non-regulated water and wastewater related businesses such as construction and engineering companies, system leasing and fabrication businesses, and contract operation services. AquaSource is acquiring and operating water utility systems throughout the country. The mission of AquaSource is to provide safe, clean and reasonably priced drinking water and environmentally sound and cost efficient wastewater services to its customers. It has invested or received corporate approval to invest over $350 million and now provides water and wastewater services to more than 370,000 customers in 12 states.

6. The purchase by ASI of Goshen Utilities is proposed to be accomplished in accordance with the Stock Purchase Agreement entered into among ASI, Goshen Utilities, and the Shareholders of Goshen Utilities dated May 18, 1999, a true copy of which is attached hereto and designated Exhibit "C". The purchase price for the shares is $3.5 million.

7. There is attached hereto, as Exhibit "D", unaudited Consolidated Financial Statements of AquaSource, as of December 31, 1998 and an

unaudited Consolidated Balance Sheet, as of March 31, 1999. This represents the most recent information available at the time of this Petition and is submitted to satisfy the Financial Exhibit required by 807 KAR 5:001, Section 6. The Petitioner ASI is included in these Consolidated Financial Statements. ASI has not paid dividends during its existence. ASI has only one class of stock authorized and issued, which is owned wholly by AquaSource.

8. ASI has agreed and does agree to the transfer of stock in Goshen Utilities, Inc. into its name and will accept and be responsible for the water service and sewer service owned by Goshen Utilities, Inc. The transaction will result in a change in the ultimate owners of Goshen, but will not change the manner in which it provides service to its customers.

ASI intends to operate Goshen as a separate wholly-owned subsidiary. Goshen would retain the permits, consent, and franchises as they exist before the stock transfer.

9. Customers would benefit by ASI's purchase of Goshen. First, it will stabilize rates. This is because ASI is committing to a rate freeze through the end of year 2000. (If savings are greater than anticipated, ASI might defer seeking a change in rates beyond this period.) Second, after the transfer, ASI will be able to make needed capital improvements. ASI anticipates spending approximately $50,000 in immediate repairs and approximately $3 – 5 million over the next five years should the need of this utility require such expenditure. Third, the transfer will permit Goshen to attract capital for system improvements and other capital expenditures at lower financial cost than the current owners because of the size and financial health of ASI's parent, AquaSource, and their parent DQE. Fourth, ASI expects to achieve savings in costs through greater efficiencies and economies and be able to provide a platform for future growth in Kentucky. The transaction will provide the opportunity to achieve cost savings

through greater operating efficiencies than would otherwise be possible in areas such as billing, customer service and regulatory compliance. Fifth, ASI intends to implement a 24-hour hotline for reporting problems. Finally, it can and will provide employee benefits to its employees.

10. ASI can achieve substantial operating efficiencies if it can acquire a "critical mass" of water companies. ASI has the financial resources to purchase the water companies; however, due to increased competition in the water and waste-water industry, ASI often times has to pay more than the currently recognized rate base amount. ASI believes that these increased investment levels are justified on the basis of increased efficiencies and improved services accruing to ratepayers over the long-term. For accounting purposes, ASI will treat the transaction as an acquistion adjustment. As such, the transaction will be recorded using the "purchase method" of accounting for business combinations in accordance with Accounting Principles Board Opinion No. 16. The purchase price will be compared to the book value of Goshen when the transaction is consummated with the difference reflected as an acquisition adjustment on the books and records of ASI and Goshen.

11. ASI requests the Commission to allow ASI to adopt certain accounting and ratemaking treatment in order to clearly reflect the economics of the acquisition of Goshen and to protect ASI's right to apply for future rate adjustments based on this acquisition. First, ASI is requesting that the Commission allow it to treat the difference between the purchase price and the book value of the acquired assets as an acquisition adjustment for accounting and future ratemaking purposes. Second, the Company wishes to amortize the acquisition premium over a fifteen-year period for accounting and ratemaking purposes. Finally, ASI proposes that the acquisition adjustment be included as an asset with an offsetting credit to shareholder equity on the books of ASI. If, at

the end of the rate freeze period (end of year 2000) earnings are inadequate, ASI will likely file a base rate case to include the un-amortized balance of the acquisition adjustment in rate base. Rates may be maintained at current levels beyond the rate freeze period if costs can be reduced further than expected thereby providing gross margins that are sufficient to allow recovery of and on investment. ASI respectfully requests that the Commission allow its requested accounting and ratemaking treatment of the acquisition premium because: 1.) The purchase price was the result of an arms-length transaction; 2.) There will be long-term benefits to customers as a result of ASI's managerial and operational expertise and its financial strength; 3.) Capital improvements will be made as needed to ensure adequate, reliable, and efficient service; 4.) The Company is committing to a rate freeze through the end of year 2000; and 5.) ASI, by paying this premium, is demonstrating their commitment to the concept of regionalization of water and wastewater systems.

12. A deviation under 807 KAR 5:001 (14) is requested from any regulation that might unduly delay the consideration of this Petition or which would be ominous to the limited nature of this Application and the agreement of the parties.

13. A notice of the proposed transfer and the effect on rates will be provided to all affected customers.

14. For all the reasons set forth herein, approval of the transfer of the stock from Goshen to ASI is in the public interest.

Wherefore, for all of the foregoing reasons, it is respectfully requested that the agreement be approved for the transfer of the stock of Goshen Utilities, Inc. to AquaSource Utilities, Inc. as requested herein.

Respectfully Submitted,

By: Terrell Black

Terrell L. Black
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, Ky. 40202

MFG-CH

The State of Texas

Secretary of State

CERTIFICATE OF INCORPORATION

OF

AQUASOURCE UTILITY, INC.
CHARTER NUMBER 01470056

THE UNDERSIGNED, AS SECRETARY OF STATE OF THE STATE OF TEXAS, HEREBY CERTIFIES THAT THE ATTACHED ARTICLES OF INCORPORATION FOR THE ABOVE NAMED CORPORATION HAVE BEEN RECEIVED IN THIS OFFICE AND ARE FOUND TO CONFORM TO LAW.

ACCORDINGLY, THE UNDERSIGNED, AS SECRETARY OF STATE, AND BY VIRTUE OF THE AUTHORITY VESTED IN THE SECRETARY BY LAW, HEREBY ISSUES THIS CERTIFICATE OF INCORPORATION.

ISSUANCE OF THIS CERTIFICATE OF INCORPORATION DOES NOT AUTHORIZE THE USE OF A CORPORATE NAME IN THIS STATE IN VIOLATION OF THE RIGHTS OF ANOTHER UNDER THE FEDERAL TRADEMARK ACT OF 1946, THE TEXAS TRADEMARK LAW, THE ASSUMED BUSINESS OR PROFESSIONAL NAME ACT OR THE COMMON LAW.

DATED DEC. 8, 1997

EFFECTIVE DEC. 8, 1997

EXHIBIT
A

Secretary of State

FILED
In the Office of the
Secretary of State of Texas

DEC 08 1997

Corporations Section

ARTICLES OF INCORPORATION

OF AQUASOURCE UTILITY, INC.

The undersigned, being a natural person of the age of 18 years or more and acting as the incorporator, does hereby adopt the following Articles of Incorporation for the purpose of organizing a corporation pursuant to the provisions of the Texas Business Corporation Act.

ARTICLE ONE

The name of the corporation is AquaSource Utility, Inc.

ARTICLE TWO

The period of duration of the corporation is perpetual.

ARTICLE THREE

The purpose or purposes for which the corporation is organized, which shall include the transaction of any or all lawful business for which corporations may be incorporated under the Texas Business Corporation Act, are:

To generally engage in the water and sewer utility business and perform any and all acts connected therewith or arising therefrom or incidental thereto, and all acts proper or necessary for the purpose of the business.

To have all of the general powers granted to corporations organized under the laws of the State of Texas whether granted by specific statutory authority or by construction of law.

The foregoing clauses shall be construed as powers as well as purposes. The enumeration herein of specific purposes and powers shall not be held to limit or restrict in any way the general purposes and powers of the corporation. The matters specified in any clause shall, except where otherwise expressed, be in no wise limited or restricted by reference to or inference from the terms of any other clause of this or any other Article of these Articles of Incorporation, but the purposes and powers specified in each of the clauses of this Article shall be regarded as independent purposes and powers.

ARTICLE FOUR

The aggregate number of shares which the corporation shall have authority to issue is 100 shares of common stock, all of which are of one class and without par value.

ARTICLE FIVE

The corporation will not commence business until it has received for the issuance of its shares consideration of the value of at least one thousand dollars, consisting of money, labor done, or property actually received.

ARTICLE SIX

Shareholders of the corporation shall have the preemptive right to acquire additional, unissued, or treasury shares of the corporation to the extent prescribed by the provisions of the Texas Business Corporation Act.

ARTICLE SEVEN

No holder of any class of shares of the corporation shall be entitled to cumulate his votes at any election of directors.

ARTICLE EIGHT

The following provisions are inserted herein for the purpose of defining, limiting, and regulating the powers of the corporation and of the directors and of the shareholders, provided, however, that said provisions shall not be deemed exclusive of any rights or liabilities otherwise granted or imposed by the laws of the State of Texas:

1. The liability of the directors of the corporation is eliminated to the fullest extent permitted by the provisions of the Texas Business Corporation Act and by the provisions of the Texas Miscellaneous Corporation Laws Act, as the same may be amended and supplemented.

2. The corporation shall, to the fullest extent permitted by the provisions of Article 2.02-1 of the Texas Business Corporation Act, as the same may be amended and supplemented, indemnify any and all persons whom it shall have power to indemnify under said Article from and against any and all of the expenses, liabilities, or other matters referred to or covered by said Article.

3. With respect to any matter for which the affirmative vote of the holders of at least a two-thirds portion of the shares entitled to vote is otherwise required by the Texas Business Corporation Act, the act of the shareholders on that matter shall be the affirmative vote of the holders of at least a majority of the shares entitled to vote on that matter, rather than the affirmative vote otherwise required by the Texas Business Corporation Act. With respect to any matter for which the affirmative vote of the holders of at least two-thirds portion of the shares of any class is otherwise required by the Texas Business Corporation Act, the act of the holders of shares of that class on that matter shall be the affirmative vote of the holders of at least a majority of the shares of that class, rather than the affirmative vote of the holders of shares of that class otherwise required by the Texas Business Corporation Act.

4. Any action required by the Texas Business Corporation Act to be taken at an annual or special meeting of shareholders, or any action which may be taken at an annual or special meeting of shareholders, may be taken without a meeting, without prior notice, and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holder or holders of shares having not less than the minimum number of votes that would be necessary to take such action at a meeting at which the holders of all shares entitled to vote on the action were present and voted.

ARTICLE NINE

The post-office address of the initial registered office of the corporation in the State of Texas is c/o AquaSource, Inc. 16810 Barker Springs, Suite B215, Houston, TX 77084, and the name of the initial registered agent of the corporation at such address is AquaSource, Inc.

ARTICLE TEN

The number of directors constituting the initial Board of Directors of the corporation is 1, and the name and the address of the person who is to serve as a director until the first annual meeting of the shareholders or until his successor is elected and qualified is:

NAME	ADDRESS
Ed Wallace	16810 Barker Springs, Suite B215 Houston, TX 77084

ARTICLE ELEVEN

The name and the address of the incorporator is:

NAME	ADDRESS
Carey Thomas	16810 Barker Springs, Suite B215 Houston, TX 77084

ARTICLE TWELVE

From time to time any of the provisions of these Articles of Incorporation may be amended, altered, or repealed, and other provisions authorized by the laws of the State of Texas at the time in force may be added or inserted in the manner and at the time prescribed by said laws, and all contracts and rights at any time conferred upon the shareholders of the corporation by these Articles of Incorporation are granted subject to the provisions of this Article.

Signed on December 5, 1997.

Carey Thomas

Incorporator

The State of Texas

SECRETARY OF STATE

CERTIFICATE OF AMENDMENT
OF

AQUASOURCE UTILITY, INC.
FILE NO: 1470056-00

The undersigned, as Secretary of State of Texas, hereby certifies that the attached Articles of Amendment for the above named entity have been received in this office and are found to conform to law.

ACCORDINGLY the undersigned, as Secretary of State, and by virtue of the authority vested in the Secretary by law, hereby issues this Certificate of Amendment.

Dated: **June 3, 1998**

Effective: **June 3, 1998**

THE STATE OF TEXAS

LCS

Alberto R. Gonzales
Secretary of State

FILED
In the Office of the
Secretary of State of Texas
JUN 02 1998
Corporations Section

ARTICLES OF AMENDMENT

TO THE

ARTICLES OF INCORPORATION

OF

AQUASOURCE UTILITY, INC.

AQUASOURCE UTILITY, INC. (the "Corporation"), a corporation organized and existing under and by virtue of the Texas Business Corporation Act (the "Act"), does hereby certify as follows:

FIRST: The name of the Corporation is AquaSource Utility, Inc.

SECOND: Article Four of the Articles of Incorporation of the Corporation is hereby amended in its entirety to read as follows:

"ARTICLE FOUR: The aggregate number of shares authorized is 200, of which 100 shall be Common Stock, no par value per share, and 100 shall be Preferred Stock, par value $50,000 per share. The terms of the Preferred Stock shall be as follows:

a. Dividends. The holders of the Preferred Stock shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available therefor, dividends at a rate per annum equal to 6.5% of the par value per whole share, payable annually on September 30.

b. Liquidation. Subject to the rights of the holders of any class of capital stock or series thereof ranking senior to the Preferred Stock as to distribution of assets on liquidation, in the event of any liquidation, dissolution or winding up of the corporation, the holders of the Preferred Stock shall be entitled to receive, out of the assets of the corporation legally available therefor, a cash liquidation payment equal to $50,000 per share plus an amount equal to all dividends accrued and unpaid thereon to the date of payment before any distribution or payment shall be made to the holders of shares of Common Stock or any other class of capital stock or series thereof ranking junior to the Preferred Stock as to the distribution of assets on liquidation. If legally available funds are not sufficient to pay the full amount owed to the holders of the Preferred Stock pursuant to the preceding sentence and the full amount owed to the holders of any other class or series of capital stock ranking pari passu with the Preferred Stock as to distribution of assets on liquidation, such funds shall be distributed to the holders of the Preferred Stock and such pari passu stock on a pro rata basis in proportion to their respective claims.

c. Redemption. The corporation may, at any time (and from time to time) following the twenty-first anniversary of the issuance of the Preferred Stock and to the extent the corporation has funds legally available therefor, redeem in whole or in part the outstanding shares of the Preferred Stock pro rata among all holders thereof, for cash at a redemption price of $50,000 per share plus an amount equal to all dividends accrued and unpaid thereon. From and after any such redemption, all dividends on Preferred Stock designated for redemption shall cease to accrue, all rights of the holders of such shares as holders of Preferred Stock shall cease with respect to such shares, and such shares shall not thereafter be transferred on the books of the corporation or be deemed to be outstanding for any purpose whatsoever. The shares of Preferred Stock not yet redeemed shall remain outstanding and the holder thereof shall be entitled to all the rights and preferences provided herein.

Written notice of redemption shall be mailed, first class, postage prepaid, to each holder of record (at the closing of business on the business day next preceding the date on which the notice is given) of the Preferred Stock at the address last shown on the records of the corporation, notifying such holder of the redemption to be effected, the redemption date, the place at which payment may be obtained and calling upon such holder to surrender to the corporation, in the manner and at the place designated, such holder's certificate or certificates representing such holder's shares of Preferred Stock.

d. Repurchase. Upon written notice from any holder of the Preferred Stock, the corporation shall, at any time (and from time to time) following the twenty-first anniversary of the issuance of the Preferred Stock and to the extent the corporation has funds legally available therefor, repurchase in whole or in part, as so provided in such notice, the outstanding shares of the Preferred Stock of which the holder making such notice is the record owner, for cash at a repurchase price of $50,000 per share plus an amount equal to all dividends accrued and unpaid thereon. From and after any such repurchase, all dividends on Preferred Stock so repurchased shall cease to accrue, all rights of the holders of such shares as holders of Preferred Stock shall cease with respect to such shares, and such shares shall not thereafter be transferred on the books of the corporation or be deemed to be outstanding for any purpose whatsoever. The shares of Preferred Stock not yet repurchased shall remain outstanding and the holder thereof shall be entitled to all the rights and preferences provided herein.

Written notice of repurchase shall be mailed, first class, postage prepaid, to the corporation, notifying the corporation of the repurchase to be effected and the repurchase date. The place at which payment may be paid and the certificate or certificates representing such shares of Preferred Stock may be delivered shall be the chief executive office of the corporation.

e. Conversion Rights. No conversion rights shall exist with respect to the Preferred Stock.

f. Voting Rights. The holders of the Preferred Stock shall not be entitled to vote at any time or under any circumstance, except as required by law.

g. Ranking.

A. Rights to Dividends. The Preferred Stock shall rank as to dividends (i) senior to the Common Stock and any other class or series of capital stock which by its express terms provides that it ranks junior to the Preferred Stock as to dividends or which does not expressly provide for any ranking as to dividends, (ii) pari passu with any class or series of capital stock which by its express terms provides that it ranks pari passu with the Preferred Stock as to dividends, and (iii) junior to any class or series of capital stock which by its express terms provides that it ranks senior to the Preferred Stock as to dividends.

B. Rights on Liquidation. The Preferred Stock shall rank as to distribution of assets on liquidation (i) senior to the Common Stock and any other class or series of capital stock which by its express terms provides that it ranks junior to the Preferred Stock as to distribution of assets on liquidation or which does not expressly provide for any ranking as to distribution of assets on liquidation, (ii) pari passu with any class or series of capital stock which by its express terms provides that it ranks pari passu with the Preferred Stock as to distribution of assets on liquidation, and (iii) junior to any class or series of capital stock which by its express terms provides that it ranks senior to the Preferred Stock as to distribution of assets on liquidation.

h. Fractional Shares. No fractional shares of Preferred Stock shall be issued at any time.

i. Transfer Restriction. No shares of Preferred Stock shall be sold, transferred or pledged without the express written consent of the corporation."

THIRD: The number of shares of the Corporation outstanding and entitled to vote is 100. The foregoing Amendment was duly adopted by consent of the sole shareholder of the Corporation on May 29, 1998.

FOURTH: The foregoing Amendment does not amend the stated capital of the Corporation.

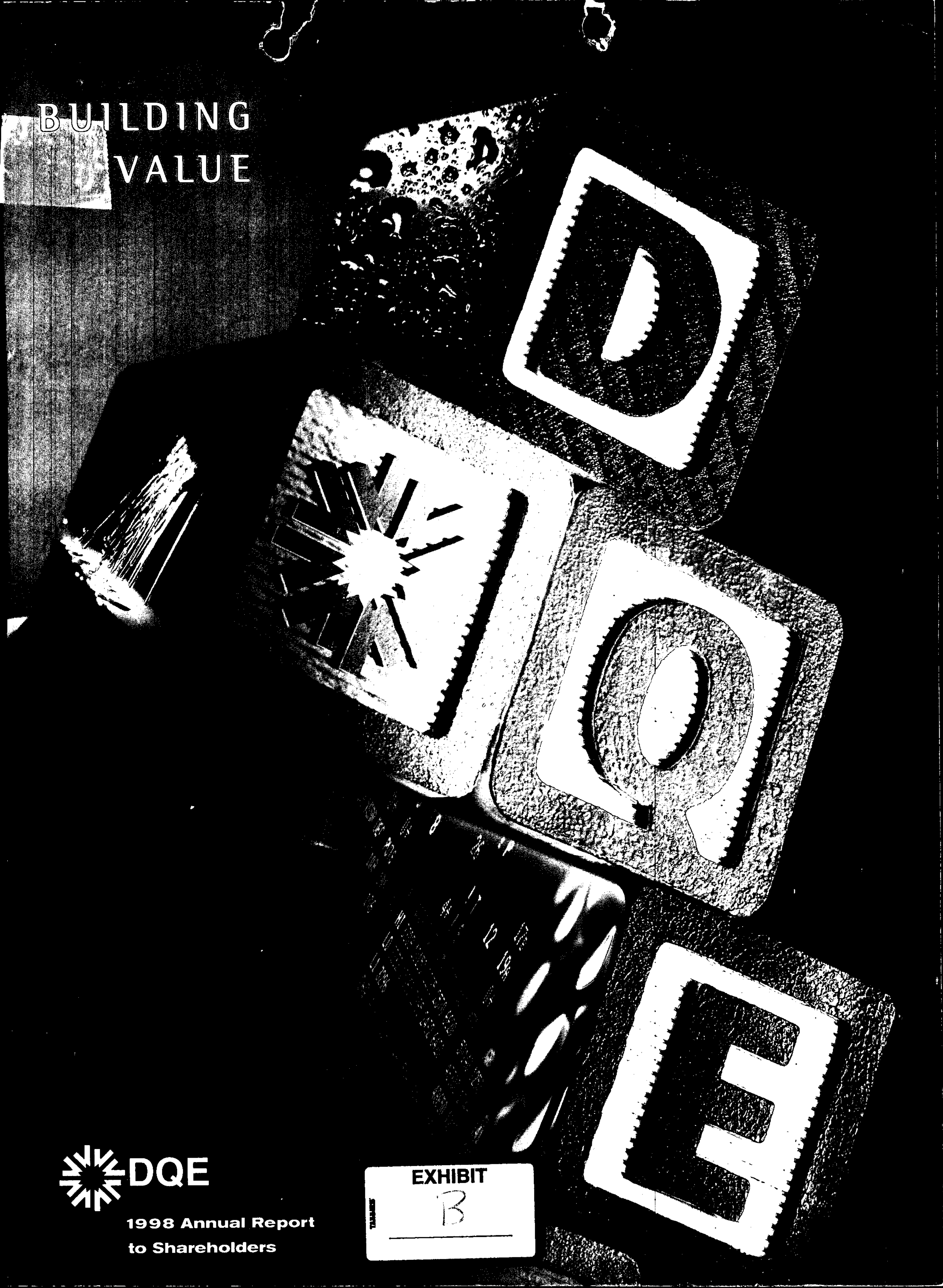
IN WITNESS WHEREOF, AquaSource Utility, Inc. has caused this certificate to be signed by its President as of this 29th day of May, 1998.

AQUASOURCE UTILITY, INC.

By: [signature]

Its: President

BUILDING VALUE



DQE

1998 Annual Report
to Shareholders

EXHIBIT
B

CORPORATE PROFILE

DQE is an innovative, *dynamic multi-utility delivery and services company with active business ventures and partnerships throughout the United States and Canada. We are positioned to meet the expanding needs of the marketplace by delivering creative solutions to our customers and value to our shareholders.*

CONTENTS

DQE 1998 RESULTS

- DQE's year-end annualized dividend increased by 5.6% over 1997's dividend level.
- Expanded business lines contributed 66 cents per share, 26% of DQE earnings per share before PA restructuring charge.
- DQE unilaterally terminated its proposed merger with Allegheny Energy on October 5, 1998.
- Duquesne Light received regulatory approval to recover most of its transition costs, in part, because of its willingness to auction its generation facilities.
- Duquesne Light announced an agreement in principle to exchange generation facilities with FirstEnergy to maximize the value of its generation auction.
- AquaSource, established in 1997 to acquire, develop and manage water and wastewater utilities, expanded to approximately 300,000 customers, with operations throughout the United States.
- With the addition of a major landfill gas collection system on Staten Island, New York, DQE now has approximately 350 billion cubic feet of gas reserves.
- DQE and North American Power Brokers executed the nation's first retail acquisition of electricity over the Internet. North American provides a low-bid, Internet auction-based approach to the retail purchasing of electricity and natural gas.
- DQE and BroadPoint Communications offered a first-of-its-kind, advertiser-sponsored, free long-distance telephone service.
- DQE Energy Services was chosen to build, own, operate and maintain the new energy facility for the Detroit Metro Airport Midfield Terminal Project, as part of a joint venture with MichCon Gas.

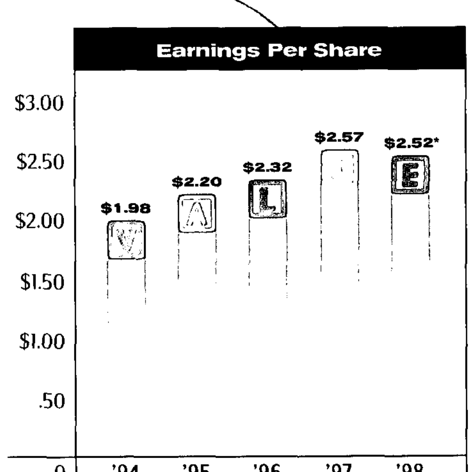
DQE HIGHLIGHTS

Financial and Operating (in millions, except per share amounts)	1998	1997	**Change**
Earnings per common share	$2.52*	$2.57	**-1.9%**
Dividends paid per common share	$1.44	$1.36	**5.9%**
Market capitalization	$3,400	$2,729	**24.6%**
Market to book value ratio	2.29	1.82	**25.8%**
Net income	$197*	$199	**-1.0%**
Operating revenues	$1,270	$1,230	**3.3%**
Interest and other charges	$110	$115	**-4.3%**
Investment and other income	$136	$130	**4.6%**
DQE return on average common equity	13.1%	13.8%	—
Electric utility return on average common equity	10.8%	10.8%	—
Peak demand (MW)	2,484	2,671**	**-7.0%**
Electric customer sales (kWh)	12,128	12,545	**-3.3%**
Total assets	$5,248	$4,694	**11.8%**
Expanded business line assets	$1,072	$854	**25.5%**
Water utility assets	$232	$10	—
Long-term investments	$760	$723	**5.1%**

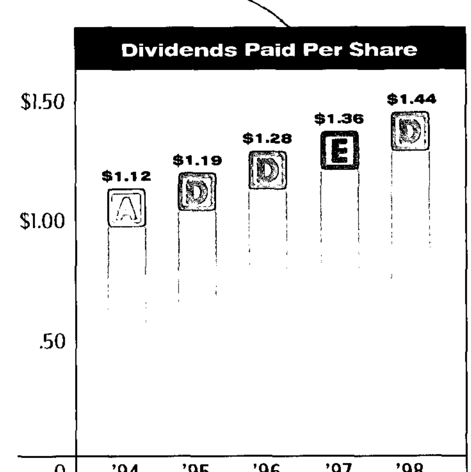
Market Price Per Share

	1998	1997	1996	1995	1994	1993	Five-Year Compound Growth Rate
High	$43.94	$35.13	$31.50	$30.75	$23.00	$24.67	**12.2%**
Low	$31.63	$26.88	$25.75	$19.63	$18.42	$20.92	**8.6%**
Year-end	$43.94	$35.13	$29.00	$30.75	$19.75	$23.00	**13.8%**

Five-year compound growth rate of 6.8%



Five-year compound growth rate of 6.2%



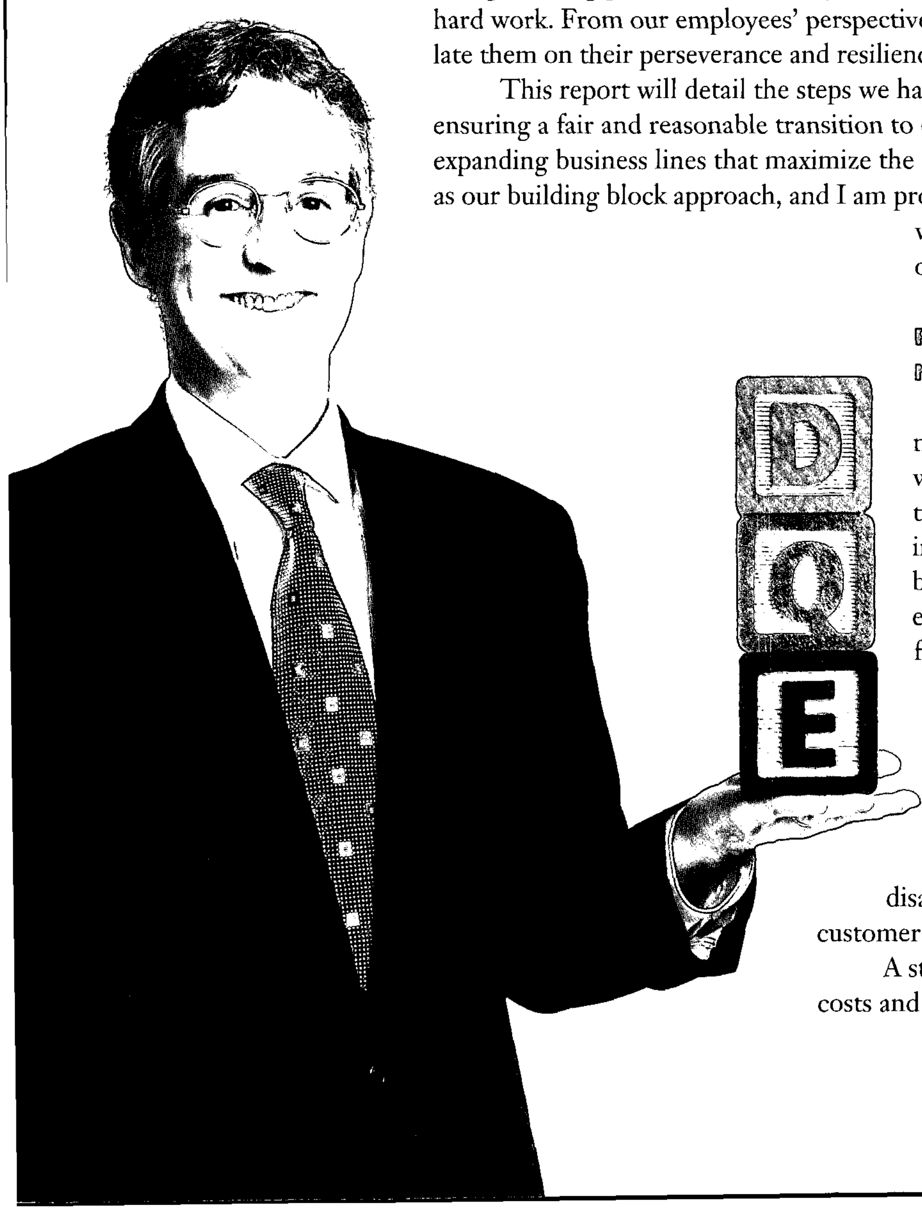
* *Excludes extraordinary $82.5 million/$1.06 per share Pennsylvania restructuring charge in June 1998*

** *All-time company record*

DEAR FELLOW SHAREHOLDER:

I AM DELIGHTED TO ONCE AGAIN HAVE THIS OPPORTUNITY TO ADDRESS THE INVESTORS OF AN INDEPENDENT DQE, A COMPANY WITH A VERY PROSPEROUS FUTURE. NEEDLESS TO SAY, IT HAS BEEN AN EVENTFUL YEAR. IN THE PAST 12 MONTHS, WE HAVE EMERGED FROM PENNSYLVANIA'S ELECTRIC CUSTOMER CHOICE RESTRUCTURING FILINGS WITH A FAIR RESULT ... WE HAVE TERMINATED OUR FAILED MERGER WITH ALLEGHENY ENERGY ... WE HAVE RECEIVED CUSTOMER AND MEDIA PRAISE FOR DUQUESNE LIGHT'S RESPONSE TO A SERIES OF TORNADOES AND SEVERE WINDSTORMS ... WE HAVE CONTINUED TO EXPAND OUR CORE DELIVERY BUSINESS AND BUILD ON OUR SUCCESSFUL LINE OF COMPLEMENTARY PRODUCTS AND SERVICES ... AND WE HAVE ACHIEVED AN ALL-TIME-HIGH STOCK PRICE.

David Marshall
President and Chief Executive Officer, DQE



Building Value Through People

These achievements are the product of many dedicated, capable professionals who come from all of DQE's companies — men and women who have embraced the many changes taking place in our industry, and who have demonstrated teamwork, innovation and hard work. From our employees' perspective, this has been a challenging year, and I congratulate them on their perseverance and resilience.

This report will detail the steps we have been taking to build value at DQE ... from ensuring a fair and reasonable transition to electric competition in western Pennsylvania, to expanding business lines that maximize the benefits of our skills and experience. I refer to this as our building block approach, and I am proud to feature some of the many team members who have contributed significantly to the progress of your company.

Proposed Merger Terminated ... No Longer in Your Best Interest

In 1997, we asked your approval of our merger plans with Allegheny Energy. At that time, we believed the merger presented the best opportunity for your company to improve, grow and win in a competitive electricity market. From the very beginning, however, we noted that favorable and expedited regulatory treatment was a critical factor for a successful merger.

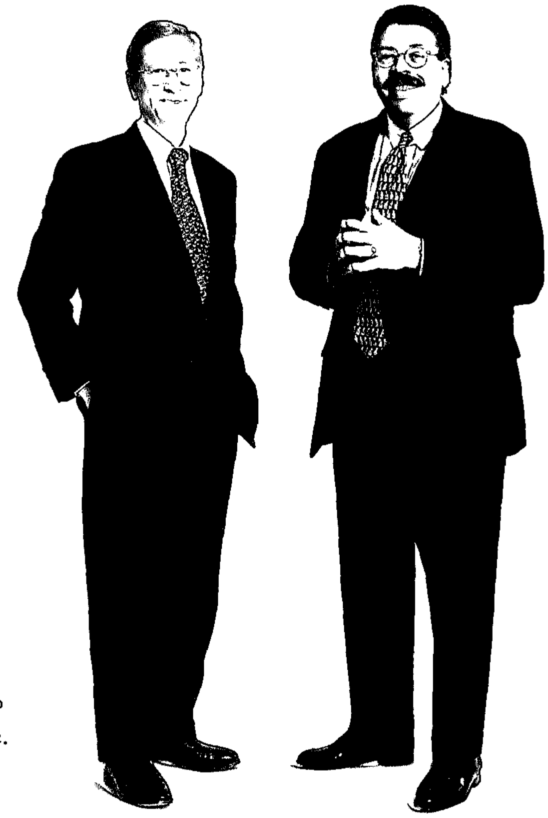
Much changed between April 5, 1997, when we signed the merger agreement, and October 5, 1998, when we terminated it. While I won't recount all the details of these changed circumstances, I want to emphasize that the intended benefits of the merger largely disappeared with the application of the state's new customer choice legislation.

A steep disallowance of Allegheny Energy's stranded costs and of the stranded costs that could be recovered by the combined company, as well as additional merger conditions, sharply reduced potential shareholder benefits. As of October 5, Allegheny subsidiary West Penn Power's restructuring order permitted the recovery of only $525 million of the $1.6 billion of stranded costs it would incur. DQE was fully justified in terminating the agreement, to avoid forcing our shareholders to absorb nearly one-half of this $1 billion disallowance.

When we considered all the facts before us on October 5 — the end of the 18-month time frame for achieving satisfactory merger conditions — DQE's Board of Directors concluded that it could not, consistent with its fiduciary duty to shareholders, consummate the merger under these circumstances.

The stock market clearly expressed its view of the divergent regulatory paths taken by the companies. On the date of the merger announcement, DQE stock stood at $27 1/8, while Allegheny Energy stock was at $29 3/4. On October 5, DQE stock was $40 15/16 — a 51% increase — while Allegheny Energy was at $31 5/16, a mere 5% increase. In other words, the relative premium that you had expected to receive as part of the merger agreement had disappeared.

And while we have moved on, I want to sincerely thank you for your support of the merger. We strongly believe that the best course of action for you, our owners, is to continue our successful growth strategies as an independent company.



left - right
Gary Schwass
Executive Vice President and Chief Financial Officer, DQE
Victor Roque
Executive Vice President and General Counsel, DQE

Your Investment Was Protected in PA Choice Restructuring

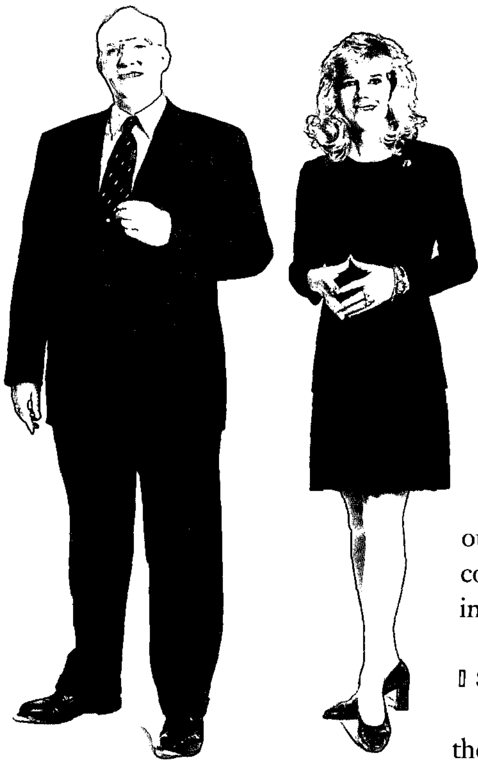
In the fall of 1997, I wrote you to reaffirm my commitment to protecting shareholder interests as we phased into customer choice in Pennsylvania. The Public Utility Commission (PUC) had just begun to review our restructuring filings to meet the conditions of the customer choice legislation, which allowed two-thirds of the state's residents to choose their generation supplier in January 1999.

"Mission Accomplished" is the best way I can define the PUC ruling on our customer choice restructuring filings as an independent company. The PUC was fair in its treatment of your investments in our company. Our approved restructuring plan, as an independent company, permits recovery of nearly all of our investments made in the generation business.

These positive results are due to the planned use of an auction to divest our generation facilities, as a means to establish transition cost values. The Duquesne Light plan includes an exchange of facilities with FirstEnergy, an auction of our generation facilities and an auction of our provider of last resort service — the obligation to provide generation service to customers who do not choose another generation supplier.

The sale of our generating plants will benefit shareholders and customers alike. Our shareholders will benefit, as we effectively reinvest cash received from the auction into our expanded business lines, which have provided a strong track record of growth. We also will add to your earnings per share growth by using auction proceeds to strategically repurchase DQE stock, as market conditions permit.

There is no doubt that exiting the generation business is a radical change for your company. However, the introduction of competition in the generation of power has changed everything. Regulated utilities no longer are the only power producers in town. And size — the sheer volume of megawatts a company controls — is rapidly becoming a critical factor in



left - right
Jack Saxer
Vice President, DQE
Beth Straka
Assistant Vice President, Investor Relations and Marketing Communications, DQE
Morgan O'Brien ▼
Vice President, Controller and Treasurer, DQE

determining generation success. Many companies larger than ours also have decided to exit this business, not only in Pennsylvania but throughout the nation.

While we are proud of our long history of electricity generation, we do not have sufficient capacity to effectively compete in generation markets that will be extremely volatile over the next few years. Margins will be narrow and unpredictable. We firmly believe it is not prudent to expose our shareholders to risks of this nature. We will not be a large-scale generator of electric power. We will not be a wholesale power marketer. We will not be a retail supplier of electricity. We see our generation auction as a means to further reduce shareholder risk and customer costs, while offering power station employees an opportunity to further their careers in companies focused on generating electricity.

I Salute Our Dedicated Employees

Although I believe many of our employees will be offered good positions with the generation companies purchasing our plants, clearly some job losses will occur. We are committed to fair treatment of any employees who may be displaced as a result of this business decision. We will help people ease the transition to new careers through early retirement options, enhanced severance benefits, job training and job counseling. I salute the employees who have dedicated their careers to establishing and maintaining one of the most reliable power generation systems in North America. Their work ethic, good will and community spirit have set the highest standard for this company's future.

Positioned for Success in a New Business Environment

A fair regulatory result ... a generation swap and auction to reduce shareholder and customer exposure ... and cash from asset sales to apply to our successful, expanded business lines. Clearly, from a shareholder perspective, we are positioned to succeed in this dynamic new business environment.

It has been DQE's consistent strategy to effectively restructure our electric utility operations, recover your capital investment and grow earnings through our expanded business lines. This strategy has served our shareholders well over the past decade. In fact, your investment in DQE has achieved a total return of 461% over the last 10 years, largely due to non-Duquesne Light investments. This surpasses both the record performance of the S&P 500 and the S&P Electric Utility Index.

Year-end operating earnings per share were $2.52, compared to 1997's result of $2.40. This represents a 5% increase in earnings per share, excluding the $82.5 million extraordinary Pennsylvania restructuring charge taken in June 1998, and the 1997 gains associated with the sale of Chester Engineers and Exide Electronics stock. Given the company's dramatic transition in 1998, we are pleased with this result.

Clear Vision of a Bright Future

Our strategic vision for the future is a simple one: to become a premier multi-utility delivery and services company. We believe our investor base will be best served through our continued focus on the delivery business in this rapidly changing environment. Our size serves as an advantage, allowing us to be opportunistic and nimble in our business approach. We recognize that we have a solidly established customer base, as well as an extensive knowledge of the utility industry and the distribution business. We are aggressively pursuing a strategy of aggregation designed to achieve efficiencies through economies of scale — targeting a primary need of the fragmented water industry. DQE is well suited to expand its interest in the water industry because of its extensive background in utility operations and maintenance, regulatory and environmental compliance, and customer service and information technology. By the end of 1998, we were providing service to approximately 300,000 water and wastewater customers throughout the country, augmenting our 580,000 electric distribution customers in western Pennsylvania. We will maximize efficiencies and capitalize on our base of knowledge as we continue our transformation into a multi-utility delivery and services company.

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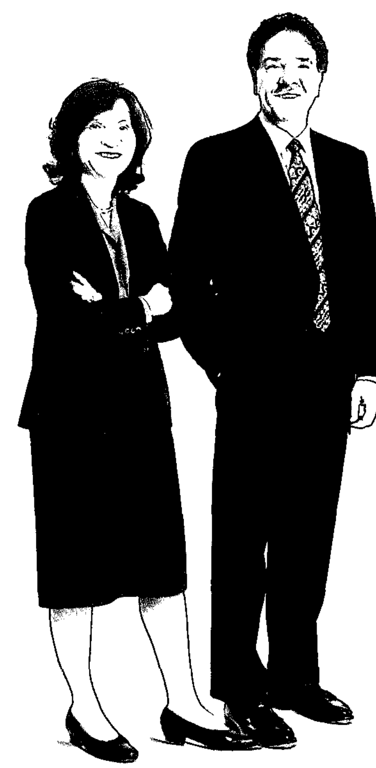
Diane Eismont
Corporate Secretary, DQE
Bill DeLeo
Vice President and Chief Administrative Officer, DQE



Expanded Customer Base Provides Opportunities for Related Products and Services

The expansion of those businesses we know best lends itself to a broader customer base. This expanded customer base, in turn, provides an outlet for the related products and services that have added value and experience over the past decade.

Recognizing that customer needs are both diverse and changing, we are "building" upon three primary expanded business lines synergistic with our core distribution business: complementary products and services; industrial and commercial energy services; and energy-related technology. The mission of these businesses, many of which are featured in the following pages, is to provide innovative, value-added, integrated customer solutions. These investments have achieved growth in earnings and value, and have effectively diversified our business lines.

I want to emphasize that our investment philosophy will remain very disciplined — with control, structure and focus on results inherent in every decision we make. By virtue of our company's history, we possess a tremendous amount of knowledge and experience in the delivery end of the business, and we plan to capitalize on that. The bottom-line result: quality, reliable service delivery for an expanded customer base. Our related investments, which have added experience as well as incremental value over the past decade, will continue to increase in importance, as we offer them to this expanded customer base.

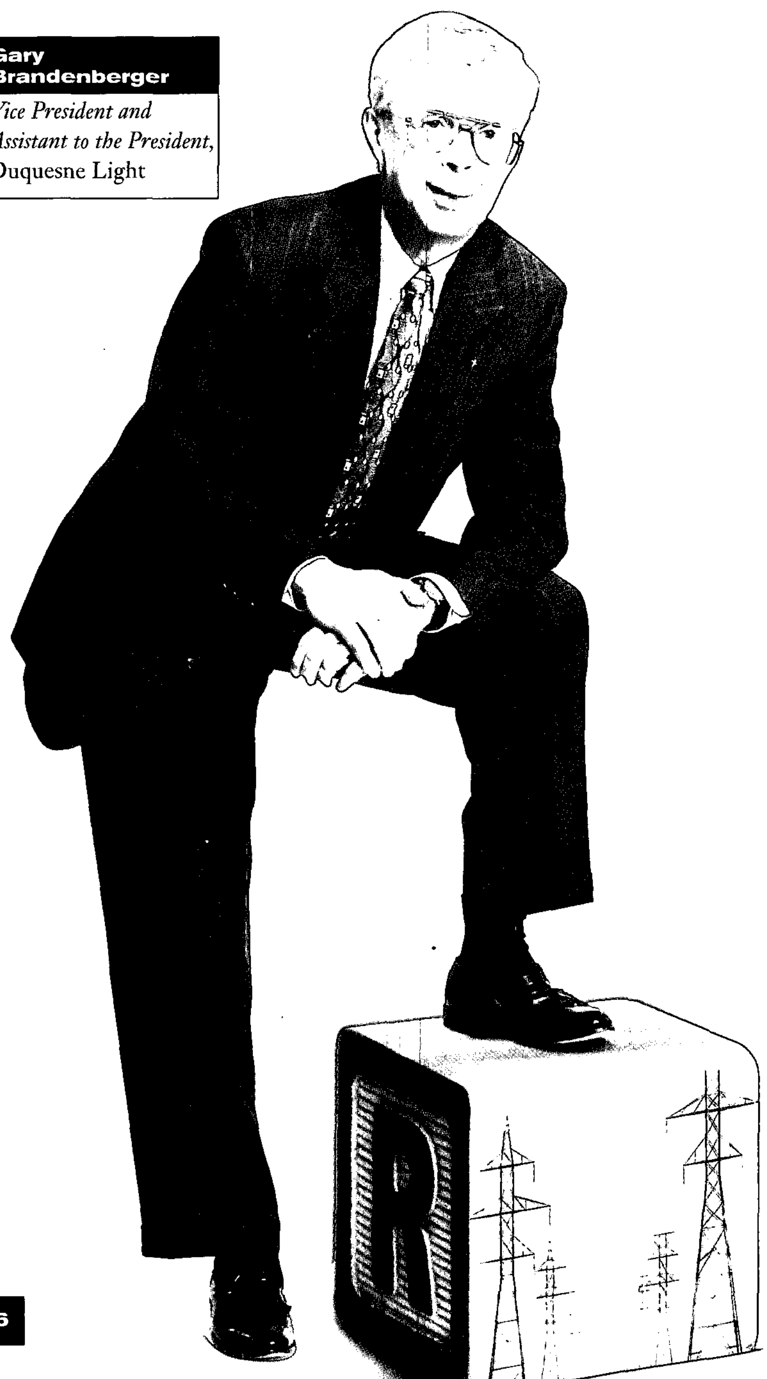
On behalf of the board and our management team, I would like to sincerely thank you for your continued confidence as we strategically navigate through the most dramatic changes this company has ever faced. While we have encountered many changes over the past decade, one thing has not changed: **We are dedicated to building value and delivering results for shareholders.**

David D. Marshall

David D. Marshall
President and Chief Executive Officer
February 26, 1999

Generation Divestiture to Benefit Shareholders and Duquesne Light Customers

Gary Brandenberger
Vice President and Assistant to the President, Duquesne Light



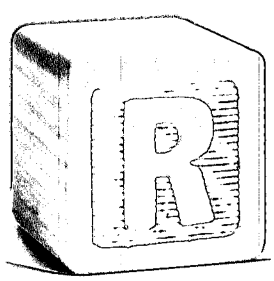
PENNSYLVANIA IS A LEADER AMONG STATES OFFERING RESIDENTS THE ABILITY TO CHOOSE THEIR ELECTRICITY GENERATION SUPPLIER. Two out of three residents became eligible for choice on January 2, 1999. All customers will have electric choice come January 1, 2000.

The Duquesne Light team has kept pace with Pennsylvania's trailblazing effort by initiating a restructuring that will benefit both shareholders and customers as the company positions for the new electricity marketplace.

The first building block in this process was extensive regulatory restructuring required by the state's Electricity Generation Customer Choice and Competition Act. Our restructuring plan, approved by the Public Utility Commission (PUC), permits recovery of nearly all of our investments in the generation business. The positive results associated with our plan are due to the planned use of an auction to divest our generation facilities as the means to establish transition cost values. In our restructuring proceedings before the PUC, divestiture was strongly argued for by the Pennsylvania Office of Consumer Advocate, the PUC's Office of Trial Staff, the City of Pittsburgh and various consumer groups.

We see divestiture as a means to further reduce both shareholder risk and customer costs while offering power station employees an opportunity to further their careers in companies focused on generating

left - right
Sushil Jain
Senior Vice President, Nuclear Services Group, Duquesne Light
Jim Cross
President, Generation Group, Duquesne Light
Tim Jones
General Manager, Fossil Generation, Duquesne Light
Ed Neal ▼
Vice President, Customer Operations, Duquesne Light



R is for Regulatory Restructuring

electricity. Our plants have a great deal to offer in terms of quality, location, and the professionalism and expertise of the people who run them.

If the plants are sold for a price that exceeds the minimum threshold set by the PUC — which many consumer advocates believe will occur — Duquesne Light customers will benefit through a shorter recovery period of the Competitive Transition Charge (CTC). The CTC represents transition costs — related to generation investments — that the PUC determined could be included in electric rates.

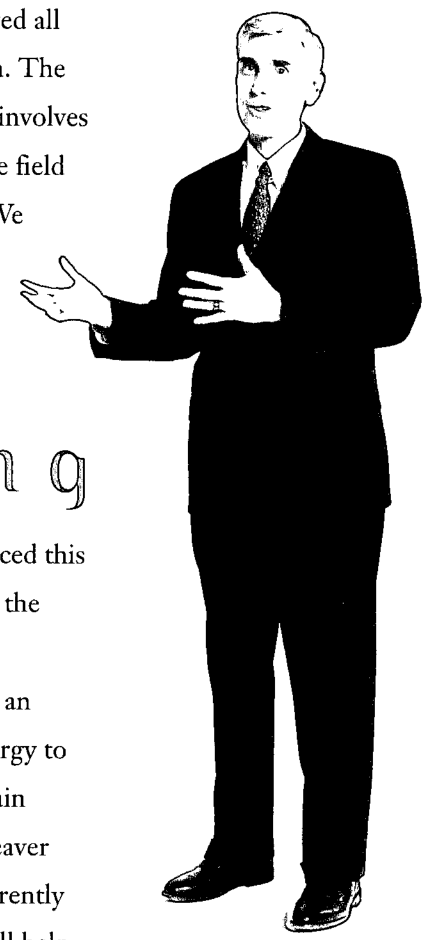
David Marshall's letter (pages 2-5) highlights the shareholder benefits of the generation auction as well as our commitment to fair treatment of employees impacted by the plant sale.

PUC Approves Plan

Duquesne's generation divestiture plan has three main parts: an asset auction, a facility exchange with FirstEnergy, and an auction of provider of last resort service.

In December, the PUC approved all three elements of the divestiture plan. The first phase of the generation auction involves non-binding bids that will narrow the field to those considered most qualified. We expect winning bidders to be announced this summer, with final PUC approval by the end of the year.

On October 15, we announced an agreement in principle with FirstEnergy to exchange ownership interests of certain generation facilities, including the Beaver Valley Nuclear Power Station we currently operate. The generation exchange will help facilitate the auction process because partici-



left - right
Jim Wilson
Controller, Duquesne Light; *Assistant Controller,* DQE
Maureen Hogel
Assistant General Counsel, Duquesne Light

pants now will be able to bid on entire plants instead of units jointly owned with other utilities. Essentially, we plan to transfer nuclear power interests and minority ownership of several coal-fired plants for 100% ownership of three fossil-fuel plants.

The final segment of the divestiture plan involves Duquesne's provider of last resort service. The winning bidder will supply wholesale power to Duquesne in the quantities required to service customers who do not choose another generation supplier, who are unable to find a supplier willing to serve them, or who no longer receive generation services from another supplier. We see the auction of the obligation to serve as another opportunity to reduce customers' transition costs.

Champions of Choice

As a result of our decision to exit the electricity generation business, Duquesne Light customers should experience the shortest transition to full electric competition of any major electric company in the state. *The Duquesne Light team has been a leader in Pennsylvania's move to customer choice in many ways.*

- ***We were one of the first electric distribution companies (EDCs) to mail bills that unbundle charges into distribution, transmission, generation and Competitive Transition Charge components.***
- ***We were the only EDC in Pennsylvania to provide participants a customer-specific price to compare and 12 months of historical power use to help them in shopping for a generation supplier.***
- ***We boosted implementation of choice by offering to generation suppliers 600 megawatts of power for the first six months of 1999 — enough to serve all our residential customers — at a price that should result in customer savings of more than 10%.***
- ***Response has been very positive to our customer choice education program, which features plain language communications and a focus on partnerships with community groups.***

In addition, we are the only electric distribution company in the state that can read most customer meters daily through an advanced metering system. Under customer choice, daily meter readings will play a critical role in forecasting electric consumption so that generation suppliers can set their

left - right
Corinne Lacich
Manager, Information Systems Development, Duquesne Light
Fred Allison
Project Manager, Customer Choice; General Manager, Financial Services; Duquesne Light
Pam Coates
Manager, Corporate Services, Duquesne Light

power load schedules accordingly. The daily readings also will enable Duquesne to accurately charge or credit suppliers for any difference in their power load schedules compared to actual customer use.

Our state-of-the-art Customer Advanced Reliability System, also known as CARS, is the only system deployed today that delivers integrated usage data for residential, commercial and industrial customers, as well as network-level outage detection and restoration notifications. This data communications link through the meter enables us to provide customers with greater choice, greater convenience and better service in a cost-effective way.

By the end of the second quarter of 1999, we will complete the installation of Alpha meters to our 30,000 commercial and industrial customers — one of the largest installations

The New Duquesne

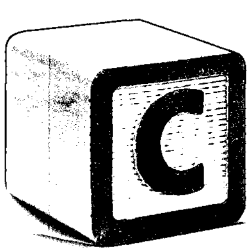
Concurrent with our generation auction, the portion of Duquesne Light that remains after divestiture also will be changed to fit the realities of the new business environment. The "wires" portion of the company is making significant progress in redesigning itself into a process organization that is appropriate to a delivery-only business. We are building on our strengths — reliability and customer service — as we develop a flexible and responsive organization that will grow and provide new products that will increase business and enhance our image with customers.

left - right

Suzanne Karlovich
Chair, Year 2000 Project Team, Duquesne Light; *General Auditor,* DQE

Tom Hubbell
General Manager, Information Technology, Duquesne Light

Estella Smith
General Manager, Public Affairs, Duquesne Light



IS FOR Customer Choice

of its kind in the country. In addition to measurement data for billing and outage notification, Alpha meters have the ability to provide voltage and power quality information, along with profile data for load research. We plan to offer customers and generation suppliers a variety of products stemming from the meter's advanced functions.

Y2K Preparations on Track

Preparations for the Year 2000 are a top priority throughout the company. We have a comprehensive plan in place to address Year 2000 issues. More information on this subject can be found on DQE's Internet site (www.dqe.com) or by calling our toll-free hotline at 1-877-393-7800.

THEY SAY EVERYTHING IS BIG IN TEXAS, AND DQE'S AQUASOURCE SUBSIDIARY HAS BECOME THE LARGEST INVESTOR-OWNED WATER UTILITY IN THE LONE STAR STATE. Formed in April 1997, the company owns and operates water and wastewater utilities in 10 states, and is rapidly expanding to other states throughout the country.

Growth Through Water Acquisitions No Tall Tale

Don Clayton
President,
AquaSource

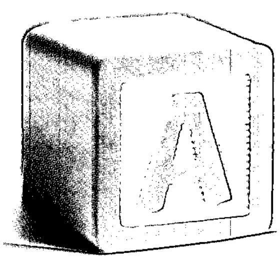
We see continuing aggregation of delivery systems as an opportunity to produce solid returns without incurring high premiums for our participation. Our relatively small size has thus far enabled our AquaSource subsidiary to capitalize on opportunities in the water business, without appearing on the "radar screen" of the competition.

AquaSource's strategy of aggregation or "roll-up" is designed to achieve efficiencies through economies of scale — targeting a primary need of the fragmented water industry. DQE is well suited to expand its interest in the water industry because of its extensive background in utility operations and maintenance, regulatory and environmental compliance, and customer service and information technology. Last

year, we continued our rapid expansion into the water business through an aggressive aggregation strategy geared toward acquiring small to mid-sized private water distribution and services companies in high-growth regions.

AquaSource brings to the market a financially strong, motivated and innovative team experienced in all facets of water and wastewater services — infrastructure, regulatory and environmental. It provides design, construction, operation and

left - right
Karl Jackson
Assistant Controller, AquaSource
Carey Thomas
Vice President, Administration, and Assistant Secretary, AquaSource
Jim Lahtinen
Vice President, Planning, Budgeting and Rates, AquaSource
Ed Wallace ▼
Senior Vice President and Chief Financial Officer, AquaSource

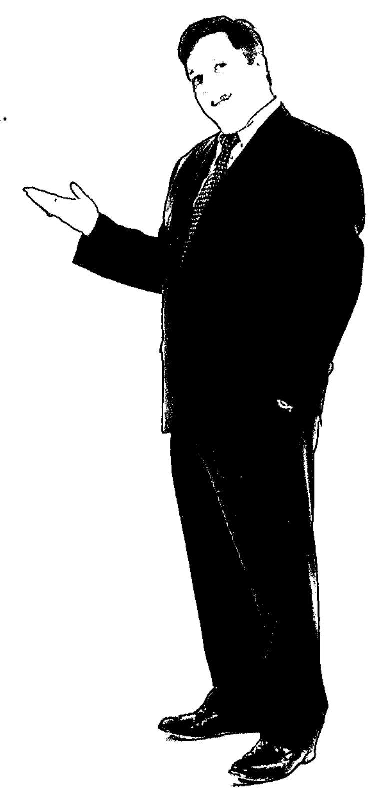


IS FOR Aggregation

management services. Providing safe, clean drinking water in today's regulatory environment has become a highly complex process. The cost to comply with governmental regulations has become prohibitive to many smaller water utilities. AquaSource can provide the benefits of economies of scale that otherwise would not be available, thus helping small municipalities and private water companies to proactively address these types of challenges.

At year-end, AquaSource had acquired approximately 300,000 customers, totaling 65 transactions. In December, AquaSource acquired a bottled water company in Canada with more than 17,000 customers in its office and home water cooler division. Based on this level of growth, we have the potential to double our size as a multi-utility distribution company in a few short years.

We believe AquaSource has the capital resources, the operational experience and the dedication to become a leading water and wastewater services provider in the country. We may not be able to stay under the radar much longer.



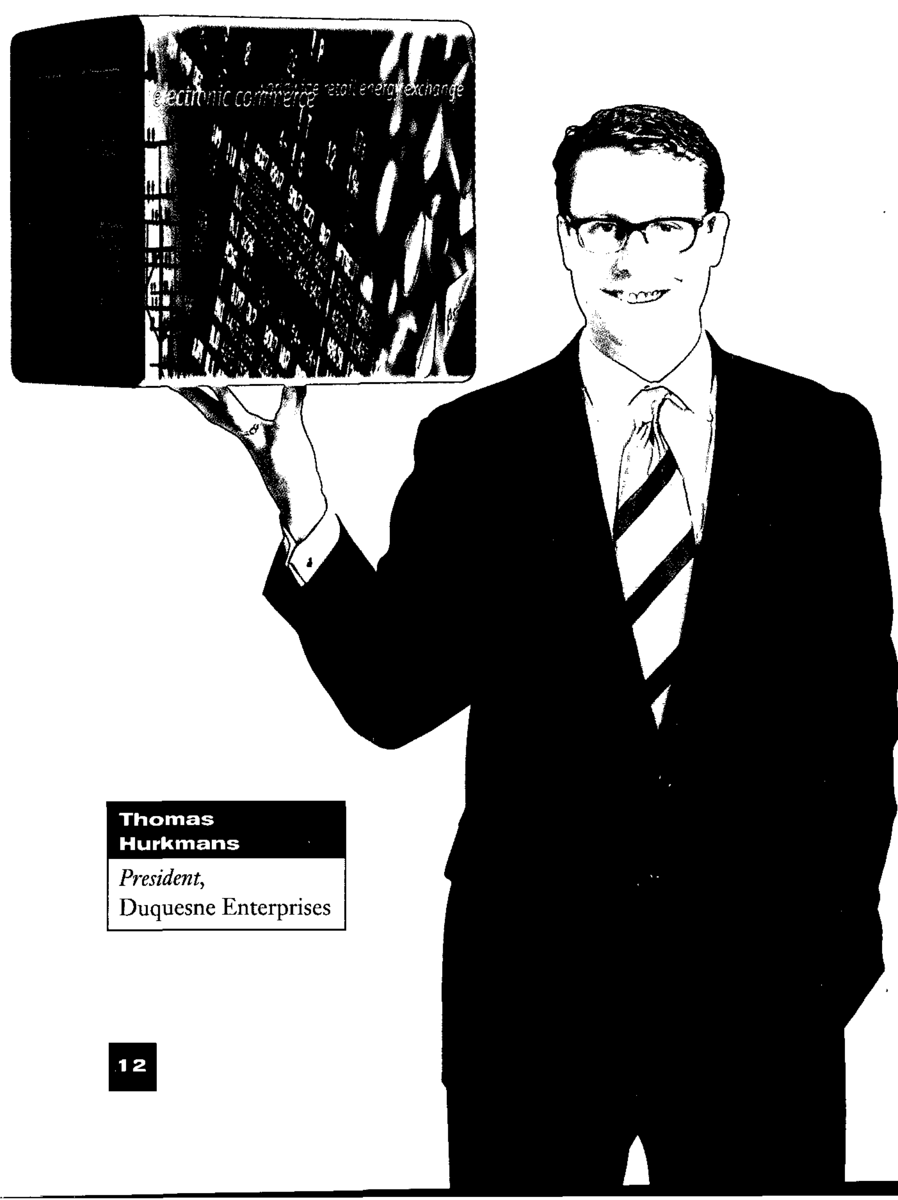
Building Value by Pursuing Well-Defined Market Opportunities

DQE FOSTERS AN ENTREPRENEURIAL SPIRIT AND AN OPERATING PHILOSOPHY OF STRATEGIC PARTNERING TO BUILD SHAREHOLDER VALUE. Thomas Hurkmans, president of Duquesne Enterprises, and his capable team, exemplify these qualities.

An important component of DQE's growth strategy is to offer products and services that make delivered commodities, such as electricity, water, gas and communications, more valuable for customers. Using a building block approach that involves acquiring and developing stand-alone, financially defensible businesses, Duquesne Enterprises pursues well-defined market opportunities in the areas of electronic commerce, communications and energy services. Because commercial and market conditions are constantly changing, Duquesne Enterprises continually reviews its operating companies for expansion opportunities and exit strategies to ensure that DQE's capital is put to the best possible use.

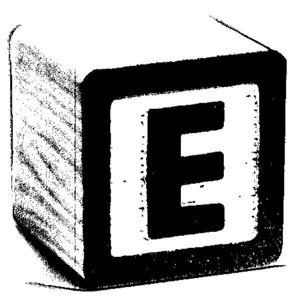
Each operating company has its own specialized, effective management team, whose financial interest is aligned with DQE. These companies are operated in an environment that is enriched and supportive, leveraging DQE's core competencies, including customer access, synergistic opportunities with affiliates, and industry knowledge.

One example of our success in energy services is our Control Solutions business, one of the largest and most successful energy services companies in the mid-Atlantic



Thomas Hurkmans
President,
Duquesne Enterprises

◄ **John Gaus**
President,
North American
Power Brokers, Inc.



IS FOR Entrepreneurialism

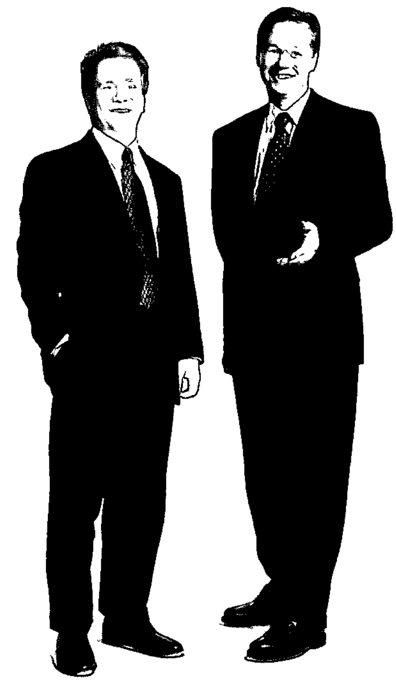
region. This business provides energy engineering, controls, and efficient facilities services. Control Solutions' focus on the industrial market — including more than 2,000 customers — complements the commercial market focus of our OnDemand Energy Solutions subsidiary. These industrial capabilities, combined with the innovative performance contracting and low-cost energy management systems of OnDemand, and the automated meter reading capabilities of our EnSite partnership with Itron, create a strong platform for expanding DQE's customer base.

DQE is building businesses through the application of electronic commerce enabling technologies. This strategy led to our investment in, and strategic alliance with, North American Power Brokers. North American provides a low-bid, Internet auction-based approach to the retail purchasing of electricity and natural gas, and is the leader in extending electronic commerce to the retail energy market. Approximately 50 energy suppliers, including many of the country's largest, regularly participate in these Internet auctions. North American's innovative service has received prestigious recognition, including nomination by Bill Gates, chairman of Microsoft, for a ComputerWorld Smithsonian Award.

BroadPoint Communications' FreeWay service is one of our newest and most innovative complementary products and services. BroadPoint is in the midst of an extremely successful national rollout of this first-of-its kind, advertiser-sponsored, free long-distance telephone service. With the FreeWay service, customers earn two free minutes of long-distance calling for each short audio advertisement they listen to.

FreeWay has been up and running successfully in Pittsburgh since April 1998, with 25,000 subscribers and more than 70 national advertisers. During the first several weeks of its national rollout, the FreeWay service has attracted hundreds of thousands of subscribers. DQE anticipates using the FreeWay service to extend its retail customer base to millions of homes, with an expandable electronic commerce connection through which it will provide additional products and services.

Duquesne Enterprises will continue to create value for DQE shareholders by acquiring and developing synergistic businesses with compelling market opportunities in the rapidly growing areas of electronic commerce, communications and energy services.



left - right
John Zbihley
President, OnDemand Energy Solutions, Inc.
Richard Housh
President, Control Solutions, LLC
Perry Kamel ▼
President, BroadPoint Communications, Inc.

left - right
Frosina Cordisco
Vice President, Montauk; *Assistant Treasurer*, DQE; *Treasurer*, Duquesne Light Company
John Fulgoney
Vice President, Legal Chief Counsel, Montauk
Bill Fields
Vice President and Treasurer, Montauk

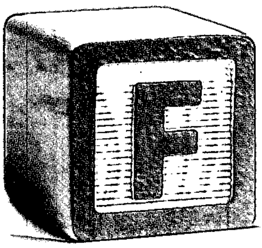
FOR NEARLY A DECADE, EARNINGS PROVIDED BY DQE'S MONTAUK SUBSIDIARY HAVE SERVED AS AN ONGOING, VALUE-ADDED BRIDGE STRATEGY. The financial flexibility generated by Montauk's diverse and sophisticated investment portfolio has enabled DQE to build a strong platform of expanded business lines, while allowing Duquesne Light to address critical issues associated with deregulation.

Financial Expertise Provides a Solid Platform for Growth

The core of Montauk's success lies in its ability to develop a diverse and distinctive group of transactions, engineered with precision across a wide range of alternative investment opportunities.

In practice, Montauk applies strict investment discipline to identify and focus on transactions that meet a very specific set of investment characteristics. These criteria include return on investment, linkages to DQE's core distribution business, credit strength, term of investment and exit opportunities. The team also factors in the possibilities for add-on investments and long-term prospects that relate to the structure, our partners, or the nature of the investment. Evaluating, structuring, negotiating and implementing these complex transactions has led to the development of a sophisticated skill set that positions Montauk well for future expansion.

Montauk's current investment portfolio generally encompasses three lines of business: renewable energy businesses, including landfill gas, coal bed methane and synthetic fuels; affordable housing; and structured financial leasing transactions. In a building block fashion, many of the initiatives that Montauk developed have evolved into opportunities for other DQE subsidiaries.



IS FOR Financial Flexibility

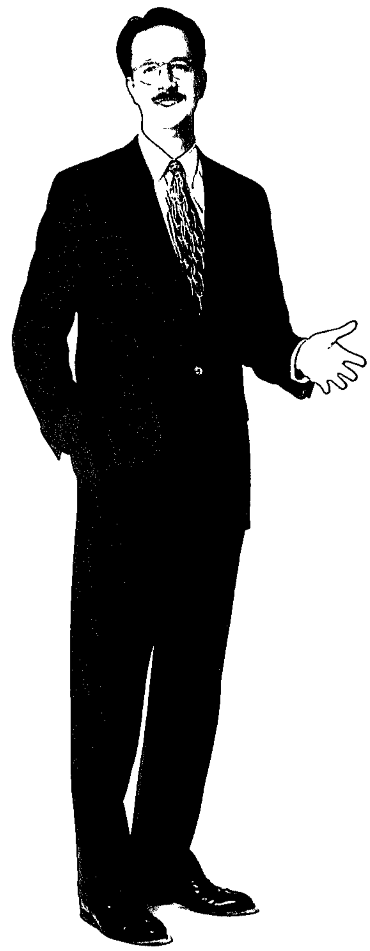
This includes Duquesne Light Company's affordable housing partnerships in the Pittsburgh region, as well as the possibilities for small-scale generation identified through Montauk's landfill gas investments. With the addition in 1998 of a major landfill gas collection system on Staten Island, New York, DQE now has approximately 350 billion cubic feet of gas reserves. Clearly, Montauk's knowledge base and position in the market for tax-advantaged transactions have provided important linkages to DQE's other expanded business lines.

Montauk's Key Strategies:

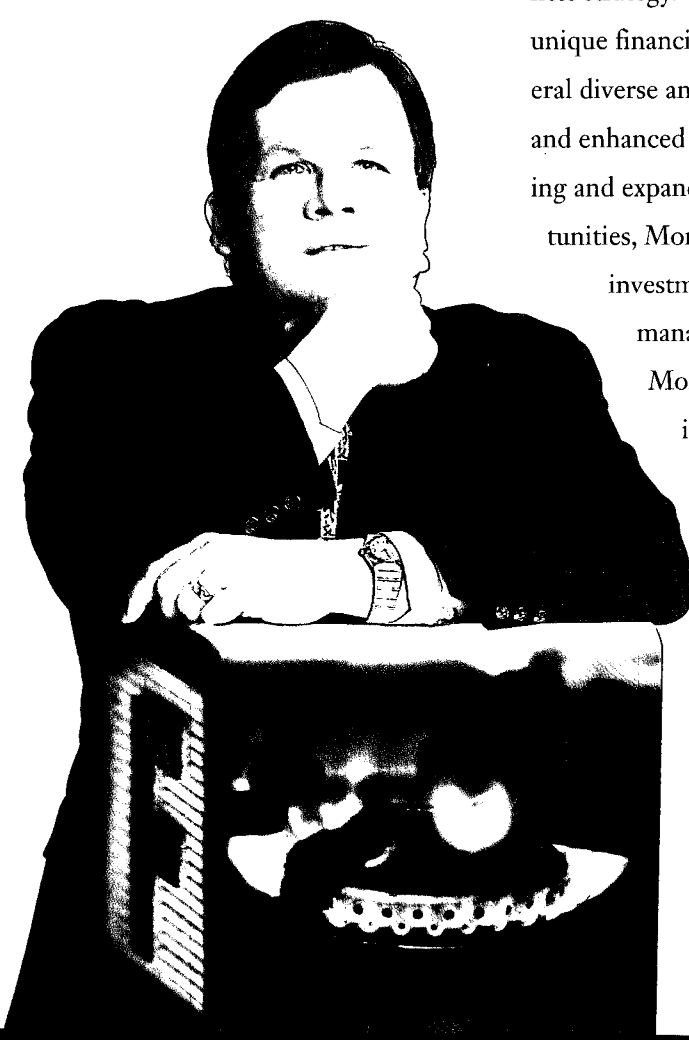
- *Driving earnings growth*
- *Optimizing portfolio values*
- *Supporting affiliate endeavors*

The financial expertise of the Montauk team plays an important role in DQE's business strategy. Montauk provides DQE with unique financial structuring capabilities, several diverse and profitable lines of business, and enhanced earnings growth. By identifying and expanding upon these unique opportunities, Montauk is recognized as an investment-generating and portfolio-management organization.

Montauk's experience in structuring complex financial transactions will be a valuable asset as DQE moves to expand its landfill gas, water and electric operations.



Steve Schott
Controller, Montauk



Jim Mitchell
President, Montauk;
Vice President, DQE

Innovative Energy Solutions for Industry, Manufacturers, Airports and Institutions

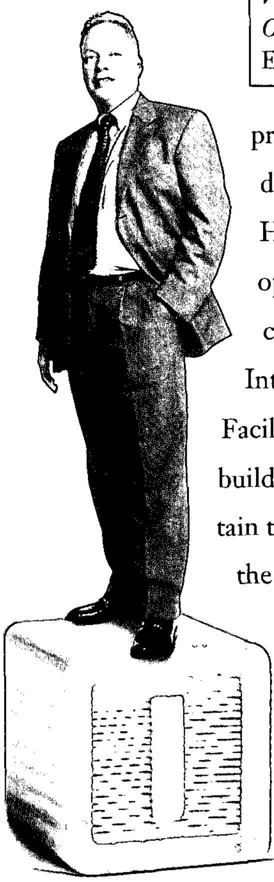
IN THE FACE OF EVER-INCREASING COMPETITIVE PRESSURES, CORPORATIONS ARE CONCENTRATING MORE AND MORE OF THEIR RESOURCES ON THEIR CORE BUSINESS. Fuel sourcing and energy facility management and optimization are viewed as non-core activities that can be handled most efficiently through outsourcing.

Lex Tsaggaris
President,
DQE Energy Services

Enter DQE Energy Services, a provider of innovative energy facility and fuel solutions. The company develops or acquires, owns, operates and maintains energy facilities and independent power projects (IPPs), and sells the outputs from these facilities back to customers under long-term agreements. Through its Duquesne Energy subsidiary, the company also produces specialty fuels and provides fuel management services.

Target markets for the energy facility business include industry, manufacturers, airports, and institutional customers that use "inside the fence" energy facilities to supply steam, electricity, chilled water, and compressed air. With a reliable, experienced, efficient partner like DQE Energy Services to operate energy facilities, purchase fuel, and even take aging energy assets off their books, customers can reduce energy costs and avoid future capital expenditures to maintain these assets. Whether the customer has existing energy assets like the H.J. Heinz facilities we operate in Pittsburgh and Leamington, Ontario, or needs a new facility, DQE Energy Services can provide a cost-effective solution.

DQE Energy Services' approach focuses on understanding the customer's site-specific problems, financial objectives, and operating requirements. The strength of DQE Energy Services is its ability to work directly with customers and take a flexible, innovative approach to solving their energy



Phil Damiani
Vice President, Operations, DQE Energy Services

problems. That strength is demonstrated in its two H.J. Heinz contracts, its operations and maintenance contract for the Pittsburgh International Airport Energy Facility, and its winning bid to build, own, operate and maintain the new energy facility for the Detroit Metro Airport Midfield Terminal Project, a joint venture with MichCon Gas.

Fuel development offers another synergy. During 1998, Duquesne Energy completed the construction of six E-Fuel® production facilities in Ohio, Pennsylvania, Kentucky, North Carolina, South Carolina and Virginia. These facilities produce an environmentally friendly pelletized fuel made from coal and by-products of the manufacture of paper and plastic. E-Fuel, which burns with reduced levels of nitrogen oxide and sulfur dioxide emissions, is targeted to industrial facilities that burn

left - right
Debbie Beck
Vice President, Finance, Treasurer and Controller, DQE Energy Services
Linda Ackerman
Vice President, Legal, DQE Energy Services
Rich LiConti
President, Duquesne Energy

I IS FOR Innovation

DQE Energy Services' approach to the independent power market is to develop or acquire small to mid-size projects, some of which may provide synergistic opportunities with other DQE companies. The Monmouth (N.J.) Energy Facility is an excellent example of the synergistic benefits our building block approach offers, by adding incremental value in businesses related to DQE's areas of expertise. DQE Energy Services built and now operates this 10-megawatt landfill gas powered IPP. A Montauk investment, GSF Energy, is responsible for well field operation and gas production. Using transactions of this type, DQE maximizes the strengths and expertise of our various subsidiaries to provide solutions to our customers.

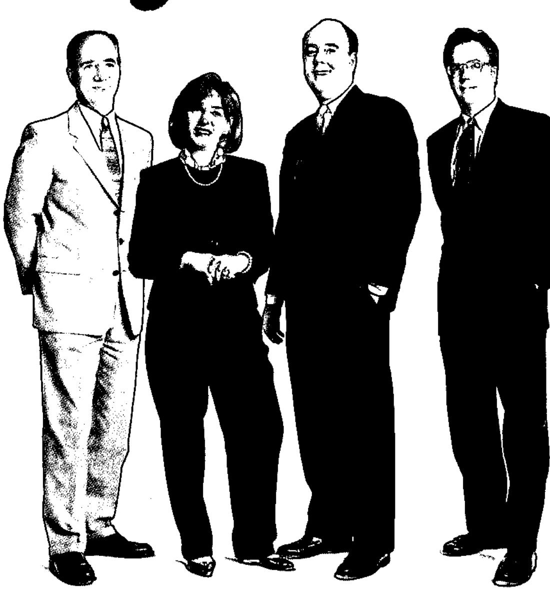
higher-priced stoker coal, and to niche steam coal markets.

Initial supply contracts were obtained for the new facilities. E-Fuel also is in use at the Heinz Pittsburgh complex, demonstrating our vertical integration strategy of facilities and fuels.

Duquesne Energy's efforts to commercialize E-Fuel technology earned the American Boiler Manufacturers Association's Annual Public Service Award for Energy and Environmental Achievement. In 1999, we will seek out additional energy facility opportunities where E-Fuel can provide customers with a competitive advantage.

In short, the flexible, responsive DQE Energy Services team is the strategic resource for customers' total energy solution.

Bringing Creativity, Efficiency, and Mass to the Business of Distribution



left - right
Frank Hoffmann
Vice President, Operations
Pat Prozzi
President, DQE Communications
Mark Daday
Vice President, Finance and Treasurer
Bill Roberts
Vice President, Legal

PILOTING COMPLEX ENERGY AND COMMUNICATIONS DELIVERY SYSTEMS INTO THE 21ST CENTURY REQUIRES EXTENSIVE EXPERIENCE AND VISION. DQEnergy PARTNERS works with a wide range of distribution system owners in the areas of gas, electric and telecommunications to help them better meet the needs of customers and the community, both today and in the future.

DQEnergy PARTNERS tailors its approach to achieve the objectives and to meet the needs of each specific opportunity. Through varied combinations of technological advancement, aggregation, development and the leveraging of current assets, PARTNERS remakes traditional industry participants into state-of-the-art distribution networks.

T is for Transformation

Systems working with DQEnergy PARTNERS benefit from a reliable source of funds, operational improvements, expanded product lines and the expert guidance of a motivated team. Together, as partners, they are meeting the complex challenge of providing exceptional service to both customer and community.

John Welch
President, DQEnergy PARTNERS

Daniel Berg

69. Term expires 2000 (1, 6). Institute Professor, Rensselaer Polytechnic Institute. Chairman of the Board and Director, Crystek Crystal Corporation (manufacturer of high reliability crystals for microprocessors and oscillators). Other directorships include Hy-Tech Machine, Inc. (specialty parts), and Joachim Machinery Co., Inc. (distributor of machine tools).

Doreen E. Boyce

64. Term expires 2001 (2, 5). President of the Buhl Foundation (supports educational and community programs). Directorships include Microbac Laboratories, Inc. and Dollar Bank, Federal Savings Bank. Trustee of Franklin & Marshall College.

Robert P. Bozzone*

65. Term expires 2000 (1, 2). Vice Chairman of Allegheny Teledyne, Inc. (specialty metals production). Life member of ASM International (engineering technical society). Directorships include Allegheny Teledyne, Inc. Former Chairman, Pittsburgh branch of the Federal Reserve Bank of Cleveland. Trustee of Rensselaer Polytechnic Institute.

Sigo Falk

64. Term expires 1999 (2, 3, 4). Management of personal investments. Chairman of Maurice Falk Medical Fund, the Leon Falk Family Trust, and the Chatham College Board of Trustees. Directorships include the Historical Society of Western Pennsylvania and the Allegheny Land Trust.

William H. Knoell*

74. Term expires 2000 (3, 4, 6). Retired Chairman and Chief Executive Officer of Cyclops Industries, Inc. (basic and specialty steels and fabricated steel products; industrial and commercial construction). Directorships include Cabot Oil and Gas Corporation and St. Clair Memorial Hospital. Life trustee of Carnegie Mellon University.

David D. Marshall

46. Term expires 2001 (3, 5, 6). President and Chief Executive Officer of DQE; President and Chief Executive Officer of Duquesne Light. Directorships include the Allegheny Conference on Community Development. Trustee of Penn's Southwest Association (economic development).

Thomas J. Murrin

69. Term expires 2000 (3, 6). Dean, A.J. Palumbo School of Business Administration, Duquesne University; former Deputy Secretary of U.S. Dept. of Commerce; former President, Westinghouse Electric Corporation Energy and Advanced Technology Group. Directorships include Motorola, Inc. (manufacturer of electric equipment and components). Member of the Executive Committee of the U.S. Council on Competitiveness and Chairman of the Pittsburgh Tissue Engineering Institute.

Eric W. Springer

69. Term expires 1999 (1, 4). Of Counsel, Horty, Springer and Mattern, P.C. (attorneys-at-law). Trustee of the Maurice Falk Medical Fund and Trustee Emeritus of Presbyterian University Hospital and the University of Pittsburgh Medical Center. Past president of the Allegheny County Bar Association.

DQE/Duquesne Light Committees:

1. Audit
2. Compensation
3. Finance
4. Nominating

Duquesne Light Committees:

5. Employment and Community Relations
6. Nuclear Review

** Lead Director*

David D. Marshall, 46. President and Chief Executive Officer. Previously held senior executive positions in finance at Central Vermont Public Service. Joined the company in 1985. Directorships included on page 19.

Gary L. Schwass, 53. Executive Vice President and Chief Financial Officer. Previously served in a variety of senior executive positions in finance and management with Consumers Power Company. Joined the company in 1985. Directorships include Chair, Western Pennsylvania Development Credit Corporation (promotes small business through lending activities), and Vice President and Treasurer, Holy Family Foundation (supports families in crisis).

Victor A. Roque, 52. Executive Vice President and General Counsel. Formerly Vice President, General Counsel and Secretary for Orange and Rockland Utilities. Joined the company in 1994. Directorships include the Pennsylvania Business Roundtable (economic development), the Hill House Association (provider of social services), the Urban League of Pittsburgh, and the United Way Good Neighbors Advisory Committee. Member, Salvation Army Greater Pittsburgh Advisory Board.

William J. DeLeo, 48. Vice President and Chief Administrative Officer. Previously held senior management positions with Duquesne Light, Gulf Oil and Price Waterhouse. Joined the company in 1985. Directorships include the Pittsburgh Civic Light Opera.

James D. Mitchell, 47. Vice President. Previously held senior financial positions with Duquesne Light and U.S. West, Inc. Joined the company in 1988. Directorships include Three Rivers Youth (helps troubled teenagers).

Morgan K. O'Brien, 38. Vice President, Controller and Treasurer. Previously held senior financial positions at DQE, Duquesne Light, PNC Bank and Deloitte & Touche. Joined the company in 1991.

Jack E. Saxer, Jr., 55. Vice President. Previously held senior financial positions with Gulf Oil and Chevron. Joined the company in 1989. Directorships include Point Venture (venture capital) and Pittsburgh Consumer Health Coalition (healthcare advocacy for the disadvantaged).

Diane S. Eismont, 54
Corporate Secretary

Duquesne Light Company Officers

David D. Marshall, 46
President and Chief Executive Officer

Gary L. Schwass, 53
Senior Vice President and Chief Financial Officer

Victor A. Roque, 52
Senior Vice President and General Counsel

James E. Cross, 52
President, Generation Group

Gary R. Brandenberger, 61
Vice President and Assistant to the President

William J. DeLeo, 48
Vice President, Corporate Services

Edward N. Neal, 52
Vice President, Customer Operations

Morgan K. O'Brien, 38
Vice President, Finance

Frosina C. Cordisco, 47
Treasurer

Diane S. Eismont, 54
Corporate Secretary and Assistant General Counsel

James E. Wilson, 33
Controller

AquaSource Officers

Donald J. Clayton, 44
President

Edward R. Wallace, 43
Senior Vice President and
Chief Financial Officer

William A. Callegari, 57
President-South

William K. Reynolds, 56
President-Midwest

James A. Lahtinen, 46
Vice President, Planning,
Budgeting and Rates

Carey A. Thomas, 34
Vice President,
Administration and Assistant
Secretary

Duquesne Enterprises Officers

Thomas A. Hurkmans, 33
President

Neal G. Taylor, 47
Senior Vice President

Anthony J. Villiotti, 52
Senior Vice President
and Treasurer

Rachael K. Lorey, 34
Vice President, Legal

Eric R. Stoltz, 41
Vice President

Anthony F. Pekny, 41
Controller

Montauk Officers

James D. Mitchell, 47
President

Frosina C. Cordisco, 47
Vice President

William F. Fields, 48
Vice President and
Treasurer

John F. Fulgoney, 52
Vice President, Legal
and Chief Counsel

Stevan R. Schott, 35
Controller

DQE Energy Services Officers

Alexis Tsaggaris, 50
President

Linda S. Ackerman, 42
Vice President, Legal

Deborrah E. Beck, 41
Vice President, Finance,
Treasurer and Controller

Philip J. Damiani, 48
Vice President, Operations

Richard M. LiConti, 54
President
Duquesne Energy

DQEnergy Partners Officers

John W. Welch, 47
President

Mark S. Daday, 37
Vice President, Finance
and Treasurer

Frank A. Hoffmann, 47
Vice President, Operations

William H. Roberts, 45
Vice President, Legal

Kelly M. Pasterick, 28
Controller

Patricia A. Prozzi, 44
President,
DQE Communications

1998 Financial Statements at a Glance

Detailed financial information can be found beginning on page 29.

Selected Financial Data

(in millions, except per share amounts)

	1998	1997	1996	1995
Selected Income Statement Items:				
Revenues from sales of electricity	$1,127	$1,124	$1,144	$1,149
Fuel and purchased power expenses	263	223	237	232
Net electric revenues	864	901	907	917
Other revenues	143	106	93	81
Net operating revenues	1,007	1,007	1,000	998
Operating and maintenance expenses	437	401	388	384
Depreciation and amortization	217	243	223	203
Taxes other than income taxes	81	83	86	89
Non-energy operating expenses	735	727	697	676
Operating income	272	280	303	322
Investment and other income	136	130	73	52
Interest and other charges	110	115	110	107
Income taxes	101	96	87	96
Pa restructuring charge (net of tax)	83	—	—	—
Net income	$ 114	$ 199	$ 179	$ 171
Basic EPS	$ 2.52*	$ 2.57	$ 2.32	$ 2.20
Diluted EPS	$ 2.48*	$ 2.54	$ 2.29	$ 2.17
Ratio of earnings to fixed charges (pre-tax)	2.92*	2.76	2.69	2.73
Selected Balance Sheet Items:				
Long-term investments	$ 760	$ 723	$ 519	$ 441
Property, plant and equipment	$1,717	$2,662	$2,817	$3,060
Total assets	$5,248	$4,694	$4,639	$4,459
Total capitalization	$3,112	$3,103	$3,055	$2,801
Capitalization Ratios:				
Common shareholders' equity	47.8%	48.3%	45.6%	47.5%
Preferred and preference stock	8.4%	7.3%	7.3%	2.5%
Long-term debt	43.8%	44.4%	47.1%	50.0%
Selected Common Stock Information:				
Average shares outstanding	77.7	77.5	77.3	77.7
Shares outstanding at year-end	77.4	77.7	77.3	77.6
Market capitalization	$3,400	$2,729	$2,241	$2,386
Dividends declared	$ 113	$ 107	$ 101	$ 94
Dividends declared per share	$ 1.46	$ 1.38	$ 1.30	$ 1.21
Book value per share at year-end	$19.18	$19.30	$18.01	$17.13
Dividend payout ratio	57.1%	52.9%	55.2%	54.1%
Dividend yield at year-end	3.5%	4.1%	4.7%	4.2%
Return on average common equity	13.1%	13.8%	13.2%	13.1%
Price-earnings ratio at year-end	17.4	13.7	12.5	14.0

** Basic EPS after Pennsylvania restructuring charge: $1.46; Diluted EPS after Pennsylvania restructuring charge: $1.44; Ratio of earnings to fixed charges (pre-tax) after Pennsylvania restructuring charge: $2.39.*

	1994	1993	1992	1991	1990	1989	1988
	$1,146	$1,132	$1,127	$1,163	$1,110	$1,097	$1,047
	244	238	239	254	229	220	231
	902	894	888	909	881	877	816
	90	63	37	38	31	48	43
	992	957	925	947	912	925	859
	421	415	365	385	388	353	335
	166	158	132	123	123	123	117
	88	71	84	94	80	93	81
	675	644	581	602	591	569	533
	317	313	344	345	321	356	326
	43	31	42	36	46	(3)	30
	110	120	132	142	157	165	175
	93	80	112	105	88	75	62
	—	—	—	—	—	—	—
	$ 157	$ 144	$ 142	$ 134	$ 122	$ 113	$ 119
	$ 1.98	$ 1.81	$ 1.78	$ 1.67	$ 1.49	$ 1.35	$ 1.24
	$ 1.96	$ 1.79	$ 1.77	$ 1.65	$ 1.48	$ 1.34	$ 1.24
	2.57	2.29	2.24	2.10	1.90	1.78	1.72
	$ 196	$ 126	$ 59	$ 44	$ 18	$ —	$ —
	$3,140	$3,168	$3,037	$3,053	$3,048	$3,055	$3,066
	$4,427	$4,550	$3,778	$3,851	$3,834	$3,921	$3,881
	$2,750	$2,781	$2,716	$2,669	$2,770	$2,827	$2,866
	46.4%	44.2%	43.1%	41.6%	39.0%	37.7%	37.4%
	3.5%	4.8%	4.9%	5.2%	6.8%	7.8%	8.5%
	50.1%	51.0%	52.0%	53.2%	54.2%	54.5%	54.1%
	79.0	79.5	79.4	80.1	81.6	83.7	95.6
	78.5	79.5	79.4	79.4	80.6	83.0	86.7
	$1,550	$1,829	$1,708	$1,621	$1,337	$1,321	$1,084
	$ 89	$ 86	$ 81	$ 78	$ 75	$ 73	$ 78
	$ 1.13	$ 1.08	$ 1.03	$ 0.97	$ 0.92	$ 0.87	$ 0.81
	$16.27	$15.47	$14.75	$14.00	$13.38	$12.85	$12.34
	56.4%	58.8%	56.9%	57.6%	60.7%	63.1%	64.5%
	5.7%	4.6%	5.0%	5.0%	5.8%	5.7%	6.8%
	12.5%	12.0%	12.4%	12.2%	11.3%	10.6%	10.4%
	9.9	12.7	12.1	12.3	11.1	11.8	10.1

Selected Operating Data

	1998	1997	1996	1995
Sales of Electricity (kilowatt-hours):				
Average annual residential use	6,093	6,247	6,362	6,474
Electric energy sales supplied (millions):				
Residential	3,191	3,268	3,321	3,378
Commercial	5,510	5,695	5,737	5,729
Industrial	3,357	3,500	3,285	3,237
Miscellaneous	70	82	83	84
Total sales to customers	12,128	12,545	12,426	12,428
Sales to other utilities	1,909	1,445	3,310	2,975
Total sales	14,037	13,990	15,736	15,403
Percentage Change in Energy Sales:				
Residential	(2.4)	(1.6)	(1.7)	4.9
Commercial	(3.2)	(0.7)	0.1	3.0
Industrial	(4.1)	6.5	1.5	(0.6)
Miscellaneous	(14.6)	(1.2)	(1.2)	0.0
Total sales to customers	(3.3)	1.0	0.0	2.5
Sales to other utilities	32.1	(56.4)	11.3	(7.4)
Total sales	0.3	(11.1)	2.2	0.4
Energy Supply and Production Data:				
Energy supply (millions of kilowatt-hours):				
Net generation - system plants	11,508	12,567	14,166	14,201
Purchased and net interchanged power	2,529	1,423	1,570	1,202
Total energy supply	14,037	13,990	15,736	15,403
Generating capability (megawatts)	2,670	2,670	2,670	2,834
Peak demand (megawatts)	2,484	2,671	2,463	2,666
Cost of fuel per million BTU	144.05¢	131.20¢	130.21¢	131.37¢
Average cost of generation per kilowatt-hour	2.41¢	2.28¢	2.12¢	2.22¢
Electric Utility Customer Data:				
Telephone access:				
% of customers waiting less than 30 seconds	88%	88%	88%	87%
Customer Service Guarantee Program error rate	.002%	.004%	.007%	.007%
Number of customers at year-end (thousands):				
Residential	523.9	523.5	522.8	522.9
Commercial	55.2	54.5	54.0	53.8
Industrial	1.5	2.0	2.0	2.0
Other	1.9	1.9	1.9	1.9
Total customers	582.5	581.9	580.7	580.6
Expanded Business Lines:				
% contribution to DQE earnings	26%	31%	19%	15%
Return on equity	12%	19%	15%	13%
Assets (millions)	$1,072	$854	$612	$470
Landfill gas reserves (Bcf)	350	224	171	—
Water and wastewater customers (thousands)	300	1	—	—

1994	1993	1992	1991	1990	1989	1988
6,170	6,201	5,901	6,331	5,953	6,060	6,168
3,219	3,231	3,069	3,285	3,078	3,119	3,156
5,563	5,490	5,358	5,450	5,236	5,145	5,055
3,256	3,046	3,059	3,042	3,296	3,221	3,302
84	84	83	84	84	84	91
12,122	11,851	11,569	11,861	11,694	11,569	11,604
3,212	2,821	4,060	2,979	1,830	2,100	2,716
15,334	14,672	15,629	14,840	13,524	13,669	14,320
(0.4)	5.3	(6.6)	6.7	(1.3)	(1.2)	3.0
1.3	2.5	(1.7)	4.1	1.8	1.8	3.2
6.9	(0.4)	0.6	(7.7)	2.3	(2.5)	13.2
0.0	1.2	(1.2)	0.0	0.0	(7.7)	(7.1)
2.3	2.4	(2.5)	1.4	1.1	(0.3)	5.7
13.9	(30.5)	36.3	62.8	(12.9)	(22.7)	12.0
4.5	(6.1)	5.3	9.7	(1.1)	(4.5)	6.8
14,678	14,056	15,074	14,220	13,266	13,455	14,144
656	616	555	620	258	214	176
15,334	14,672	15,629	14,840	13,524	13,669	14,320
2,834	2,834	2,834	2,835	2,835	2,835	2,836
2,535	2,499	2,308	2,402	2,379	2,381	2,372
137.23¢	143.65¢	140.15¢	153.70¢	149.62¢	143.87¢	145.74¢
2.23¢	2.33¢	2.19¢	2.44¢	2.51¢	2.73¢	2.58¢
86%	76%	41%	26%	—	—	—
—	—	—	—	—	—	—
522.6	522.3	521.2	520.0	518.3	516.8	513.8
53.6	52.9	52.8	52.6	52.3	52.0	51.5
2.0	2.0	2.0	2.0	2.0	2.0	2.0
1.9	1.9	1.8	1.9	1.9	1.8	1.8
580.1	579.1	577.8	576.5	574.5	572.6	569.1
10%	4%	1%	—	—	—	—
10%	6%	2%	2%	—	—	—
$350	$212	$106	$53	$31	$2	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—

Condensed Statement of Consolidated Income

(millions of dollars, except per share amounts)

	Year Ended December 31, 1998	1997
Revenues from sales of electricity	**$1,127**	$1,124
Fuel and purchased power expenses	**263**	223
Net electric revenues	**864**	901
Other revenues	**143**	106
Net operating revenues	**1,007**	1,007
Operating and maintenance expenses	**437**	401
Depreciation and amortization	**217**	243
Taxes other than income taxes	**81**	83
Non-energy operating expenses	**735**	727
Operating income	**272**	280
Investment and other income	**136**	130
Interest and other charges	**110**	115
Income before income taxes and extraordinary item	**298**	295
Income taxes	**101**	96
Income before extraordinary item	**197**	199
Extraordinary item (net of tax)	**(83)**	—
Net income	**$ 114**	$ 199
Earnings per share - before extraordinary item	**$ 2.52**	$ 2.57
Earnings per share - after extraordinary item	**$ 1.46**	$ 2.57

Stable utility sales with increased fuel costs due to nuclear station outages

New investments related to core business

Reduced generation plant depreciation

Continued growth in expanded business lines

Refinancing of long-term debt

PUC restructuring order

Sale of Chester and Exide stock in 1997 added 17 cents per share

Condensed Consolidated Balance Sheet

(millions of dollars)

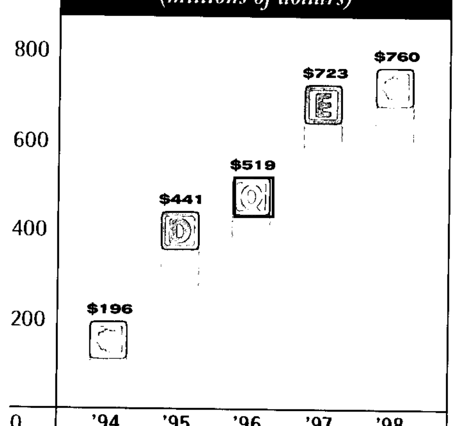
Continued growth in expanded business lines

Generation plant reclassified as transition costs

Increase reflects BV Unit 2 lease liability

	As of December 31, 1998	1997
Current assets	**$ 375**	$ 569
Long-term investments	**760**	723
Property, plant and equipment	**1,717**	2,662
Regulatory assets	**2,198**	681
Other non-current assets	**198**	59
Total assets	**$5,248**	$4,694
Current liabilities	**$ 354**	$ 308
Deferred income	**157**	225
Non-current liabilities	**1,625**	1,058
Long-term debt	**1,365**	1,376
Total liabilities	**3,501**	2,967
Preferred and preference stock	**263**	228
Common shareholders' equity	**1,484**	1,499
Total liabilities and equity	**$5,248**	$4,694

Long-Term Investments
(millions of dollars)



Investments in utility delivery businesses, complementary products and services, industrial and commercial energy services, and energy-related technology have added value while effectively diversifying our expanded business lines.

Condensed Statement of Consolidated Cash Flows

(millions of dollars)

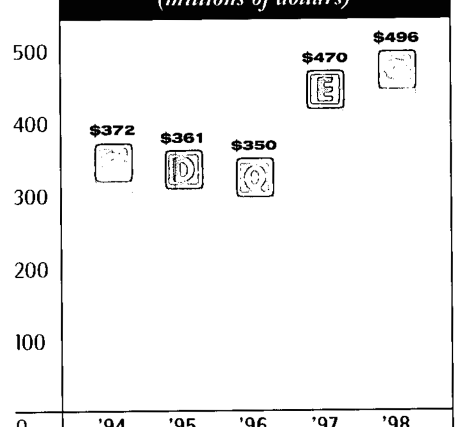
Continued strong cash flow provides financial flexibility

Growth in expanded business lines through aggregation strategy and targeted investments

Continued dividend growth

	Year Ended December 31, 1998	1997
Operating cash flows	**$ 496**	$ 470
Changes in working capital	**(37)**	(37)
Other	**(98)**	(66)
Cash from operating activities	**361**	367
Capital expenditures	**(190)**	(116)
Purchase of companies	**(144)**	(6)
Long-term investments	**(69)**	(219)
Disposition of investments	**7**	86
Other	**(1)**	(1)
Cash used in investing activities	**(397)**	(256)
Common and preferred stock dividends	**(114)**	(107)
Net change in long-term debt	**(71)**	(66)
Common stock repurchases	**(14)**	—
Other	**(12)**	7
Cash used in financing activities	**(211)**	(166)
Net change in cash	**$(247)**	$ (55)

Net Operating Cash Flow*
(millions of dollars)



Positive cash flow allows DQE to meet its operating and construction requirements, improve its capital structure and develop its expanded business lines.

* *Excludes working capital and other balance sheet changes*

Contents

Company Report on Financial Statements

THE COMPANY IS RESPONSIBLE FOR THE FINANCIAL INFORMATION AND REPRESENTATIONS CONTAINED IN THE FINANCIAL STATEMENTS AND OTHER SECTIONS OF THIS ANNUAL REPORT TO SHAREHOLDERS. The Company believes that the consolidated financial statements have been prepared in conformity with generally accepted accounting principles that are appropriate in the circumstances to reflect, in all material respects, the substance of events and transactions that should be included in the statements and that the other information in the annual report to shareholders is consistent with those statements. In preparing the financial statements, the Company makes informed judgments and estimates based on currently available information about the effects of certain events and transactions. The Company maintains a system of internal accounting control designed to provide reasonable assurance that the Company's assets are safeguarded, and that transactions are executed and recorded in accordance with established procedures. There are limits inherent in any system of internal control and such limits are based on recognition that the cost of such a system should not exceed the benefits derived. The system of internal accounting control is supported by written policies and guidelines and is supplemented by a staff of internal auditors. The Company believes that the internal accounting control system provides reasonable assurance that its assets are safeguarded and the financial information is reliable.

David D. Marshall

David D. Marshall
President and Chief Executive Officer

Gary L. Schwass

Gary L. Schwass
Executive Vice President and
Chief Financial Officer

CORPORATE STRUCTURE

DQE, Inc. (DQE) is a multi-utility delivery and services company. Its subsidiaries are Duquesne Light Company (Duquesne); AquaSource, Inc. (AquaSource); DQE Energy Services, Inc. (DES); DQEnergy Partners, Inc. (DQEnergy); Duquesne Enterprises, Inc. (DE); and Montauk, Inc. (Montauk). DQE and its subsidiaries are collectively referred to as "the Company."

The Company's utility operations include an electric utility engaged in the generation, transmission, distribution and sale of electric energy and a water resource management company that acquires, develops and manages water and wastewater utilities. The Company's expanded business lines offer a wide range of energy-related technologies, industrial and commercial energy services, telecommunications, and other complementary services. The expanded business lines' initiatives include energy facility development and operation, domestic and international independent power production, the production and supply of innovative fuels, investments in communications systems (including long-distance telephone service) and electronic commerce. In addition, one of the Company's subsidiaries is a financial services company that makes long-term investments and provides financing for the other expanded business lines and related customers.

On December 18, 1998, the Pennsylvania Public Utility Commission (PUC) approved the Company's plan to divest itself of its generation assets through an auction (including an auction of its provider of last resort service), and an agreement in principle to exchange certain power stations with FirstEnergy Corporation (FirstEnergy). Final agreements governing these transactions must be approved by various regulatory agencies. The Company currently expects these transactions to close in late 1999 or early 2000. (See "Rate Matters" discussion on page 39.)

The Company's Service Areas

The Company's electric utility operations provide service to customers in the City of Pittsburgh and surrounding areas. (See "Rate Matters" on page 39.) This territory represents approximately 800 square miles in southwestern Pennsylvania. The population of the area served by the Company's electric utility operations, based on 1990 census data, is approximately 1,510,000, of whom 370,000 reside in the City of Pittsburgh. In addition to serving approximately 580,000 direct customers, the Company's utility operations also sell electricity to other utilities.

The Company's water utility operations provide service throughout the United States. The Company's water utility and related service operations have grown rapidly and are currently approaching 300,000 customer connections.

Regulation

The Company is subject to the accounting and reporting requirements of the Securities and Exchange Commission (SEC). In addition, the Company's electric utility operations are subject to regulation by the PUC, including regulation under the *Pennsylvania Electricity Generation Customer Choice and Competition Act* (Customer Choice Act), and the Federal Energy Regulatory Commission (FERC) under the *Federal Power Act* with respect to rates for interstate sales, transmission of electric power, accounting and other matters. (See "Rate Matters" on page 39.)

The Company's electric utility operations are also subject to regulation by the Nuclear Regulatory Commission (NRC) under the *Atomic Energy Act of 1954*, as amended, with respect to the operation of its jointly owned/leased nuclear power plants, Beaver Valley Unit 1 (BV Unit 1), Beaver Valley Unit 2 (BV Unit 2) and Perry Unit 1.

The Company's water utility operations are subject to regulation by the utility regulatory bodies in their respective states.

As a result of the PUC's May 29, 1998, final order regarding the Company's restructuring plan under the Customer Choice Act (see "Rate Matters" on page 39), the electricity generation portion of the Company's business no longer meets the criteria of *Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation* (SFAS No. 71). Accordingly, application of SFAS No. 71 to this portion of the Company's business has been discontinued and the Company now applies *SFAS No. 101, Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No. 71* (SFAS No. 101), as interpreted by Emerging Issues Task Force (EITF) 97-4, *Deregulation of the Pricing of Electricity – Issues Related to the Application of FASB Statements No. 71 and 101.* Under SFAS No. 101, the regulatory assets and liabilities of the generation portion of the Company are determined on the basis of the source from which the regulated cash flows to realize such regulatory assets and settle such liabilities will be derived. Pursuant to the PUC's final restructuring order, certain of the Company's generation-related regulatory assets will be recovered through a competitive transition charge (CTC) collected in connection with providing transmission and distribution services (the electricity delivery business segment). The Company will continue to apply SFAS No. 71 with respect to such assets. Fixed assets related to the generation portion of the Company's business have been evaluated in accordance with *SFAS No. 121, Accounting for the Impairment of Long-Lived Assets to Be Disposed Of* (SFAS No. 121). Applying SFAS No. 121 to the non-regulated generation assets, it has been determined that the Company's generation assets are impaired. However, pursuant to the PUC's final restructuring order, the Company will recover its above-market investment in generation assets through the CTC. Under the Company's plan to auction its generation assets (currently expected to close in late 1999 or early 2000), the market value utilized by the PUC in determining the value of the generation assets will be the net after-tax proceeds received from the auction of its generation assets. Accordingly, the amount of book value authorized by the PUC to be recovered has been reclassified on the consolidated balance sheet from property, plant and equipment to transition costs, until the auction has been completed and all approvals for the final CTC accounting have been granted. The electricity delivery business segment continues to meet SFAS No. 71 criteria, and accordingly reflects regulatory assets and liabilities consistent with cost-based ratemaking regulations. The regulatory assets represent probable future revenue to the Company, because provisions for these costs are currently included, or are expected to be included, in charges to electric utility customers through the ratemaking process. (See "Rate Matters" on page 39.)

RESULTS OF OPERATIONS

Overall Performance

1998 Compared to 1997

On May 29, 1998, the PUC issued its final order related to the Company's restructuring plan. In the second quarter of 1998 the Company recorded an extraordinary charge (Pennsylvania restructuring charge) against earnings for $142.3 million ($82.5 million net of tax) for the generation-related stranded costs not considered by the PUC's restructuring order to be recoverable from customers. The Pennsylvania restructuring charge included Phillips Power Station (Phillips), Brunot Island Power Station (BI), deferred caretaker costs related to the two stations, and deferred coal costs. The charge resulted in a reduction of Duquesne's contribution to the Company's earnings per share by $1.06. (See "Rate Matters" on page 39.)

The Company's earnings per share in 1998 were $2.52, excluding the Pennsylvania restructuring charge, compared to $2.57 in 1997, resulting in a decrease of $0.05 per share or 1.9 percent. Earnings available for common stock were $195.8 million in 1998, excluding the Pennsylvania restructuring charge, compared to $199.1 million in 1997, resulting in a decrease of $3.3 million or 1.7 percent. The decrease in earnings available for common stock can be primarily attributed to the gains recorded on the sale of Chester Engineers (Chester) and of Exide Electronics Group, Inc. (Exide) stock in 1997, which together contributed $0.17 to earnings per share. Excluding these gains, the resulting increase to earnings per share of $0.12 in 1998 is primarily the result of income attributable to the increased level of long-term investments made late in 1997 and throughout 1998 through the expanded business lines.

1997 Compared to 1996

The Company's earnings per share in 1997 of $2.57 increased by $0.25 or 10.8 percent, compared to earnings per share of $2.32 in 1996. Earnings for common stock were $199.1 million in 1997 compared to $179.1 million in 1996, an increase of $20.0 million or 11.2 percent. The sale of Chester and of Exide stock in 1997 together contributed $0.17 to earnings per share, and an additional $0.19 per share was earned by the expanded business lines, the result of income attributable to the increased level of long-term investments. A partial offset to these increases in net income in 1997 was an incremental $25 million of accelerated nuclear fixed asset recovery as detailed in Duquesne's 1996 PUC-approved mitigation plan.

Dividends

Once all dividends on DQE's Preferred Stock, Series A (Convertible), $100 liquidation preference per share (DQE Preferred Stock), have been paid, dividends may be paid on the Company's common stock to the extent permitted by law and as declared by the board of directors. However, payments of dividends on Duquesne's common stock may be restricted by Duquesne's obligations to holders of preferred and preference stock pursuant to Duquesne's Restated Articles of Incorporation and by obligations of Duquesne's subsidiaries to holders of their preferred securities. No dividends or distributions may be made on Duquesne's common stock if Duquesne has not paid dividends or sinking fund obligations on its preferred or preference stock. Further, the aggregate amount of Duquesne's common stock dividend payments or distributions may not exceed certain percentages of net income if the ratio of total common shareholder's equity to total capitalization is less than specified percentages. As all of Duquesne's common stock is owned by DQE, to the extent that Duquesne cannot pay common dividends, the Company may not be able to pay dividends on its common stock or DQE Preferred Stock.

The Company has continuously paid dividends on common stock since 1953. The Company's annualized dividends per share were $1.52, $1.44, and $1.36 at December 31, 1998, 1997 and 1996. During 1998, the Company paid a quarterly dividend of $0.36 per share on each of January 1, April 1, July 1 and October 1. The quarterly dividend declared in the fourth quarter of 1998 was increased from $0.36 to $0.38 per share payable January 1, 1999. The Company expects that funds generated from operations will continue to be sufficient to pay dividends. The Company's need for and the availability of funds will be influenced by, among other things: new investment opportunities; the economic activity within the Company's utility service territory; competitive and environmental legislation; the results of the anticipated divestiture; and regulatory matters experienced by the electric utility industry generally, more specifically the transition to competition in Pennsylvania. (See "Rate Matters" on page 39.) The Company's stock price was $43 15/16 at the end of 1998.

Results of Business Segments

Historically, Duquesne has been treated as a single integrated business segment due to its regulated operating environment. The PUC authorized a combined rate for supplying and delivering electricity to customers. This rate was based on the Company's cost of service, which was designed to recover the Company's operating expenses and investment in electric utility assets and to provide a return on the investment. As a result of the Customer Choice Act, generation of electricity will be deregulated and charged at a separate rate from the delivery of electricity beginning in 1999 (5 percent of customers chose alternative generation suppliers in 1998). For the purposes of complying with the *SFAS No. 131*, *"Disclosures about Segments of an Enterprise and Related Information"* (SFAS No. 131), the Company is required to disclose information about its business segments separately. Accordingly, the Company has used the PUC-approved separate rates for 1999 to develop the financial information of the business segments for the periods ended December 31, 1998, 1997 and 1996.

Beginning in 1999, the Company will have two principal business segments: (1) the transmission and distribution by Duquesne of electricity (electricity delivery business segment) and (2) the generation by Duquesne of electricity and collection of the CTC (electricity generation business segment). To comply with SFAS No. 131, the Company has reported the results for 1998, 1997 and 1996 by these business segments and an "all other" category. The all other category includes the Company's expanded business lines and Duquesne investments. These expanded business lines include water utilities, energy products and services, and other activities. Intercompany transactions primarily relate to sales of electricity, property rental, management fees and dividends. (See Note O, "Business Segments and Related Information," in the Notes to the Consolidated Financial Statements on page 75.) Upon the anticipated completion of the auction of the Company's generation assets and provider of last resort services, the electricity generation business segment will be comprised solely of the collection of the CTC.

1998 Compared to 1997

Electricity Delivery Business Segment. The electricity delivery business segment contributed $57.2 million to net income in 1998 compared to $61.9 million in 1997, a decrease of $4.7 million or 7.6 percent. Operating revenues for this business segment are primarily derived from the Company's delivery of electricity.

Sales to residential and commercial customers are influenced by weather conditions. Warmer summer and colder winter seasons lead to increased customer use of electricity for cooling and heating. Commercial sales are also affected by regional development. Sales to industrial customers are influenced by national and global economic conditions.

Operating revenues increased by $4.5 million or 1.4 percent compared to 1997 due to an increase in sales to electric utility customers of 1.0 percent in 1998. Residential and commercial sales increased as a result of warmer summer temperatures during 1998 compared to 1997. Industrial sales decreased primarily due to a reduction in electricity consumption by steel manufacturers, which experienced a decline in demand. The following table sets forth kilowatt-hours (KWH) delivered to electric utility customers.

	KWH Delivered		
	(In Thousands)		
	1998	1997	Change
Residential	3,382,323	3,273,532	3.3 %
Commercial	5,896,036	5,785,745	1.9 %
Industrial	3,411,648	3,501,107	(2.6)%
Sales to Electric Utility Customers	12,690,007	12,560,384	1.0 %

Operating expenses for the electricity delivery business segment are primarily made up of costs to operate and maintain the transmission and distribution system; meter reading and billing costs; customer service; collection; administrative expenses; and non-income taxes, such as property and payroll taxes. Operating expenses increased $9.9 million or 7.2 percent from 1997, primarily as a result of higher costs of maintenance of the transmission and distribution system, and start-up costs related to the Customer Advanced Reliability System, including electronic meter reading and installation. The increase in the system maintenance was primarily due to the increase in frequency and severity of storms during 1998.

Depreciation and amortization expense increased $1.7 million or 3.8 percent in 1998 due to additions to the plant and equipment balance throughout the year partially offset by retirements.

Other income is primarily comprised of interest and dividend income. A decrease of $1.6 million or 22.8 percent was the result of lower interest income from a smaller amount of cash available for investing compared to the prior year.

Interest and other charges include interest on long-term debt, other interest and preferred stock dividends of Duquesne. In 1998, there was $0.9 million or 2.3 percent less in interest and other charges compared to 1997. The decrease was the result of the refinancing of long-term debt at lower interest rates and the maturity of approximately $75 million of long-term debt during 1998.

Decreased taxable income during 1998 resulted in lower income taxes by $3.1 million or 7.6 percent.

Electricity generation business segment. In 1998, the electricity generation business segment reported net income of $71.9 million, excluding the Pennsylvania restructuring charge, compared to $60.5 million in 1997, an increase of $11.4 million or 18.8 percent.

For the electricity generation business segment, operating revenues are primarily derived from the Company's supply of electricity for delivery to retail customers and the supply of electricity to wholesale customers. Beginning in 1999, revenues will include the recovery of transition costs through the collection of the CTC. Under prior fuel cost recovery provisions, fuel revenues generally equaled fuel expense, as costs were recoverable from customers through the Energy Cost Rate Adjustment Clause (ECR), including the fuel component of purchased power, and did not affect net income. Beginning May 29, 1998 (the date of the PUC's final restructuring order), fuel costs were expensed as incurred, and had an impact on net income to the extent fuel costs exceeded amounts included in Duquesne's authorized generation rates. (See "Rate Matters" on page 39.)

Energy requirements for residential and commercial customers are influenced by weather conditions. Warmer summer and colder winter seasons lead to increased customer use of electricity for cooling and heating. Commercial energy requirements are also affected by regional development. Energy requirements for industrial customers are influenced by national and global economic conditions.

Short-term sales to other utilities are made at market rates. Fluctuations in electricity sales to other utilities are related to the Company's customer energy requirements, the energy market and transmission conditions, and the availability of the Company's generating stations. Future levels of short-term sales to other utilities will be affected by market rates, the level of participation in customer choice, the Company's decision to sell 600 megawatts (MW) to licensed generation suppliers and the Company's divestiture of its generation assets. (See "Rate Matters" on page 39.)

Operating revenues decreased by $3.7 million or 0.4 percent compared to 1997. The decrease in revenues can be attributed to a decrease in energy supplied to electric utility customers due to participation in the customer choice pilot program, and a decrease in energy costs that were recovered through the ECR. Partially offsetting these decreases were increased energy supplied to other utilities of 32.2 percent in 1998, due to higher demand from other utilities and increased capacity available to sell as a result of participation in the customer choice pilot program. The following table sets forth KWH supplied for customers who have not chosen an alternative generation supplier.

	KWH Supplied		
	(In Thousands)		
	1998	1997	Change
Residential	3,190,451	3,267,941	(2.4)%
Commercial	5,579,888	5,777,750	(3.4)%
Industrial	3,357,371	3,499,699	(4.1)%
Sales to Electric Utility Customers	12,127,710	12,545,390	(3.3)%
Sales to Other Utilities	1,909,342	1,444,822	32.2 %
Total Sales	14,037,052	13,990,212	0.3 %

Operating expenses for the electricity generation business segment are primarily made up of energy costs; costs to operate and maintain the power stations; administrative expenses; and non-income taxes, such as property and payroll taxes.

Fluctuations in energy costs generally result from changes in the cost of fuel, the mix between coal and nuclear generation, total KWHs supplied, and generating station availability. Because of the ECR, changes in fuel and purchased power costs did not impact earnings for the first five months of 1998 or any of 1997 or 1996. Beginning May 29, 1998, fuel costs for customers were expensed as incurred, and had an impact on net income to the extent fuel costs exceeded amounts included in Duquesne's authorized generation rates. (See "Rate Matters" on page 39.)

Operating expenses increased $14.4 million or 2.8 percent from 1997 as a result of increased energy costs, partially offset by decreased maintenance costs and reduced BV Unit 2 lease costs due to the PUC's final restructuring order.

In 1998, fuel and purchased power expense increased by $39.1 million or 17.5 percent compared to 1997. This increase was the result of increased energy costs due to an unfavorable power supply mix and higher purchased power prices. Reduced availability of nuclear generating stations due to an increase in outage hours required the Company to purchase power and generate power from the higher fuel cost fossil stations. (See "Beaver Valley Power Station" on page 45.)

Maintenance expense decreased in 1998, primarily related to the reversal of fossil station maintenance outage accruals for outages scheduled after the Company's planned divestiture of generation. (See "Rate Matters" on page 39.) A reduction in nuclear station outage cost amortization in 1998 also contributed to the decrease in maintenance expense.

Depreciation and amortization expense includes the depreciation of the power stations' plant and equipment and accrued nuclear decommissioning costs. A decrease of $32.3 million or 16.8 percent compared to 1997 was the result of reduced depreciation of generation assets in accordance with the PUC's final restructuring order. Beginning in 1999, the Company will be recovering its $2,133 million ($1,485 million, net of tax) of transition costs, as may be adjusted to account for the proceeds of the generation asset auction, through the CTC and will reflect amortization expense related to this recovery.

Other income is primarily comprised of interest and dividend income. A decrease of $3.7 million or 29.1 percent was the result of lower interest income, due to a smaller amount of cash available for investing compared to the prior year.

Interest and other charges include interest on long-term debt, other interest and preferred stock dividends of Duquesne. In 1998 there was a $5.2 million or 8.1 percent reduction in interest and other charges compared to 1997. The decrease reflected the refinancing of long-term debt at lower interest rates and the maturity of approximately $75 million of long-term debt during 1998.

Increased taxable income during 1998 resulted in higher income tax expense by $4.4 million or 13.5 percent.

All Other. The all other category contributed $69.0 million to net income in 1998 compared to $78.1 million in 1997, a decrease of $9.1 million or 11.6 percent.

Operating revenues primarily include revenues from operating activities of the expanded business lines. Operating revenues increased in 1998 by $41.7 million or 64.3 percent compared to 1997. This increase was primarily the result of increased revenues from AquaSource and other new investments through the operating activities of the expanded business lines, partially offset by the loss of operating revenues from the sale of Chester in the second quarter of 1997.

Operating expenses include expenses from operating activities of the expanded business lines and Duquesne investments. In 1998, operating expenses increased $51.1 million or 81.4 percent over 1997. The growth of the expanded business lines' start-up and developmental activities and acquisitions accounted for most of the increase. Also, in the third quarter of 1998 the Company wrote off costs related to the failed merger with Allegheny Energy, Inc. (AYE), resulting in an increase to other operating expenses of $14.1 million. (See "Rate Matters" on page 39.) Offsetting in part the increases to operating expenses was the 1997 sale of Chester, which resulted in reduced operating costs of $7.8 million and the recognition of the favorable resolution of certain associated contingencies in 1998.

Depreciation and amortization expense primarily includes the depreciation of plant and equipment of the expanded business lines and amortization of certain investments. In 1998, depreciation and amortization expense increased by $4.9 million or 107.1 percent, primarily due to the acquisition of water and water-related companies by AquaSource during 1997 and throughout 1998.

Other income primarily includes long-term investment income, and interest and dividend income related to the expanded business lines and Duquesne investments. Other income in 1998 was $9.7 million or 8.1 percent higher than in 1997. This increase was the result of new investments made by the expanded business lines during late 1997 and throughout 1998, and a new investment made at Duquesne in the fourth quarter of 1997. Partially offsetting the increase were the gains on the sale of Chester and of Exide stock in 1997 of approximately $23 million ($13 million, net of tax), net of costs of the sale and reserves for contingencies realized for the sale of Chester.

Interest and other charges are made up of interest on long-term debt, other interest and preferred stock dividends of the expanded business lines, and Duquesne investments. An increase of $0.6 million or 4.5 percent in 1998 was the result of higher long-term debt interest expense, primarily related to AquaSource debt assumptions associated with the acquisition of certain water and water service companies.

Higher income tax expense of $3.8 million or 15.6 percent in 1998 can be attributed to the increase in taxable income.

1997 Compared to 1996

Electricity Delivery Business Segment. The electricity delivery business segment contributed $61.9 million to net income in 1997 compared to $56.6 million in 1996, an increase of $5.3 million or 9.4 percent.

Operating revenues increased by $8.1 million or 2.6 percent compared to 1996, due to an increase in sales to electric utility customers of 1.1 percent in 1997 and a settlement for pole rental revenue in 1997. Sales to electric utility customers increased despite 1997's mild temperatures compared to 1996 primarily as a result of stronger industrial sales. The following table sets forth KWH delivered for electric utility customers.

	KWH Delivered *(In Thousands)*		
	1997	1996	Change
Residential	3,273,532	3,320,870	(1.4)%
Commercial	5,785,745	5,820,585	(0.6)%
Industrial	3,501,107	3,284,986	6.6 %
Sales to Electric Utility Customers	12,560,384	12,426,441	1.1 %

Operating expenses decreased $1.0 million or 0.7 percent from 1996, as a result of small decreases in operating and maintenance costs of the transmission and distribution system.

Depreciation and amortization expense increased $0.2 million or 0.5 percent in 1997 due to additions to the plant and equipment balance throughout the year, which were partially offset by retirements.

Other income increased $1.6 million or 31.4 percent and was the result of higher interest income from a larger amount of cash available for investing compared to 1996.

In 1997, there was a $1.4 million or 3.8 percent increase in interest and other charges compared to 1996. This increase was the result of paying a full year of dividends in 1997 related to the Monthly Income Preferred Securities (MIPS) issued in May 1996.

Increased taxable income during 1997 resulted in higher income tax expense by $3.8 million or 10.3 percent.

Electricity generation business segment. In 1997, the electricity generation business segment reported net income of $60.5 million compared to $77.6 million in 1996, a decrease of $17.0 million or 22.0 percent.

Operating revenues decreased by $19.6 million or 2.2 percent compared to 1996, due to a decrease in energy supplied to other utilities of 56.4 percent in 1997. This decrease was due to reduced availability resulting from the sale of the Ft. Martin Power Station in the fourth quarter of 1996 and increased forced outages. Partially offsetting the decrease in energy supplied to other utilities was a $3.2 million increase related to charges to the other Beaver Valley Power Station (BVPS) owners for administrative costs. The following table sets forth KWH supplied for customers who have not chosen an alternative generation supplier.

	KWH Supplied (In Thousands)		
	1997	1996	Change
Residential	3,267,941	3,320,870	(1.6)%
Commercial	5,777,750	5,820,585	(0.7)%
Industrial	3,499,699	3,284,986	6.5 %
Sales to Electric Utility Customers	12,545,390	12,426,441	1.0 %
Sales to Other Utilities	1,444,822	3,310,206	(56.4)%
Total Sales	13,990,212	15,736,647	(11.1)%

Operating expenses decreased $9.7 million or 1.8 percent from 1996, as a result of decreased energy volume supplied partially offset by increased maintenance costs.

In 1997, fuel and purchased power expense decreased by $13.5 million or 5.7 percent compared to 1996, as a result of an 11.1 percent reduction in energy volume supplied. This $26.7 million decrease due to energy volume supplied was partially offset by increased energy costs of $13.2 million, primarily the result of purchased power prices. Reduced availability of generating stations due to an increase in outage hours forced the Company to purchase power during high demand periods, resulting in increased costs.

Maintenance expense increased in 1997 compared to 1996. The increase was due to more forced outage hours at nuclear stations than during 1996.

An increase in depreciation and amortization expense of $19.7 million or 11.4 percent over 1996 was due to the May 1, 1996, increase in the Company's nuclear generation plant depreciation rate resulting in higher depreciation for the first four months of 1997. In addition, accelerated nuclear lease recovery, which began on May 1, 1997, resulted in higher annualized amortization expense of $25 million. Offsetting these increases by $8.5 million was the mid-1996 completion of the recovery of the investment in Perry Unit 2, the construction of which was abandoned by the Company in 1986. The remaining increase can be attributed to incremental depreciation for 1997 fixed asset additions and an increased level of nuclear decommissioning cost recognition.

Other income increased $2.9 million or 29.7 percent and was the result of higher interest income, due to a larger amount of cash available for investing compared to the prior year.

In 1997 there was a $0.4 million or 0.7 percent increase in interest and other charges compared to 1996. The increase was the result of paying a full year of dividends in 1997 related to the MIPS issued in May 1996.

Decreased taxable income during 1997 resulted in lower income tax expense by $10.1 million or 23.9 percent.

All Other. The all other category contributed $78.1 million to net income in 1997 compared to $48.7 million in 1996, an increase of $29.4 million or 60.4 percent.

Operating revenues increased in 1997 by $5.9 million or 10.0 percent compared to 1996. The increase resulted primarily from a $20.4 million increase in revenues from a landfill gas recovery investment made in the fourth quarter of 1996 and growth in the operating activities of the expanded business lines. Partially offsetting the increase in revenues was the sale of Chester in the second quarter of 1997, which decreased revenues by approximately $20 million.

In 1997 operating expenses increased $8.3 million or 15.2 percent over 1996. The increase is attributable to operating costs from a landfill gas recovery investment made during 1996 and the growth of the expanded business lines, partially offset by the reduced operating costs associated with Chester during the first half of 1997.

Other income in 1997 was $48.0 million or 67.5 percent higher compared to 1996. The increase was the result of long-term investment income, gains on the sale of Chester and of Exide stock, and interest and dividend income from a higher level of short-term investments. The increase in long-term investment income of approximately $15 million was the result of investments made during 1996 and 1997. The Company invested approximately $180 million in lease investments in 1997. In the second quarter of 1997, Chester was sold for a pre-tax gain of approximately $12 million, net of estimated costs of the sale. Also, in the fourth quarter of 1997, the Company sold its investment in Exide stock for a pre-tax gain of approximately $11 million.

An increase in interest and other charges of $3.0 million or 27.5 percent in 1997 compared to 1996 was the result of higher long-term debt interest expense associated with higher average borrowings outstanding.

Higher income tax expense of $13.2 million or 117.7 percent in 1997 resulted from an increase in taxable income.

LIQUIDITY AND CAPITAL RESOURCES

Capital Expenditures

The Company spent approximately $190.5 million in 1998, $116.0 million in 1997 and $101.2 million in 1996 for capital expenditures, of which $113.3 million in 1998, $90.4 million in 1997 and $87.9 million in 1996 was spent for electric utility construction. The remaining capital expenditures were related to the Company's expanded business lines and Duquesne investments. The Company's capital expenditures for electric utility construction focus on improving and/or expanding electric utility generation, transmission and distribution systems. The Company currently estimates that it will spend, excluding allowance for funds used during construction (AFC) and nuclear fuel, approximately $110 million during 1999 (including $30 million for generation), $75 million in 2000 (excluding generation) and $70 million in 2001 (excluding generation) for electric utility construction.

In 1998 the Company completed construction of six plants to produce E-Fuel®, a coal-based synthetic fuel, at a cost of approximately $40 million. All of these plants are currently in operation.

Long-Term Investments

The Company has made long-term investments in the following areas: leases, affordable housing, gas reserves and energy solutions. Investing activities during 1998 included approximately $22 million in affordable housing partnerships, $22 million in natural gas reserves and the remaining $25 million in the decommissioning trust fund and other investments. This $25 million includes investments in BroadPoint Communications, Inc. BroadPoint has introduced the FreeWay™ Service, in which customers earn free long-distance telephone service in exchange for listening to short, targeted audio advertisements. The Company also invested in North American Power Brokers, Inc., a provider of a low-bid, Internet auction-based approach to purchasing natural gas and electricity through a secure website. Investing activities during 1997 included approximately $180 million in lease investments, $11 million in landfill gas reserve investments, $16 million in affordable housing partnerships, and $12 million in the decommissioning trust fund and other investments. During 1997, the Company committed to approximately $5 million in equity funding obligations for lease investments. Investing activities during 1996 included approximately $50 million in lease investments, $30 million in gas reserve investments, $15 million in affordable housing partnerships, and $6 million in energy solution and other investments. During 1996, the Company also committed to approximately $37 million in equity funding obligations for lease and affordable housing partnerships.

Acquisitions and Dispositions

In 1998, the Company issued 337,262 shares of DQE Preferred Stock, representing an investment of approximately $34 million (out of a total investment of approximately $156 million in stock and cash) in the acquisition of water and water-related companies. The Company has invested approximately $35 million in stock and cash for additional water and water-related company acquisitions through February 1999. The Company also invested $22 million to acquire a 50 percent interest in and finance the growth of Control Solutions, LLC, a commercial and industrial heating, ventilation and air conditioning service and energy controls company.

Dispositions in 1998 relate to assets acquired by the Company through leasehold interest investments. Dispositions in 1997 related primarily to the sale of Chester and of Exide stock. Dispositions in 1996 were comprised of long-term leveraged lease assets totaling $18 million.

The Company is studying restructuring its current investment portfolio, including the possible divestiture of its $131 million portfolio of affordable housing investments.

Financing

The Company currently expects to meet its current obligations and debt maturities through the year 2003 with funds generated from operations, through new financings and through the proceeds from the auction of generation assets. To the extent that acquisition and long-term investment opportunities prior to the generation divestiture exceed current expectations, the Company may explore various financing alternatives. At December 31, 1998, the Company was in compliance with all of its debt covenants.

During 1998, $75 million of mortgage bonds matured and were retired and $100 million of 8.75 percent mortgage bonds due in May 2022 were redeemed. The retirement and redemption were financed using available cash, the proceeds of the $40 million of 6.45 percent mortgage bonds due in February 2008 and the proceeds of the $100 million of 7.375 percent mortgage bonds due in April 2038 issued by Duquesne. Mortgage bonds in the amount of $75 million will mature in July 1999. The Company expects to retire these bonds with available cash, or to refinance the bonds.

In connection with the investment in certain landfill gas property and equipment during 1998, the Company issued a $25 million note maturing in 2019, with an annual interest rate of 8.0 percent.

In connection with the power station exchange with FirstEnergy, the Company anticipates terminating the BV Unit 2 lease, in which case the lease liability recorded on the consolidated balance sheet would no longer be an obligation of the Company. The underlying collateralized lease bonds ($371.0 million at December 31, 1998) would become direct obligations of the Company and be recorded on the consolidated balance sheet. The Company would also pay approximately $230 million in termination costs, a portion of which the Company expects to recover through the proceeds of the generation asset auction. (See "Power Station Exchange" discussion on page 40.)

The Company has $150 million in bank term loans outstanding at December 31, 1998, with $65 million maturing in 2000 and $85 million maturing in 2001.

In July 1997, the Company authorized and registered 1,000,000 shares of the DQE Preferred Stock, all with $100 liquidation preference, for use in connection with acquisitions by the Company of other businesses, assets or securities. Approximately $25 million in long-term debt has been assumed in connection with these acquisitions. (See "Acquisitions and Dispositions" discussion on page 37.) As of December 31, 1998, 352,742 shares of DQE Preferred Stock had been issued and were outstanding. An additional 29,928 shares of DQE Preferred Stock were issued in January and February 1999.

A Duquesne subsidiary has 15 shares of preferred stock, par value $100,000 per share outstanding. The holders of such shares are entitled to a 6.5 percent annual dividend to be paid each September 30.

In May 1996, Duquesne Capital L.P. (Duquesne Capital), a special-purpose limited partnership of which Duquesne is the sole general partner, issued $150.0 million principal amount of 8⅜ percent MIPS with a stated liquidation value of $25.00. The holders of MIPS are entitled to annual dividends of 8⅜ percent, payable monthly. Such dividends are guaranteed by Duquesne.

The Company repurchased shares of its common stock on the open market late in 1998.

Short-Term Borrowings

At December 31, 1998, the Company had two extendible revolving credit arrangements, including a $125 million facility expiring in June 1999 and a $150 million facility expiring in October 1999. Interest rates can, in accordance with the option selected at the time of the borrowing, be based on prime, Eurodollar or certificate of deposit rates. Commitment fees are based on the unborrowed amount of the commitments. Both credit facilities contain two-year repayment periods for any amounts outstanding at the expiration of the revolving credit periods. At December 31, 1998 and December 31, 1997, there were no short-term borrowings outstanding.

Sale of Accounts Receivable

The Company and an unaffiliated corporation have an agreement that entitles the Company to sell, and the corporation to purchase, on an ongoing basis, up to $50 million of accounts receivable. The Company had no receivables sold at December 31, 1998 or December 31, 1997. The accounts receivable sales agreement, which expires in June 1999, is one of many sources of funds available to the Company. The Company may attempt to extend the agreement, replace it with a similar facility, or eliminate it upon expiration.

Nuclear Fuel Leasing

The Company finances its acquisitions of nuclear fuel through a leasing arrangement, under which it may finance up to $75 million of nuclear fuel. As of December 31, 1998, the amount of nuclear fuel financed by the Company under this arrangement totaled approximately $41.8 million. The actual nuclear fuel costs to be financed will be influenced by such factors as changes in interest rates; lengths of the respective fuel cycles; reload cycle design; operations; the power station exchange; and changes in nuclear material costs and services, the prices and availability of which are not known at this time. Such costs may also be influenced by other events not presently foreseen. The Company plans to continue leasing nuclear fuel to fulfill its requirements at least through September 1999, the remaining term of the leasing arrangement. The Company may attempt to extend the arrangement, replace it with a similar facility, or eliminate it upon expiration through the purchase of the balance of the nuclear fuel. The Company anticipates divesting its nuclear stations. (See "Power Station Exchange" discussion on page 40.)

RATE MATTERS

Competition and the Customer Choice Act

The electric utility industry continues to undergo fundamental change in response to development of open transmission access and increased availability of energy alternatives. Under historical ratemaking practice, regulated electric utilities were granted exclusive geographic franchises to sell electricity, in exchange for making investments and incurring obligations to serve customers under the then-existing regulatory framework. Through the ratemaking process, those prudently incurred costs were recovered from customers, along with a return on the investment. Additionally, certain operating costs were approved for deferral for future recovery from customers (regulatory assets). As a result of this historical ratemaking process, utilities had assets recorded on their balance sheets at above-market costs, thus creating transition and stranded costs.

In Pennsylvania, the Customer Choice Act went into effect on January 1, 1997. The Customer Choice Act enables Pennsylvania's electric utility customers to purchase electricity at market prices from a variety of electric generation suppliers (customer choice). Although the Customer Choice Act will give customers their choice of electric generation suppliers, the existing, franchised local distribution utility is still responsible for delivering electricity from the generation supplier to the customer. The local distribution utility is also required to serve as the provider of last resort for all customers in its service territory, unless other arrangements are approved by the PUC. The provider of last resort must provide electricity for any customer who cannot or does not choose an alternative electric generation supplier, or whose supplier fails to deliver. The Customer Choice Act provides that the existing franchised utility may recover, through a CTC, an amount of transition costs that are determined by the PUC to be just and reasonable. Pennsylvania's electric utility restructuring is being accomplished through a two-stage process consisting of an initial customer choice pilot period (which ended in December 1998) and a phase-in to competition period (which began in January 1999). The Company's estimated negative net income impact of the customer choice pilot program during 1998, with 5 percent of customers participating, was approximately $6 million.

Phase-In to Competition

The phase-in to competition began in January 1999, when 66 percent of customers became eligible to participate in customer choice (including customers covered by the pilot program); all customers will have customer choice in January 2000. As of February 8, 1999, approximately 12 percent of the Company's customers had chosen alternative generation suppliers. Customers that have chosen an electricity generation supplier other than the Company pay that supplier for generation charges, and pay the Company a CTC (discussed below) and charges for transmission and distribution. Customers that continue to buy their generation from the Company pay for their service at current regulated tariff rates divided into generation, transmission and distribution charges. Under the Customer Choice Act, an electric distribution company, such as Duquesne, remains a regulated utility and may only offer PUC-approved rates, including generation rates. Also under the Customer Choice Act, electricity delivery (including transmission, distribution and customer service) remains regulated in substantially the same manner as under current regulation.

In an effort to "jump start" retail competition, the Company has made 600 MW of power available to licensed electric generation suppliers, to be used in supplying electricity to Duquesne's customers who have chosen alternative generation suppliers. The power will be available for the first six months of 1999 at a price of 2.6 cents per KWH. This power availability will be structured to ensure the power is used to benefit Duquesne's retail customers.

Rate Cap

An overall four-and-one-half-year rate cap from January 1, 1997, has been imposed on the transmission and distribution charges of Pennsylvania electric utility companies under the Customer Choice Act. Additionally, electric utility companies may not increase the generation price component of rates as long as transition costs are being recovered, with certain exceptions.

Restructuring Plan

In its May 29, 1998, final restructuring order, the PUC determined that the Company should recover most of the above-market costs of the generation assets, including plant and regulatory assets through the collection of the CTC from electric utility customers. The total of the transition costs to be recovered is $2,133 million ($1,485 million, net of tax) over a seven-year period beginning January 1, 1999, as may be adjusted to account for the proceeds of the generation asset auction. In addition, the transition costs as reflected on the consolidated balance sheet will be amortized over the same period that the CTC revenues are being recognized. The Company will earn an 11 percent pre-tax return on the unrecovered balance.

In the second quarter of 1998, the Company recorded an extraordinary charge (PUC restructuring charge) against earnings of $142.3 million ($82.5 million, net of tax) for the generation-related stranded costs not considered by the PUC's restructuring order to be recoverable from customers. The Pennsylvania restructuring charge included Phillips, BI, deferred caretaker costs related to the two stations and deferred coal costs. The charge resulted in a reduction of Duquesne's contribution to the Company's earnings per share by $1.06.

Restructuring Plan and Auction Plan. With respect to transition cost recovery, the PUC's final order on the restructuring plan approved Duquesne's proposal to auction its generation assets and use the proceeds to offset transition costs. The remaining balance of such costs (with certain exceptions described below) will be recovered from ratepayers through a CTC, collectible through 2005. Until the divestiture is complete, Duquesne has been ordered to use an interim system average CTC and price to compare based on the methodology approved in its pilot program (approximately 2.9 cents per KWH for the CTC and approximately 3.8 cents per KWH for the price to compare).

On December 18, 1998, the PUC approved Duquesne's auction plan, including an auction of its provider of last resort service, as well as an agreement in principle to exchange certain generation assets with FirstEnergy. The assets to be auctioned will include Duquesne's wholly owned Cheswick Power Station, Elrama Power Station, Phillips and BI, as well as the stations to be received from FirstEnergy in the power station exchange described below. The auction plan calls for a two-phase, sealed bid process similar to that used in other power plant divestitures. The initial confidential bidding process is expected to begin in March 1999, with potential buyers identified by Duquesne being asked to submit non-binding bids. Final agreements governing the transactions must be approved by various regulatory agencies, including the PUC, the FERC, the NRC, the Department of Justice and/or the Federal Trade Commission. Duquesne currently expects the sale to close at the end of 1999 or the beginning of 2000.

Power Station Exchange. Pursuant to the agreement in principle and subject to the execution and regulatory approval of definitive agreements, Duquesne and FirstEnergy will exchange ownership interests in certain power stations. Duquesne will receive 100 percent ownership rights in three coal-fired power plants located in Avon Lake and Niles, Ohio and New Castle, Pennsylvania (totaling approximately 1,300 MW), which the Company expects to sell simultaneously as part of the auction of generation assets. FirstEnergy will acquire Duquesne's interests in BV Unit 1, BV Unit 2, Perry Unit 1, Sammis Unit 7, Eastlake Unit 5 and Bruce Mansfield Units 1, 2 and 3 (totaling approximately 1,400 MW). In connection with the power station exchange, the Company anticipates terminating the BV Unit 2 lease. (See "Financing" discussion on page 38.) Pursuant to the December 18, 1998, PUC order and subject to final approval, the proceeds from the sale of the power stations received in the exchange will be used to offset the transition costs associated with Duquesne's currently-held generation assets and the costs associated with completing the exchange. Duquesne expects this exchange to enhance the value received from the auction, because participants will bid on plants that are wholly owned by Duquesne, rather than plants that are jointly owned and/or operated by another entity. Additionally, the auction will include only coal- and oil-fired plants, which are anticipated to have a higher market value than nuclear plants. These value-enhancing features, along with a minimum level of auction proceeds guaranteed by FirstEnergy, are expected to maximize auction proceeds, minimize transition costs required to be recovered through the CTC (by shortening the length of the CTC recovery period), and thus reduce customer bills as rapidly as possible. Other benefits of this exchange include the resolution of all joint ownership issues, and other risks and costs associated with the jointly-owned units. Although the PUC has said the exchange appears to be in the public interest, the definitive exchange agreement must be submitted for PUC approval, and certain aspects of the exchange will have to be approved by, among other agencies, the FERC, the NRC and the Department of Justice. The power station exchange is expected to occur simultaneously with the anticipated closing of the sale of Duquesne's generation through the auction at the end of 1999 or in early 2000.

Termination of the AYE Merger

On July 28, 1998, DQE's Board of Directors concluded that it could not consummate the merger with AYE, toward which the Company had been working. The Company believes that AYE suffered a material adverse effect as a result of the PUC's final restructuring order regarding AYE's utility subsidiary, West Penn Power Company. More information regarding this decision is set forth in the Company's Current Report on Form 8-K dated July 28, 1998. On July 30, 1998, AYE informed DQE that it would continue to work toward consummation of the merger, and also pursue all remedies available to protect the legal and financial interests of AYE and its shareholders.

On September 17, 1998, the PUC issued an order stating that, unless the parties jointly agreed to an extension of time to consummate the merger beyond October 5, 1998 (the relevant date under the merger agreement), their merger application with the PUC would be considered withdrawn. On October 5, 1998, the Company announced its unilateral termination of the merger agreement. More information regarding this termination is set forth in the Company's Current Report on Form 8-K dated October 5, 1998. In a letter dated February 24, 1999, the PUC informed the Company that the merger application was deemed withdrawn and the docket was closed.

AYE filed suit in the United States District Court for the Western District of Pennsylvania, seeking to compel the Company to proceed with the merger and seeking a temporary restraining order and preliminary injunction to prevent the Company from certain actions pending a trial, or in the alternative seeking an unspecified amount of money damages. On October 28, 1998, the judge denied AYE's motion for the temporary restraining order and preliminary injunction. AYE appealed to the United States Court of Appeals for the Third Circuit, asking for an injunction pending the appeal and expedited treatment of the appeal. On November 6, 1998, the Third Circuit denied the motion for an injunction and granted the motion to expedite the appeal. Argument was held on January 15, 1999, and a decision is pending. The ultimate outcome of this suit cannot be determined at this time.

Deferred Energy Costs

As part of its restructuring plan filing, the Company requested recovery of $11.5 million ($6.7 million net of tax) through the CTC for energy costs previously deferred under the ECR. Recovery of this amount was approved in the PUC's final restructuring order. The Company also requested recovery of an additional $31.2 million ($18.2 million net of tax). This amount relates to fuel costs that had been deferred between the time of the restructuring plan filing and the restructuring order in accordance with a PUC order with respect to the Company's ECR. As part of its December 18, 1998, order the PUC denied recovery of this additional amount. The Company has appealed the PUC's denial of recovery to the Pennsylvania Commonwealth Court.

Based upon the Customer Choice Act, which mandates recovery of all regulatory assets, and the PUC's specific authorization for the Company to create a regulatory asset for these costs, the Company believes that it is probable that these costs will be recovered through retail rates. In the event that the Company does not prevail in its appeal with the Pennsylvania Commonwealth Court, these costs would be written off as a charge against income during 1999.

YEAR 2000

Many existing computer programs and embedded microprocessors use only two digits to identify a year (for example, "98" is used to represent "1998"). Such programs read "00" as the year 1900, and thus may not recognize dates beginning with the year 2000, or may otherwise produce erroneous results or cease processing when dates after 1999 are encountered.

Year 2000 Plan. In 1994, the Company began reviewing its critical information systems that impact operations and financial reporting in order to develop a strategy to address required computer software and system changes and upgrades. The Company has since assembled a Year 2000 team, comprised of management representatives from all functional areas of the Company, which continues to explore the exposure to Year 2000-related issues in computer software and in devices and equipment (such as plant components, substations, elevators, and heating and cooling systems) containing embedded microprocessors that may not correctly identify the year. The team is also exploring potential related issues that may originate with third parties with whom the Company does business. To support the planning, organization and management of its efforts, the team has retained Year 2000 consultants.

In general, the Company's overall strategy to address the Year 2000 issue is comprised of four phases that, in some cases, are performed simultaneously. These phases are: inventory, assessment, remediation, and testing and implementation.

Inventory consists of identifying the various components, equipment, hardware, and software used in the Company's operations that may potentially be faced with Year 2000 issues. This inventory effort was completed during the fourth quarter of 1998.

Assessment consists of evaluating all inventoried items for Year 2000 compliance or readiness. This is accomplished by contacting the vendors and manufacturers, inspecting software and code, researching the results of other companies' assessment of like components, and various other means. Assessment activities have been completed as of the date of this report. The Company's business is dependent upon external suppliers for the reliable delivery of their products and services. The Company has inquired in writing of its suppliers and service providers with regard to their Year 2000 readiness. The Company is meeting with critical suppliers and service providers to further corroborate evidence of their Year 2000 readiness.

Remediation refers to the activities necessary to fix or replace those components that have Year 2000 issues that will adversely affect the Company's operations. Remediation concentrates first on those systems, components, and equipment that substantially impact the Company's ability to perform its essential business functions (mission critical). Remediation is currently under way and is scheduled to be substantially complete in the second quarter of 1999. This remediation is in addition to previously planned improvements to the Company's systems with benefits beyond Year 2000 solutions, such as total system replacements discussed below.

Testing and implementation consists of placing renovated processes, systems, equipment, and other items into use within the Company's operations. Testing is performed on all mission critical processes, whether or not remediation activities were involved in the process. Testing and implementation will be substantially completed during the second quarter of 1999.

Throughout the execution of its Year 2000 plan, the Company has been providing and will continue to provide information on its activities to the PUC, the NRC and the North American Electric Reliability Counsel (NERC), which coordinates the network of interconnected utilities across the nation. The Company's plan is in accordance with NRC guidelines, and the Company is working with the NRC to certify that its nuclear power station safety and operations systems, and issues related to suppliers, will be ready for the Year 2000. NERC has been requested by the DOE to review the national electric power production and delivery infrastructure to ensure a reliable power supply during the Year 2000 transition period. The Company is working with NERC to address these issues through monthly status reporting and participation in regional Year 2000 tests. The Company also participates in the Electric Power Research Institute's project to share information about technical issues regarding Year 2000 with other entities in the electric utility industry.

Risks and Contingency Plans. The Company currently believes that implementation of its plan will minimize the Year 2000 issues relating to its systems and equipment. The Company's goal is to ensure that all components and services that in any material manner contribute to operational reliability, customer relations, safety, revenue and regulatory compliance will be suitable for continued use beyond December 31, 1999, in some cases with appropriate work-arounds or contingency plans. The Company understands that many variables outside the control of the Company may have an adverse affect on the ability of the Company to perform its mission critical processes (e.g., telecommunication providers may not be able to provide uninterrupted service). Therefore, the Company is developing contingency plans for all mission critical processes in an effort to mitigate these risks. Contingency plans will be developed and tested for all mission critical processes by the end of the second quarter of 1999. The Company continues to review its operations and its critical external suppliers and service providers in order to determine any worst-case scenarios it could face as a result of Year 2000 problems.

Costs. The estimated total cost of implementing the Company's Year 2000 plan is approximately $49 million, which includes costs related to total system replacements (the Year 2000 solution comprises only a portion of the benefit resulting from such replacements). These costs to date, primarily incurred as a result of software and system changes and upgrades by Duquesne, have been approximately $39 million. Of this amount, approximately $35 million represents capital costs attributable to the licensing and installation of new software for total system replacements. The remaining $4 million has been expensed as incurred. Funds for the Company's Year 2000 plan have come from the Company's operating and capital budgets. Approximately $10 million has been budgeted for 1999 to address Year 2000 issues. The Company does not anticipate that Year 2000 issues and related costs will be material to the Company's operations, financial condition and results of operations.

The foregoing paragraphs contain forward-looking statements regarding the timetable, effectiveness and ultimate cost of the Company's Year 2000 strategy. Actual results could materially differ from those implied by such statements due to known and unknown risks and uncertainties, including, but not limited to: the possibility that changes and upgrades are not timely completed, that corrections to the systems of other companies on which the Company's systems rely may not be timely completed, and that such changes and upgrades may be incompatible with the Company's systems; the availability and cost of trained personnel; and the ability to locate and correct all relevant computer code and microprocessors.

PROPERTY, PLANT AND EQUIPMENT (PP&E)

Investment in PP&E and Accumulated Depreciation

The Company's total investment in PP&E and the related accumulated depreciation balances for major classes of property at December 31, 1998 and 1997 are as follows:

PP&E and Related Accumulated Depreciation at December 31,

	(Thousands of Dollars)					
	1998			1997		
	Investment	Accumulated Depreciation	Net Investment	Investment	Accumulated Depreciation	Net Investment
Electric delivery	$1,531,116	$ 522,531	$1,008,585	$1,528,128	$ 509,998	$1,018,130
Electric production	2,797,800	2,491,162(a)	306,638	2,528,927	1,175,516	1,353,411
Electric general	130,431	64,544	65,887	334,565	192,439	142,126
Capital leases	123,374	63,604	59,770	113,662	50,725	62,937
Other	301,417	25,487	275,930	119,846	34,116	85,730
Total	$4,884,138	$3,167,328	$1,716,810	$4,625,128	$1,962,794	$2,662,334

(a) See "Restructuring Plan" discussion on page 40.

Electric delivery PP&E includes: (1) high voltage transmission wires used in delivering electricity from the generating stations to substations; (2) substations and transformers; (3) lower voltage distribution wires used in delivering electricity to customers; and (4) related poles and equipment. Electric production PP&E includes fossil and nuclear generating stations and, in 1998, an allocated portion of general PP&E. This allocation was done in conjunction with the PUC restructuring order. Electric production accumulated depreciation in 1998 reflects the write-down of production plant values to the PUC-determined market value. (See "Restructuring Plan" discussion on page 40.) Electric general PP&E includes internal telecommunication equipment, vehicles and office equipment. The Company's capital leases are primarily associated with leased nuclear fuel and, to a lesser extent, other electric plant. The Other PP&E is comprised of water systems, water treatment facilities, various buildings and land, E-Fuel® facilities, landfill gas recovery equipment and other property related to the Company's expanded business lines.

Joint Interests in Generating Units

The Company has various contracts with subsidiaries of FirstEnergy (Ohio Edison Company, Pennsylvania Power Company, The Cleveland Electric Illuminating Company (CEI) and The Toledo Edison Company), with respect to several jointly owned/leased generating units, which include provisions for coordinated maintenance responsibilities, limited and qualified mutual back-up in the event of outages, and certain capacity and energy transactions.

In September 1995, the Company commenced arbitration against CEI, seeking damages, termination of the operating agreement for Eastlake Unit 5 (Eastlake) and partition of the parties' interests in Eastlake through a sale and division of the proceeds. The arbitration demand alleged, among other things, the improper allocation by CEI of fuel and related costs; the mismanagement of the administration of the Saginaw coal contract in connection with the closing of the Saginaw mine, which historically supplied coal to Eastlake; and the concealment by CEI of material information. CEI also seeks monetary damages from the Company for alleged unpaid joint costs in connection with the operation of Eastlake. The Company removed the action to the United States District Court for the Northern District of Ohio, Eastern Division, where it is now pending. Pursuant to the agreement in principle regarding the power station exchange between Duquesne and FirstEnergy, the parties jointly sought and received, on October 26, 1998, a court order staying all proceedings pending execution of definitive exchange agreements. Upon such execution, the parties will seek a further stay of proceedings pending the closing of the exchange. (See "Power Station Exchange" discussion on page 40.)

Joint Interests in Power Stations

Nuclear Power Stations	**Beaver Valley**		**Perry**
	Unit 1	**Unit 2**	**Unit 1**
Duquesne	* 47.50%	* 13.74% (a)	13.74%
FirstEnergy Corporation	52.50%	86.26%	* 86.26%

Fossil Power Stations	**Sammis**	**Bruce Mansfield**			**Eastlake**
	Unit 7	**Unit 1**	**Unit 2**	**Unit 3**	**Unit 5**
Duquesne	31.20%	29.30%	8.00%	13.74%	31.20%
FirstEnergy Corporation	* 68.80%	* 70.70%	* 92.00%	* 86.26%	* 68.80%

*Denotes Operator

(a) In 1987, the Company sold and leased back its 13.74 percent interest in BV Unit 2. The Company leased back its interest in the unit for a term of 29.5 years.

EMPLOYEES

At December 31, 1998, the Company had 3,986 employees. Duquesne had 1,521 employees in the electricity generation business segment, 1,258 in the electricity delivery business segment and 582 in administration. AquaSource had 539 employees in the water and water service companies, and the other expanded business lines had 86 employees. Duquesne is party to a labor contract expiring in September 2001 with the International Brotherhood of Electrical Workers (IBEW), which represents approximately 2,000 of Duquesne's employees. The contract provides, among other things, employment security, income protection and 3 percent annual wage increases through September 2000. Duquesne and the IBEW have agreed on a package of additional benefits and protections for union employees affected by the divestiture of generation assets. Any buyer of generation assets currently owned by Duquesne will be required to offer work to current IBEW employees on a seniority basis, recognize the IBEW as the exclusive bargaining representative, establish comparable employee benefit plans, and assume the current labor contract.

In connection with the anticipated divestiture, Duquesne has developed early retirement programs and enhanced separation packages available for eligible IBEW and management employees. Duquesne expects to recover related costs through the divestiture proceeds.

ELECTRIC UTILITY OPERATIONS

The Company anticipates divesting itself of its generation assets through the auction and the power station exchange by early 2000 and, depending on the regulatory approvals of the final agreements regarding the divestiture, expects certain obligations related to the divested assets will be transferred to the future owners thereof.

The Company's fossil plants operated at an availability factor of 80 percent in 1998 and 84 percent in 1997. The Company's nuclear plants operated at an availability factor of 52 percent in 1998 and 68 percent in 1997. The next refueling outage for BV Unit 1 is currently scheduled to begin in the spring of 2000. The next refueling outages for BV Unit 2 and Perry Unit 1 are currently scheduled to begin at the end of February 1999 and in March 1999, respectively. The timing and duration of scheduled maintenance and refueling outages, as well as the duration of forced outages, affect the availability of power stations. The Company normally experiences its peak demand in the summer. The 1998 customer system peak demand of 2,484 MW occurred on August 7, 1998.

Beaver Valley Power Station

BV Unit 1 went off-line on January 30, 1998, due to an issue identified in a technical review completed by the Company. BV Unit 2 went off-line on December 16, 1997, to repair the emergency air supply system to the control room. BV Unit 2 remained off-line due to other issues identified by a technical review, similar to that performed at BV Unit 1. These technical reviews, held in response to a 1997 commitment made by the Company to the NRC, have been completed. The Company was one of many utilities faced with similar issues, some of which date back to the initial start-up of BVPS. BV Unit 1 returned to service on August 15, 1998, and BV Unit 2 returned to service on September 28, 1998.

BVPS's two units are equipped with steam generators designed and built by Westinghouse Electric Corporation (Westinghouse). Similar to other Westinghouse nuclear plants, outside diameter stress corrosion cracking (ODSCC) has occurred in the steam generator tubes of both units. The units still have the capability to operate at 100 percent reactor power, although approximately 17 percent of BV Unit 1 and 3 percent of BV Unit 2 steam generator tubes have been removed from service. Material acceleration in the rate of ODSCC could lead to a loss in plant efficiency and significant repairs or replacement of BV Unit 1 steam generators. The total replacement cost of the BV Unit 1 steam generators is estimated at $125 million, $59 million of which would be the Company's responsibility. The earliest that the BV Unit 1 steam generators could be replaced during a currently scheduled refueling outage is the fall of 2001. BV Unit 2, which was placed in service 11 years after BV Unit 1, has not yet exhibited the degree of ODSCC experienced at BV Unit 1. It is too early in the life of BV Unit 2 to determine the extent to which ODSCC may become a problem at that unit.

Fossil Fuel

The Company believes that sufficient coal for its coal-fired generating units will be available from various sources to satisfy its requirements for the foreseeable future. During 1998, approximately 2.0 million tons of coal were consumed at the Company's two wholly owned coal-fired stations, Cheswick Power Station (Cheswick) and Elrama Power Station (Elrama).

The Company owns Warwick Mine, an underground mine located in southwestern Pennsylvania. At December 31, 1998, the Company's net investment in the mine was $4.4 million. The Company estimates that, at December 31, 1998, its economically recoverable coal reserves at Warwick Mine were in excess of 1.4 million tons. Commencing in 1997, an unaffiliated operator began producing up to 360,000 tons of coal per year, for exclusive use at Elrama. This arrangement terminates in March 2000. The Company purchases the remaining coal for use at Elrama on the open market. The current estimated liability for mine closing, including final site reclamation, mine water treatment and certain labor liabilities is $47.6 million, and the Company has recorded a liability on the consolidated balance sheet of approximately $39.9 million toward these costs. The remaining $7.7 million will be charged to expense during 1999 and the first quarter of 2000.

During 1998, 48 percent of the Company's coal supplies were provided by contracts, including Warwick Mine, with the remainder satisfied through purchases on the spot market. The Company had three long-term contracts in effect at December 31, 1998, that, in combination with spot market purchases, are expected to furnish an adequate future coal supply. The Company does not anticipate any difficulty in replacing or renewing these contracts as they expire from 2000 through 2005. At December 31, 1998, the Company's wholly owned generating units had on hand an average coal supply of 45 days.

Nuclear Fuel

The cycle of production and utilization of nuclear fuel consists of (1) mining and milling of uranium ore and processing the ore into uranium concentrates, (2) converting uranium concentrates to uranium hexafluoride, (3) enriching the uranium hexafluoride, (4) fabricating fuel assemblies, (5) utilizing the nuclear fuel in the generating station reactor, and (6) storing and disposing of spent fuel.

An adequate supply of uranium is under contract to meet the Company's requirements for its jointly owned/leased nuclear units through 2000. An adequate supply of conversion services through the year 2002 is also under contract. Enrichment services for the Company's joint interests in BV Units 1 and 2 and Perry Unit 1 will be supplied through fiscal year 1999 under a United States Enrichment Corporation (USEC) Utility Services contract. The Company has terminated, at zero cost, all of its enrichment services requirements under this contract for the fiscal years 2000 through 2009 and is planning to secure required enrichment services during this period from other suppliers. The Company continues to review on an annual basis its alternatives for enrichment services for the years 2010 through 2014 under the USEC contract and may terminate these future years if it can arrange more cost-effective enrichment services. Fuel fabrication contracts are in place to supply reload requirements through 2005 and 2004 respectively, for BV Unit 1 and BV Unit 2, and for the life of plant for Perry Unit 1. The Company will continue to make arrangements for future uranium supply and related services, as required. (See "Nuclear Fuel Leasing" discussion on page 39.)

Nuclear Decommissioning

The Company expects to decommission BV Unit 1, BV Unit 2 and Perry Unit 1 no earlier than the expiration of each plant's operating license in 2016, 2027 and 2026, respectively. At the end of its operating life, BV Unit 1 may be placed in safe storage until BV Unit 2 is ready to be decommissioned, at which time the units may be decommissioned together.

Based on site-specific studies conducted in 1997 for BV Unit 1 and BV Unit 2, and a 1997 update of the 1994 study for Perry Unit 1, the Company's approximate share of the total estimated decommissioning costs, including removal and decontamination costs, is $170 million, $55 million and $90 million, respectively. The amount currently being used to determine the Company's cost of service related to decommissioning all three nuclear units is $224 million.

Funding for nuclear decommissioning costs is deposited in external, segregated trust accounts and invested in a portfolio of corporate common stock and debt securities, municipal bonds, certificates of deposit and United States government securities. The market value of the aggregate trust fund balances at December 31, 1998, totaled approximately $62.7 million.

As part of the power station exchange, FirstEnergy has agreed in principle to assume the decommissioning liability for each of the nuclear plants in exchange for the balance in the decommissioning trust funds, plus the decommissioning costs expected to be collected through the CTC.

Nuclear Insurance

The Price-Anderson Amendments to the *Atomic Energy Act of 1954* limit public liability from a single incident at a nuclear plant to $9.8 billion. The maximum available private primary insurance of $200 million has been purchased by the Company. Additional protection of $9.6 billion would be provided by an assessment of up to $88.1 million per incident on each licensed nuclear unit in the United States. The Company's maximum total possible assessment, $66.1 million, which is based on its ownership or leasehold interests in three nuclear generating units, would be limited to a maximum of $7.5 million per incident per year. This assessment is subject to indexing for inflation and may be subject to state premium taxes. If assessments from the nuclear industry prove insufficient to pay claims, the United States Congress could impose other revenue-raising measures on the industry.

The Company's share of insurance coverage for property damage, decommissioning and decontamination liability is $1.2 billion. The Company would be responsible for its share of any damages in excess of insurance coverage. In addition, if the property damage reserves of Nuclear Electric Insurance Limited (NEIL), an industry mutual insurance company that provides a portion of this coverage, are inadequate to cover claims arising from an incident at any United States nuclear site covered by that insurer, the Company could be assessed retrospective premiums totaling a maximum of $7.3 million.

In addition, the Company participates in a NEIL program that provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. Subject to the policy deductible, terms and limit, the coverage provides for a weekly indemnity of the estimated incremental costs during the three-year period starting 17 weeks after an accident, with no coverage thereafter. If NEIL's losses for this program ever exceed its reserves, the Company could be assessed retrospective premiums totaling a maximum of $2.6 million.

Spent Nuclear Fuel Disposal

The Nuclear Waste Policy Act of 1982 established a federal policy for handling and disposing of spent nuclear fuel and a policy requiring the establishment of a final repository to accept spent nuclear fuel. Electric utility companies have entered into contracts with the United States Department of Energy (DOE) for the permanent disposal of spent nuclear fuel and high-level radioactive waste in compliance with this legislation. The DOE has indicated that its repository under these contracts will not be available for acceptance of spent nuclear fuel before 2010. The DOE has not yet established an interim or permanent storage facility, despite a ruling by the United States Court of Appeals for the District of Columbia Circuit that the DOE was legally obligated to begin acceptance of spent nuclear fuel for disposal by January 31, 1998. Existing on-site spent nuclear fuel storage capacities at BV Unit 1, BV Unit 2 and Perry Unit 1 are expected to be sufficient until 2018, 2012 and 2011, respectively.

In early 1997, the Company joined 35 other electric utilities and 46 states, state agencies and regulatory commissions in filing suit in the United States Court of Appeals for the District of Columbia Circuit against the DOE. The parties requested the court to suspend the utilities' payments into the Nuclear Waste Fund and to place future payments into an escrow account until the DOE fulfills its obligation to accept spent nuclear fuel. The DOE had requested that the court delay litigation while it pursued alternative dispute resolution under the terms of its contracts with the utilities. The court ruling, issued November 14, 1997, and affirmed on rehearing May 5, 1998, denied the relief requested by the utilities and states and permitted the DOE to pursue alternative dispute resolution, but prohibited the DOE from using its lack of a spent fuel repository as a defense. The United States Supreme Court declined to review the decision. The utilities' remaining remedy is to sue the DOE in federal court for money damages caused by the DOE's delay in fulfilling its obligations.

Uranium Enrichment Obligations

Nuclear reactor licensees in the United States are assessed annually for the decontamination and decommissioning of DOE uranium enrichment facilities. Assessments are based on the amount of uranium a utility had processed for enrichment prior to enactment of the *National Energy Policy Act of 1992* and are to be paid by such utilities over a 15-year period. At December 31, 1998, the Company's liability for contributions was approximately $6.2 million (subject to an inflation adjustment), which will be recovered through the CTC as part of transition costs.

ENVIRONMENTAL MATTERS

Various federal and state authorities regulate the Company with respect to air and water quality and other environmental matters. The Company believes it is in current compliance with all material applicable environmental regulations. As discussed above, the Company anticipates divesting itself of its generation assets, and expects that environmental obligations related to divested assets will transfer to the new owners.

As required by Title V of the *Clean Air Act Amendments* (Clean Air Act), the Company filed comprehensive air operating permit applications for Cheswick, Elrama, BI and Phillips in 1995. Approval is still pending for these applications. The Company filed its Title IV Phase II Clean Air Act compliance plan with the PUC on December 27, 1995. The Company also filed Title IV Phase II permit applications for oxides of nitrogen (NO_X) emissions from Cheswick, Elrama and Phillips with the Allegheny County Health Department and the Pennsylvania Department of Environmental Protection (DEP) on December 23, 1997. Approval is also pending for these applications.

Acid Rain Program Requirements. Although the Company believes it has satisfied all of the Phase I Acid Rain Program requirements of the Clean Air Act, the Phase II Acid Rain Program requires significant additional reductions of sulfur dioxide (SO_2) through the end of 2000. The Company currently has 662 MW of nuclear capacity and 887 MW of coal capacity equipped with SO_2 emission-reducing equipment. Through the year 2000, the Company will implement a combination of compliance methods that include fuel switching; increased use of, and improvements in, SO_2 emission-reducing equipment; and the purchase of emission allowances for those remaining stations where it is anticipated that emissions will exceed allocated SO_2 allowances.

The Company has developed, patented and installed low NO_X burner technology for the Elrama boilers. These cost-effective NO_X reduction systems installed on the Elrama roof-fired boilers were specified as the benchmark for the industry for this class of boilers in the Environmental Protection Agency's (EPA) final Group II rulemaking. In 1998, the Company installed low-cost burner modifications to existing low NO_X burner technology and a new flue gas conditioning system to maximize the effects of combustion-related controls at Cheswick.

Ozone Reduction Requirements. In addition to the Phase II Acid Rain Program requirements, the Company is responsible for NO_X reduction requirements to meet the current Ozone Ambient Air Quality Standards under Title I of the Clean Air Act. Compliance with the current ozone standard is based on pre-1997 ozone data, using a one-hour average value approach. During the 1998 summer ozone season, the western Pennsylvania "area" achieved compliance with the one-hour ozone standard. The Company believes it will continue its current low NO_X emission levels under the maintenance plan being established by the DEP. The Company further believes it will be able to meet any additional NO_X reduction levels specified under the maintenance plan, through reductions required in 1999 under the Ozone Transport Commission control program described below.

In September 1998, the EPA issued additional ozone-related NO_X reduction requirements under the Clean Air Act, which will affect the Company's power plants and will supersede reduction levels specified for 2003 by the Ozone Transport Commission control program. The EPA requires states in the northeast and midwest to amend their implementation plans to impose NO_X allowance caps on emissions during the May to September control period. Because the DEP has only recently proposed implementation regulations, the costs of compliance cannot be determined by the Company at this time. However, the Company anticipates that compliance would require additional capital and operation costs beyond those already estimated through 2000.

Future Air Quality Requirements. The Company is closely monitoring other future air quality programs and air emission control requirements that could result from more stringent ambient air quality and emission standards for SO_2 and NO_X particulates and other by-products of coal combustion. In 1997, the DEP finalized a regulation to implement additional NO_X control requirements that were recommended by the Ozone Transport Commission. The estimated costs to comply with this program have been included in the Company's capital cost estimates through the year 2000. The Company currently estimates that additional capital costs to comply with Clean Air Act requirements through the year 2000 will be approximately $5 million. These capital costs may be reduced by short term optimization of NO_X reduction systems and the purchase of NO_X emission allowances.

In July 1997, the EPA announced new national ambient air quality standards for ozone and fine particulate matter. To allow each state time to determine which areas may not meet the standards, and to adopt control strategies to achieve compliance, the ozone standards will not be implemented until 2004, and the fine particulate matter standards will not be implemented until 2007 or later. Because appropriate state ambient air monitoring and implementation plans have not been developed, the costs of compliance with these new standards cannot be determined by the Company at this time.

In December 1997, more than 160 nations reached a preliminary agreement (Kyoto Protocol), under which, among other things, the United States would be required to reduce its greenhouse gas emissions during the years 2008 through 2012. The Kyoto Protocol has been signed by the Clinton administration. However, until the Kyoto Protocol has been ratified by the Senate and the related greenhouse gas reduction programs have been developed, the costs of compliance cannot be determined by the Company at this time.

Other. In 1992, the DEP issued *Residual Waste Management Regulations* governing the generation and management of non-hazardous residual waste, such as coal ash. The Company is assessing the sites it utilizes and has developed compliance strategies that are currently under review by the DEP. Capital costs of $3.8 million were incurred by the Company in 1998 to comply with these DEP regulations. Based on information currently available, approximately $4.5 million will be spent in 1999. The additional capital cost of compliance is estimated, based on current information, to be approximately $4.8 million per year for the next three years. This estimate is subject to the results of groundwater assessments and DEP final approval of compliance plans.

Under the *Emergency Planning and Community Right-to-Know Act of 1986*, certain manufacturing and industrial companies are required to file annual toxic release inventory reports. The first submission by coal- and oil-fired electric utility generating stations is due July 1, 1999, to report on emissions and discharges for 1998. Toxic release inventory reporting does not involve emission reductions. The Company does not anticipate any material impact resulting from this requirement.

The *Comprehensive Environmental Response, Compensation and Liability Act of 1980* and the *Superfund Amendments and Reauthorization Act of 1986* established a variety of informational and environmental action programs. Through its investment in GSF Energy (GSF), the Company indirectly became involved in three hazardous waste sites. GSF was a minor contributor of materials to each site, and other solvent potentially responsible parties are involved. GSF believes that available defenses, along with its overall limited involvement, will limit any potential liability it may have for clean-up costs. Additionally, as part of the GSF investment the Company is indemnified for any costs that it may incur related to these sites by at least one financially responsible party. Accordingly, the Company believes that these matters will not have a material adverse effect on its financial position, results of operations or cash flows.

The Company's water and water-related operations are subject to the federal *Safe Drinking Water Act*, which provides for uniform minimum national water quality standards, as well as governmental authority to specify treatment processes to be used for drinking water. These operations are also subject to the federal *Clean Water Act*, which regulates the discharge of pollutants into waterways.

The Company is involved in various other environmental matters. The Company believes that such matters, in total, will not have a materially adverse effect on its financial position, results of operations or cash flows.

OTHER

Customer Advanced Reliability System

The Customer Advanced Reliability System (CARS) is a communications service that provides the Company with an electronic link to its customers, including the ability to read customer meters. During 1998, the Company's service contract with Itron, Inc. was expanded to include additional advanced commercial and industrial customer metering capabilities and associated software. Installation of this advanced metering subsystem commenced in 1998 and will continue during 1999. As of December 31, 1998, the base CARS system had essentially been completed, with nearly all residential meters adapted for CARS, and approximately 470,000 meters being read daily.

Retirement Plan Measurement Assumptions

The Company decreased the discount rate used to determine the projected benefit obligation on the Company's retirement plans at December 31, 1998, to 6.5 percent. The assumed change in compensation levels and the assumed rate of return on plan assets were also decreased to reflect current market and economic conditions. The effects of these changes on the Company's retirement plan obligations are reflected in the amounts shown in "Employee Benefits," Note N to the consolidated financial statements, on page 73. The resulting change in related expenses for subsequent years is not expected to be material.

Recent Accounting Pronouncement

In June 1998, the Financial Accounting Standards Board (FASB) issued *SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133). This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. The adoption of SFAS No. 133 is not expected to have a significant impact on the Company's financial statements and disclosures.

Except for historical information contained herein, the matters discussed in this annual report are forward-looking statements which involve risks and uncertainties including, but not limited to, economic, competitive, governmental and technological factors affecting the Company's operations, markets, products, services and prices and other factors discussed in the Company's filings with the Securities and Exchange Commission.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Directors and Shareholders of DQE, Inc.:

We have audited the accompanying consolidated balance sheet of DQE, Inc. and its subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, comprehensive income, retained earnings, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of DQE, Inc. and its subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

Deloitte & Touche LLP

Deloitte & Touche LLP
Pittsburgh, Pennsylvania
January 26, 1999

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS OF DQE

The Audit Committee, composed entirely of non-employee directors, meets regularly with the independent certified public accountants and the internal auditors to discuss results of their audit work, their evaluation of the adequacy of the internal accounting controls and the quality of financial reporting.

In fulfilling its responsibilities in 1998, the Audit Committee recommended to the Board of Directors, subject to shareholder approval, the selection of the Company's independent certified public accountants. The Audit Committee reviewed the overall scope and details of the independent certified public accountants' and internal auditors' respective audit plans and reviewed and approved the independent certified public accountants' general audit fees and non-audit services.

Audit Committee meetings are designed to facilitate open communications with internal auditors and independent certified public accountants. To ensure auditor independence, both the independent certified public accountants and the internal auditors have full and free access to the Audit Committee.

The Audit Committee of the Board of Directors of DQE

Statement of Consolidated Income

		(Thousands of Dollars, Except Per Share Amounts) Year Ended December 31,		
		1998	1997	1996
OPERATING REVENUES	Sales of Electricity:			
	Residential	$ 410,960	$ 405,915	$ 405,392
	Commercial	490,009	494,834	489,646
	Industrial	189,617	198,708	190,723
	Total customer revenues	1,090,586	1,099,457	1,085,761
	Utilities	36,203	24,861	58,292
	Total Sales of Electricity	1,126,789	1,124,318	1,144,053
	Other	142,809	105,856	92,724
	Total Operating Revenues	1,269,598	1,230,174	1,236,777
OPERATING EXPENSES	Fuel and purchased power	262,560	223,411	236,924
	Other operating	361,790	317,747	309,559
	Maintenance	74,908	82,869	78,386
	Depreciation and amortization	217,156	242,843	222,928
	Taxes other than income taxes	81,318	82,567	85,974
	Total Operating Expenses	997,732	949,437	933,771
OPERATING INCOME	**Operating Income**	271,866	280,737	303,006
OTHER INCOME	Long-term investment income	105,139	64,464	49,636
	Gain on dispositions	6,809	34,364	5,119
	Interest and other income	24,057	30,979	19,035
	Total Other Income	136,005	129,807	73,790
	Interest and Other Charges	110,201	115,638	110,270
	Income Before Income Taxes and Extraordinary Item	297,670	294,906	266,526
	Income Taxes	100,982	95,805	87,388
	Income Before Extraordinary Item	196,688	199,101	179,138
	Extraordinary Item, Net of Tax	(82,548)	—	—
NET INCOME	**Net Income, After Extraordinary Item**	114,140	199,101	179,138
	Dividends on Preferred Stock	866	—	—
	Earnings Available for Common Stock	$ 113,274	$ 199,101	$ 179,138
	Average Number of Common Shares Outstanding (Thousands of Shares)	77,683	77,492	77,349
EARNINGS PER SHARE	**Basic Earnings Per Share of Common Stock:**			
	Before Extraordinary Item	$ 2.52	$ 2.57	$ 2.32
	Extraordinary Item	$(1.06)	—	—
	After Extraordinary Item	$ 1.46	$ 2.57	$ 2.32
	Diluted Earnings Per Share of Common Stock:			
	Before Extraordinary Item	$ 2.48	$ 2.54	$ 2.29
	Extraordinary Item	$(1.04)	—	—
	After Extraordinary Item	$ 1.44	$ 2.54	$ 2.29
DIVIDENDS DECLARED	**Dividends Declared Per Share of Common Stock**	$ 1.46	$ 1.38	$ 1.30

See notes to consolidated financial statements.

Consolidated Balance Sheet

	(Thousands of Dollars) As of December 31, 1998	1997
ASSETS		
Current Assets:		
Cash and temporary cash investments	$ 108,790	$ 356,412
Receivables:		
Electric customer accounts receivable	87,262	90,149
Water customer accounts receivable	10,591	471
Other utility receivables	25,412	23,106
Other receivables	51,944	33,001
Less: Allowance for uncollectible accounts	(9,415)	(15,016)
Total Receivables – Net	165,794	131,711
Materials and supplies (at average cost):		
Operating and construction	58,747	53,088
Coal	25,702	20,418
Total Materials and Supplies	84,449	73,506
Other current assets	15,719	7,727
Total Current Assets	374,752	569,356
Long-Term Investments:		
Leveraged leases	388,113	349,129
Affordable housing	131,395	137,860
Gas reserves	103,270	92,645
Other leases	38,783	69,329
Other	98,877	73,823
Total Long-Term Investments	760,438	722,786
Property, Plant and Equipment:		
Electric plant in service	4,379,703	4,335,149
Property held under capital leases	123,374	113,662
Construction work in progress	79,644	56,471
Other	301,417	119,846
Gross property, plant and equipment	4,884,138	4,625,128
Less: Accumulated depreciation and amortization	(3,167,328)	(1,962,794)
Total Property, Plant and Equipment – Net	1,716,810	2,662,334
Other Non-Current Assets:		
Transition costs	2,132,980	—
Regulatory assets	64,568	680,885
Other	198,015	59,041
Total Other Non-Current Assets	2,395,563	739,926
Total Assets	$5,247,563	$4,694,402

See notes to consolidated financial statements.

LIABILITIES AND CAPITALIZATION

	(Thousands of Dollars) As of December 31, 1998	1997
Current Liabilities:		
Accounts payable	**$ 121,100**	$ 85,085
Current maturities and sinking fund requirements	**100,822**	97,844
Dividends declared	**33,009**	30,312
Accrued liabilities	**87,944**	79,949
Notes payable	**4,525**	—
Other	**6,864**	14,339
Total Current Liabilities	**354,264**	307,529
Non-Current Liabilities:		
Deferred income taxes – net	**777,017**	667,652
Beaver Valley lease liability	**475,570**	—
Deferred income	**156,579**	225,107
Capital lease obligations	**36,596**	37,540
Deferred investment tax credits	**24,076**	97,782
Other	**310,981**	255,467
Total Non-Current Liabilities	**1,780,819**	1,283,548
Commitments and Contingencies (Notes B through O)		
Capitalization:		
Long-Term Debt	**1,364,879**	1,376,121
Preferred and Preference Stock:		
DQE preferred stock	**35,274**	1,548
Preferred stock of subsidiaries	**215,608**	214,608
Preference stock of subsidiaries	**26,914**	28,295
Total preferred and preference stock before deferred employee stock ownership plan (ESOP) benefit	**277,796**	244,451
Deferred ESOP benefit	**(14,240)**	(16,400)
Total Preferred and Preference Stock	**263,556**	228,051
Common Shareholders' Equity:		
Common stock – no par value (authorized – 187,500,000 shares; issued – 109,679,154 shares)	**994,996**	996,508
Retained earnings	**869,671**	869,749
Treasury stock (at cost) (32,305,726 and 31,998,723 shares)	**(385,976)**	(371,821)
Accumulated other comprehensive income	**5,354**	4,717
Total Common Shareholders' Equity	**1,484,045**	1,499,153
Total Capitalization	**3,112,480**	3,103,325
Total Liabilities and Capitalization	**$5,247,563**	$4,694,402

See notes to consolidated financial statements.

Statement of Consolidated Cash Flows

		(Thousands of Dollars) Year Ended December 31,		
		1998	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES	Net income	$114,140	$199,101	$179,138
	Principal non-cash charges (credits) to net income:			
	Extraordinary item, net of tax	82,548	—	—
	Depreciation and amortization	217,156	242,843	222,928
	Deferred income and other taxes	119,945	60,811	(43,170)
	Capital lease, nuclear fuel and investment amortization	80,574	67,671	53,166
	Investment income	(111,904)	(66,246)	(57,429)
	Gain on disposition of investments	(6,809)	(34,364)	(5,119)
	Changes in working capital other than cash	(36,995)	(36,758)	2,915
	Increase in ECR	(19,219)	(25,318)	(3,948)
	Other	(78,479)	(40,038)	34,445
	Net Cash Provided from Operating Activities	360,957	367,702	382,926
CASH FLOWS FROM INVESTING ACTIVITIES	Capital expenditures	(190,548)	(116,004)	(101,150)
	Acquisition of water companies	(122,007)	(6,611)	—
	Long-term investments	(68,895)	(219,122)	(101,381)
	Acquisition of Control Solutions	(21,954)	—	—
	Proceeds from disposition of investments	6,809	86,300	18,100
	Sale of generating station	—	—	169,100
	Other	(512)	(1,132)	(1,898)
	Net Cash Used in Investing Activities	(397,107)	(256,569)	(17,229)
CASH FLOWS FROM FINANCING ACTIVITIES	Reductions of long-term obligations:			
	Long-term debt	(198,272)	(52,100)	(50,812)
	Capital leases	(12,897)	(13,551)	(19,326)
	Dividends on common and preferred stock	(114,218)	(106,959)	(100,517)
	Repurchase of common stock	(14,155)	(30)	(11,717)
	Increase (decrease) in notes payable	4,313	—	(28,637)
	Issuance of long-term debt	140,000	—	85,000
	Issuance of subsidiary preferred stock	—	—	150,000
	Other	(16,243)	6,941	(3,477)
	Net Cash (Used in) Provided from Financing Activities	(211,472)	(165,699)	20,514
	Net (decrease) increase in cash and temporary cash investments	(247,622)	(54,566)	386,211
	Cash and temporary cash investments at beginning of year	356,412	410,978	24,767
	Cash and temporary cash investments at end of year	$108,790	$356,412	$410,978

Supplemental Cash Flow Information

		1998	1997	1996
CASH PAID DURING THE YEAR	Interest (net of amount capitalized)	$ 91,462	$ 95,413	$ 95,702
	Income taxes	$ 27,978	$ 66,703	$ 91,641
NON-CASH INVESTING AND FINANCING ACTIVITIES	Preferred stock issued in conjunction with long-term investments	$ 33,726	$ 2,548	$ —
	Note payable issued in conjunction with purchase of property	$ 25,000	$ —	$ —
	Capital lease obligations recorded	$ 7,855	$ 27,514	$ 13,050
	Equity funding obligations cancelled	$ —	$ 9,107	$ —
	Equity funding obligations recorded	$ —	$ 5,441	$ 36,716

On May 1, 1997, DQE exchanged its shares in Chester Engineers for shares of common stock of the purchaser of Chester Engineers, which were subsequently sold at various dates through June 5, 1997.

See notes to consolidated financial statements.

Statement of Consolidated Comprehensive Income

	(Thousands of Dollars)		
	Year Ended December 31,		
	1998	1997	1996
Net income	$ 114,140	$ 199,101	$ 179,138
Other comprehensive income:			
Unrealized holding gains arising during the year, net of tax of $452, $5,154 and $0	637	7,268	—
Less: reclassification adjustment for gains included in net income, net of tax of $0, $4,440 and $0	—	(6,260)	—
Total Other Comprehensive Income	637	1,008	—
Comprehensive Income	$ 114,777	$ 200,109	$ 179,138

See notes to consolidated financial statements.

Statement of Consolidated Retained Earnings

	(Thousands of Dollars)		
	As of December 31,		
	1998	1997	1996
Balance at beginning of year	$ 869,749	$ 777,607	$ 698,986
Net income	114,140	199,101	179,138
Dividends declared	(114,218)	(106,959)	(100,517)
Balance at End of Year	$ 869,671	$ 869,749	$ 777,607

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

DQE, Inc. (DQE) is a multi-utility delivery and services company. Its subsidiaries are Duquesne Light Company (Duquesne); AquaSource, Inc. (AquaSource); DQE Energy Services, Inc. (DES); DQEnergy Partners, Inc. (DQEnergy); Duquesne Enterprises, Inc. (DE); and Montauk, Inc. (Montauk). DQE and its subsidiaries are collectively referred to as "the Company."

The Company's utility operations include an electric utility engaged in the generation, transmission, distribution and sale of electric energy and a water resource management company that acquires, develops and manages water and wastewater utilities. The Company's expanded business lines offer a wide range of energy-related technologies, industrial and commercial energy services, telecommunications and other complementary services. The expanded business lines' initiatives include energy facility development and operation, domestic and international independent power production, the production and supply of innovative fuels, investments in communications systems (including long-distance telephone service) and electronic commerce. In addition, one of the Company's subsidiaries is a financial services company that makes long-term investments and provides financing for the other expanded business lines and related customers.

On December 18, 1998, the Pennsylvania Public Utility Commission (PUC) approved the Company's plan to divest itself of its generation assets through an auction (including an auction of its provider of last resort service), and an agreement in principle to exchange certain power stations with FirstEnergy Corporation (FirstEnergy). Final agreements governing these transactions must be approved by various regulatory agencies. The Company currently expects these transactions to close in late 1999 or early 2000. (See "Rate Matters" discussion, Note F, on page 60.)

Basis of Accounting

The Company is subject to the accounting and reporting requirements of the Securities and Exchange Commission (SEC). In addition, the Company's electric utility operations are subject to regulation by the PUC, including regulation under the *Pennsylvania Electricity Generation Customer Choice and Competition Act* (Customer Choice Act), and the Federal Energy Regulatory Commission (FERC) under the *Federal Power Act* with respect to rates for interstate sales, transmission of electric power, accounting and other matters.

As a result of the PUC's final order regarding the Company's restructuring plan under the Customer Choice Act (see "Rate Matters," Note F, on page 60), the electricity generation portion of the Company's business no longer meets the criteria of *Statement of Financial Accounting Standards (SFAS) No. 71, Accounting for the Effects of Certain Types of Regulation* (SFAS No. 71). Accordingly, application of SFAS No. 71 to this portion of the Company's business has been discontinued and the Company now applies *SFAS No. 101, Regulated Enterprises – Accounting for the Discontinuation of Application of FASB Statement No 71* (SFAS No. 101) as interpreted by *Emerging Issues Task Force (EITF) 97-4, Deregulation of the Pricing of Electricity – Issues Related to the Application of FASB Statements No. 71 and 101*. Under SFAS No. 101, the regulatory assets and liabilities of the generation portion of the Company are determined on the basis of the source from which the regulated cash flows to realize such regulatory assets and settle such liabilities will be derived. Pursuant to the PUC's final restructuring order, certain of the Company's generation-related regulatory assets will be recovered through a competitive transition charge (CTC) collected in connection with providing transmission and distribution services (the electricity delivery business segment). The Company will continue to apply SFAS No. 71 with respect to such assets. Fixed assets related to the generation portion of the Company's business have been evaluated in accordance with *SFAS No. 121, Accounting for the Impairment of Long-Lived Assets to Be Disposed Of* (SFAS No. 121). Applying SFAS No. 121 to the non-regulated generation assets, it has been determined that the Company's generation assets are impaired. However, pursuant to the PUC's final restructuring order, the Company will recover its above-market investment in generation assets through the CTC. Under the Company's plan to auction its generation assets, the market value utilized by the PUC in determining the value of the generation assets will be the net after-tax proceeds received from the auction of its generation assets. Accordingly, the amount of book value authorized by the PUC to be recovered has been reclassified on the consolidated balance sheet from property, plant and equipment to transition costs, until the auction has been completed and all approvals for the final CTC accounting have been granted. The electricity delivery business segment continues to meet SFAS No. 71 criteria and accordingly reflects regulatory assets and liabilities consistent with cost-based ratemaking regulations. The regulatory assets represent probable future revenue to the Company, because provisions for these costs are currently included, or are expected to be included, in charges to electric utility customers through the ratemaking process. (See "Rate Matters," Note F, on page 60.)

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements. The reported amounts of revenues and expenses during the reporting period may also be affected by the estimates and assumptions management is required to make. Actual results could differ from those estimates.

Energy Cost Rate Adjustment Clause (ECR)

Through the ECR, the Company previously recovered (to the extent that such amounts were not included in base rates) nuclear fuel, fossil fuel and purchased power expenses. Also through the ECR, the Company passed to its customers the profits from short-term power sales to other utilities (collectively, ECR energy costs). As a consequence of the PUC's final order regarding the Company's restructuring plan (see "Rate Matters," Note F, on page 60), such fuel costs are no longer recoverable through the ECR. Instead, effective May 29, 1998 (the date of the PUC's final restructuring order), fuel costs are expensed as incurred and thus impact net income.

Under-recoveries from customers prior to May 29, 1998, were recorded on the consolidated balance sheet as a regulatory asset. At December 31, 1998, $42.7 million was receivable from customers. The Company expects to recover this amount through the CTC. (See "Restructuring Plan" discussion, Note F, on page 61.) At December 31, 1997, $23.5 million was receivable from customers.

Revenues from Utility Sales

The Company's electric utility operations provide service to customers in the City of Pittsburgh and surrounding areas. (See "Rate Matters," Note F, on page 60.) This territory represents approximately 800 square miles in southwestern Pennsylvania. The population of the area served by the Company's electric utility operations, based on 1990 census data, is approximately 1,510,000, of whom 370,000 reside in the City of Pittsburgh. In addition to serving approximately 580,000 direct customers, the Company's utility operations also sell electricity to other utilities.

The Company's water utility operations provide service to customers throughout the United States. The Company's water operations have grown rapidly and are currently approaching 300,000 customer connections.

Meters are read monthly and utility customers are billed on the same basis. Revenues are recorded in the accounting periods for which they are billed, with the exception of energy cost recovery revenues. (See "Energy Cost Rate Adjustment Clause" discussion on page 56.)

Maintenance

Effective January 1, 1999, as a result of the PUC's final restructuring order, all electric utility maintenance costs will be expensed as incurred. Historically, incremental maintenance costs incurred for refueling outages at the Company's nuclear units were deferred for amortization over the period between refueling outages (generally 18 months); the Company would accrue, over the periods between outages, anticipated costs for scheduled major fossil generating station outages. Maintenance costs incurred for non-major scheduled outages and for forced outages were charged to expense as such costs were incurred. During the fourth quarter of 1998, a reversal of the fossil maintenance outage accrual was made for outages planned to occur after the divestiture of the generation assets.

Depreciation and Amortization

Depreciation of property, plant and equipment, including plant-related intangibles, is recorded on a straight-line basis over the estimated remaining useful lives of properties. Goodwill, representing the excess of the cost over the net tangible and identifiable assets of acquired businesses, is stated at cost and is amortized on a straight-line basis over the estimated future periods to be benefited (25 to 40 years). Goodwill is included in other non-current assets on the consolidated balance sheet. In certain regulatory jurisdictions the Company expects to recover its goodwill and to earn a return on those costs through the ratemaking process. Amortization of gas reserve investments and depreciation of related property are on a units of production method over the total estimated gas reserves. Amortization of interests in affordable housing partnerships is based upon a method that approximates the equity method; and amortization of certain other leases is on the basis of benefits recorded over the lives of the investments. Depreciation and amortization of other properties are calculated on various bases.

The Company records nuclear decommissioning costs under the category of depreciation and amortization expense, and accrues a liability, equal to that amount, for nuclear decommissioning expense. On the Company's consolidated balance sheet, the decommissioning trusts have been reflected in other long-term investments, and the related liability has been recorded as other non-current liabilities. Trust fund earnings increase the fund balance and the recorded liability. (See "Nuclear Decommissioning" discussion, Note J, on page 66.)

The Company's electric utility operations' composite depreciation rate increased from 3.5 percent to 4.25 percent effective May 1, 1996. Also in 1996, the Company expensed $9 million related to the depreciation portion of deferred rate synchronization costs in conjunction with the Company's 1996 PUC-approved mitigation plan. As a result of the May 29, 1998, PUC restructuring order, the Company reduced its rate of depreciation on its generation assets, including plant and transition costs, to achieve a net book value as of December 31, 1998, equal to the level approved for recovery as transition costs.

Income Taxes

The Company uses the liability method in computing deferred taxes on all differences between book and tax bases of assets. These book/tax differences occur when events and transactions recognized for financial reporting purposes are not recognized in the same period for tax purposes. The deferred tax liability or asset is also adjusted in the period of enactment for the effect of changes in tax laws or rates.

For its electricity delivery business segment, the Company recognizes a regulatory asset for the deferred tax liabilities that are expected to be recovered from customers through rates. (See "Rate Matters," Note F, and "Income Taxes," Note H, on pages 60 and 64.)

The Company reflects the amortization of the regulatory tax receivable resulting from reversals of deferred taxes as depreciation and amortization expense. Reversals of accumulated deferred income taxes are included in income tax expense.

When applied to reduce the Company's income tax liability, investment tax credits related to the electricity delivery business segment generally are deferred. Such credits are subsequently reflected, over the lives of the related assets, as reductions to income tax expense.

Other Operating Revenues and Other Income

Other operating revenues include the Company's non-kilowatt-hour (KWH) utility revenues and revenues from expanded business lines' operating activities. Other income primarily is made up of income from long-term investments entered into by the expanded business lines. The income is separated from other revenues as the investment income does not result from operating activities.

Property, Plant and Equipment

The asset values of the Company's properties are stated at original construction cost, which includes related payroll taxes, pensions and other fringe benefits, as well as administrative costs. Also included in original construction cost is an allowance for funds used during construction (AFC), which represents the estimated cost of debt and equity funds used to finance construction.

Additions to, and replacements of, property units are charged to plant accounts. Maintenance, repairs and replacement of minor items of property are recorded as expenses when they are incurred. The costs of electricity delivery business segment properties that are retired (plus removal costs and less any salvage value) are charged to accumulated depreciation and amortization.

The asset values of the Company's electricity generation business segment properties were written down to market value in accordance with SFAS No. 121 in conjunction with the final PUC restructuring order. (See "Basis of Accounting" discussion on page 56.)

Substantially all of the Company's electric utility properties are subject to a first mortgage lien.

Temporary Cash Investments

Temporary cash investments are short-term, highly liquid investments with original maturities of three or fewer months. They are stated at market, which approximates cost. The Company considers temporary cash investments to be cash equivalents.

Earnings Per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock, or resulted in the issuance of common stock that then shared in the earnings of the entity.

The preference stock of the ESOP, as described in Note N, "Employee Benefits," was the primary cause for the dilution of earnings per share for the years ended December 31, 1998, 1997 and 1996 as shown on the statement of consolidated income. Each share of the preference stock is exchangeable for one and one-half shares of DQE common stock. Assuming conversion at the beginning of each year, the number of DQE shares was added to the denominator (weighted-average number of common shares outstanding). Partially offsetting the dilutive effect of the additional shares, the preference stock has an annual dividend rate of $2.80 per share, which was added back to the numerator (income available to common stockholders). The result of calculating both basic and dilutive earnings per share was a $0.02 dilutive effect for 1998, after the Pennsylvania restructuring charge, and a $0.03 dilutive effect for 1997 and 1996.

Stock-Based Compensation

The Company accounts for stock-based compensation using the intrinsic value method prescribed in *APB Opinion No. 25, Accounting for Stock Issued to Employees*, and related interpretations. Accordingly, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of the grant over the amount any employee must pay to acquire the stock. Compensation cost for stock appreciation rights is recorded annually, based on the quoted market price of the Company's stock at the end of the period.

Reclassification

The 1997 and 1996 consolidated financial statements have been reclassified to conform with 1998 presentation.

Recent Accounting Pronouncement

In June 1998, the Financial Accounting Standards Board (FASB) issued *SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities* (SFAS No. 133). This statement establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. The adoption of SFAS No. 133 is not expected to have a significant impact on the Company's financial statements and disclosures.

B. CHANGES IN WORKING CAPITAL OTHER THAN CASH

Changes in Working Capital Other than Cash (Net of Dispositions and Acquisitions) for the Year Ended December 31,

	(Thousands of Dollars)		
	1998	1997	1996
Receivables	$ (19,080)	$ (14,476)	$ (1,946)
Materials and supplies	(10,942)	(1,740)	1,286
Other current assets	(1,020)	(519)	(948)
Accounts payable	30,745	(4,993)	4,691
Other current liabilities	(36,698)	(15,030)	(168)
Total	$ (36,995)	$ (36,758)	$ 2,915

C. PROPERTY, PLANT AND EQUIPMENT

In addition to its wholly owned generating units, the Company, together with FirstEnergy, has an ownership or leasehold interest in certain jointly owned units. The Company is required to pay its share of the construction and operating costs of the units. The Company's share of the operating expenses of the units is included in the statement of consolidated income. The Company anticipates divesting itself of its generation assets. (See "Rate Matters," Note F, on page 60.)

Generating Units

Unit	Generating Capability *(Megawatts)*	Fuel Source
Cheswick	570	Coal
Elrama (a)	487	Coal
Eastlake Unit 5 (f)	186	Coal
Sammis Unit 7 (f)	187	Coal
Bruce Mansfield Units 1, 2 and 3 (a)(f)	400	Coal
Beaver Valley Unit 1 (b)(f)	385	Nuclear
Beaver Valley Unit 2 (c)(d)(f)	113	Nuclear
Perry Unit 1 (e)(f)	164	Nuclear
Brunot Island Units 2a and 2b	178	Fuel Oil
Total Generating Units	2,670	

(a) The unit is equipped with flue gas desulfurization equipment.
(b) The Nuclear Regulatory Commission (NRC) has granted a license to operate through January 2016.
(c) In 1987, the Company sold and leased back its 13.74 percent interest in Beaver Valley Unit 2.
(d) The NRC has granted a license to operate through May 2027.
(e) The NRC has granted a license to operate through March 2026.
(f) Jointly owned with FirstEnergy.

Additionally, the Company has an ownership interest in certain cold-reserved generating units. The Brunot Island (BI) Units 1 and 3 and the Phillips Power Station (Phillips), with a combined capacity of 428 MW, will be offered as part of the Company's generation asset auction.

D. LONG-TERM INVESTMENTS

The Company makes equity investments in affordable housing and gas reserve partnerships as a limited partner. At December 31, 1998, the Company had investments in 27 affordable housing funds and 29 gas reserve sites. The Company is the lessor in 9 leveraged lease arrangements involving mining equipment, rail equipment, fossil generating stations, a waste-to-energy facility, high speed service ferries and natural gas processing equipment. These leases expire in various years beginning in 2004 through 2033. The recorded residual value of the equipment at the end of the lease terms is approximately 2 percent of the original cost. The Company's aggregate investment represents 20 percent of the aggregate original cost of the property and is either leased to a creditworthy lessee or is secured by guarantees of the lessee's parent or affiliate. The remaining 80 percent was financed by non-recourse debt provided by lenders who have been granted, as their sole remedy in the event of default by the lessees, an assignment of rentals due under the leases and a security interest in the leased property. This debt amounted to $949 million and $950 million at December 31, 1998 and 1997.

Net Leveraged Lease Investments at December 31,	*(Thousands of Dollars)*	
	1998	1997
Rentals receivable (net of non-recourse debt)	**$632,879**	$638,030
Estimated residual value of leased assets	**22,029**	22,029
Less: Unearned income	**(266,795)**	(310,930)
Leveraged lease investments	**388,113**	349,129
Less: Deferred taxes arising from leveraged leases	**(185,639)**	(115,383)
Net Leveraged Lease Investments	**$202,474**	$233,746

The Company's other leases include investments in fossil generating stations, a waste-to-energy facility, computers, vehicles and equipment. The Company's other investments are primarily in assets of nuclear decommissioning trusts and marketable securities. Deferred income primarily relates to the Company's other lease investments and certain gas reserve investments. Deferred amounts will be recognized as income over the lives of the underlying investments for periods generally not exceeding seven years from the time of investment.

E. ACQUISITIONS

In 1997, the Company created the Preferred Stock, Series A (Convertible), $100 liquidation preference per share (DQE Preferred Stock), to issue as consideration in lieu of cash in connection with acquisitions by the Company of other businesses, assets or securities. (See "Preferred and Preference Stock," Note L, on page 70.) Through December 31, 1998, the Company had invested approximately $166 million (of which approximately $35 million was in the form of DQE Preferred Stock) to acquire the stock or assets of water and water-related companies. The Company also invested $22 million to acquire a 50 percent interest in and finance the growth of Control Solutions, LLC, a commercial and industrial heating, ventilation and air conditioning service and energy controls company.

F. RATE MATTERS

Competition and the Customer Choice Act

The electric utility industry continues to undergo fundamental change in response to development of open transmission access and increased availability of energy alternatives. Under historical ratemaking practice, regulated electric utilities were granted exclusive geographic franchises to sell electricity, in exchange for making investments and incurring obligations to serve customers under the then-existing regulatory framework. Through the ratemaking process, those prudently incurred costs were recovered from customers, along with a return on the investment. Additionally, certain operating costs were approved for deferral for future recovery from customers (regulatory assets). As a result of this historical ratemaking process, utilities had assets recorded on their balance sheets at above-market costs, thus creating transition and stranded costs.

In Pennsylvania, the Customer Choice Act went into effect on January 1, 1997. The Customer Choice Act enables Pennsylvania's electric utility customers to purchase electricity at market prices from a variety of electric generation suppliers (customer choice). Although the Customer Choice Act will give customers their choice of electric generation suppliers, the existing, franchised local distribution utility is still responsible for delivering electricity from the generation supplier to the customer. The local distribution utility is also required to serve as the provider of last resort for all customers in its service territory, unless other arrangements are approved by the PUC. The provider of last resort must provide electricity for any customer who cannot or does not choose an alternative electric generation supplier, or whose supplier fails to deliver. The Customer Choice Act provides that the existing franchised utility may recover, through a CTC, an amount of transition costs that are determined by the PUC to be just and reasonable. Pennsylvania's electric utility restructuring is being accomplished through a two-stage process consisting of an initial customer choice pilot period (which ended in December 1998) and a phase-in to competition period (which began in January 1999). The Company's estimated negative net income impact of the customer choice pilot program during 1998, with 5 percent of customers participating, was approximately $6 million.

Phase-In to Competition

The phase-in to competition began in January 1999, when 66 percent of customers became eligible to participate in customer choice (including customers covered by the pilot program); all customers will have customer choice in January 2000. As of February 8, 1999, approximately 12 percent of the Company's customers had chosen alternative generation suppliers. Customers that have chosen an electricity generation supplier other than the Company pay that supplier for generation charges, and pay the Company a CTC (discussed below) and charges for transmission and distribution. Customers that continue to buy their generation from the Company pay for their service at current regulated tariff rates divided into generation, transmission and distribution charges. Under the Customer Choice Act, an electric distribution company, such as Duquesne, remains a regulated utility and may only offer PUC-approved rates, including generation rates. Also under the Customer Choice Act, electricity delivery (including transmission, distribution and customer service) remains regulated in substantially the same manner as under current regulation.

In an effort to "jump start" retail competition, the Company has made 600 megawatts (MW) of power available to licensed electric generation suppliers, to be used in supplying electricity to Duquesne's customers who have chosen alternative generation suppliers. The power will be available for the first six months of 1999 at a price of 2.6 cents per KWH. This power availability will be structured to ensure the power is used to benefit Duquesne's retail customers.

Rate Cap

An overall four-and-one-half-year rate cap from January 1, 1997, has been imposed on the transmission and distribution charges of Pennsylvania electric utility companies under the Customer Choice Act. Additionally, electric utility companies may not increase the generation price component of rates as long as transition costs are being recovered, with certain exceptions.

Restructuring Plan

In its May 29, 1998, final restructuring order, the PUC determined that the Company should recover most of the above-market costs of the generation assets, including plant and regulatory assets through the collection of the CTC from electric utility customers. The total of the transition costs to be recovered is $2,133 million ($1,485 million, net of tax) over a seven-year period beginning January 1, 1999, as may be adjusted to account for the proceeds of the generation asset auction. In addition, the transition costs as reflected on the consolidated balance sheet will be amortized over the same period that the CTC revenues are being recognized. The Company will earn an 11 percent pre-tax return on the unrecovered balance.

In the second quarter of 1998, the Company recorded an extraordinary charge (PUC restructuring charge) against earnings of $142.3 million ($82.5 million, net of tax) for the generation-related stranded costs not considered by the PUC's restructuring order to be recoverable from customers. The Pennsylvania restructuring charge included Phillips, BI, deferred caretaker costs related to the two stations and deferred coal costs. The charge resulted in a reduction of Duquesne's contribution to the Company's earnings per share by $1.06. The table below sets forth the amounts reclassified from regulatory assets and property, plant, and equipment to transition costs.

Other Non-Current Assets as of December 31,

(Thousands of Dollars)	Transition Costs 1998	Other Regulatory Assets 1998	Regulatory Assets 1997
Power plants (a)	$1,073,730	$ —	$ —
Beaver Valley Unit 2 lease liability (See Note I)	475,570	—	—
Regulatory tax receivable	236,480	23,177	301,664
Beaver Valley Unit 2 sale/leaseback deferred taxes (b)	55,130	—	—
Unamortized debt costs	45,770	33,612	87,915
Beaver Valley Unit 2 sale/leaseback costs	37,790	—	38,299
Deferred rate synchronization costs	25,370	—	37,231
Deferred employee costs	14,240	7,779	25,130
Deferred energy costs	11,510	—	23,514
DOE decontamination and decommissioning receivable	5,580	—	8,847
Deferred nuclear maintenance outage costs	3,250	—	17,013
Brunot Island and Phillips cold reserve units (c)	—	—	105,693
Deferred coal costs (c)	—	—	15,711
Other (c) (d)	148,560	—	19,868
Total	$2,132,980	$ 64,568	$680,885

(a) Amount represents the above-market costs of the power plants and was reclassified in the second quarter of 1998 from property, plant, and equipment to transition costs. A final determination of plant market value will be determined in conjunction with the generation auction.

(b) Amount represents deferred taxes related to the taxable gain on the sale/leaseback of Beaver Valley Unit 2 and was reclassified from deferred tax liabilities to transition costs.

(c) In the second quarter of 1998 amounts were written off as an extraordinary charge to the consolidated statement of income as part of the Pennsylvania restructuring charge.

(d) Amounts reflected in transition costs include reclassifications from other non-current assets and other non-current liabilities. In addition, there are amounts included in transition costs that had not previously been recorded on the consolidated balance sheet but were determined in the final PUC restructuring order to be costs recoverable from customers through the CTC. In the case of amounts not recorded, a regulatory liability was recorded for the same amount as the transition costs.

As part of its restructuring plan filing, the Company requested recovery of $11.5 million ($6.7 million net of tax) through the CTC for energy costs previously deferred under the ECR. Although recovery of this amount was approved in the PUC's final restructuring order, the Company subsequently requested recovery of an additional $31.2 million ($18.2 million net of tax) in deferred fuel costs. On December 18, 1998, the PUC denied recovery of this additional amount. The Company has appealed the PUC's denial of recovery to the Pennsylvania Commonwealth Court. Based upon the Customer Choice Act, which mandates recovery of all regulatory assets, and the PUC's specific authorization for the Company to create a regulatory asset for these costs, the Company believes that it is probable that these costs will be recovered through retail rates. In the event that the Company does not prevail in its appeal, these costs would be written off as a charge against income during 1999.

Restructuring Plan and Auction Plan. With respect to transition cost recovery, the PUC's final order on the restructuring plan approved Duquesne's proposal to auction its generation assets and use the proceeds to offset transition costs. The remaining balance of such costs (with certain exceptions described below) will be recovered from ratepayers through a CTC, collectible through 2005. Until the divestiture is complete, Duquesne has been ordered to use an interim system average CTC and price to compare based on the methodology approved in its pilot program (approximately 2.9 cents per KWH for the CTC and approximately 3.8 cents per KWH for the price to compare).

On December 18, 1998, the PUC approved Duquesne's auction plan, including an auction of its provider of last resort service, as well as an agreement in principle to exchange certain generation assets with FirstEnergy. The assets to be auctioned will include Duquesne's wholly owned Cheswick Power Station, Elrama Power Station, Phillips and BI, as well as the stations to be received from FirstEnergy in the power station exchange described below. The auction plan calls for a two-phase, sealed bid process similar to that used in other power plant divestitures. The initial confidential bidding process is expected to begin in March 1999, with potential buyers identified by Duquesne being asked to submit non-binding bids. Final agreements governing the transactions must be approved by various regulatory agencies, including the PUC, the FERC, the NRC, the Department of Justice and/or the Federal Trade Commission. Duquesne currently expects the sale to close at the end of 1999 or the beginning of 2000.

Power Station Exchange. Pursuant to the agreement in principle and subject to the execution and regulatory approval of definitive agreements, Duquesne and FirstEnergy will exchange ownership interests in certain power stations. Duquesne will receive 100 percent ownership rights in three coal-fired power plants located in Avon Lake and Niles, Ohio and New Castle, Pennsylvania (totaling approximately 1,300 MW), which the Company expects to sell simultaneously as part of the auction of generation assets. FirstEnergy will acquire Duquesne's interests in Beaver Valley Unit 1 (BV Unit 1), Beaver Valley Unit 2 (BV Unit 2), Perry Unit 1, Sammis Unit 7, Eastlake Unit 5 and Bruce Mansfield Units 1, 2 and 3 (totaling approximately 1,400 MW). In connection with the power station exchange, the Company anticipates terminating the BV Unit 2 lease. (See "Leasing" discussion, Note I, on page 65.) Pursuant to the December 18, 1998, PUC order and subject to final approval, the proceeds from the sale of the power station received in the exchange will be used to offset the transition costs associated with Duquesne's currently-held generation assets and costs associated with completing the exchange. Duquesne expects this exchange to enhance the value received from the auction, because participants will bid on plants that are wholly owned by Duquesne, rather than plants that are jointly owned and/or operated by another entity. Additionally, the auction will include only coal- and oil-fired plants, which are anticipated to have a higher market value than nuclear plants. These value-enhancing features, along with a minimum level of auction proceeds guaranteed by FirstEnergy, are expected to maximize auction proceeds, minimize transition costs required to be recovered through the CTC (by shortening the length of the CTC recovery period), and thus reduce customer bills as rapidly as possible. Other benefits of this exchange include the resolution of all joint ownership issues, and other risks and costs associated with the jointly-owned units. Although the PUC has said the exchange appears to be in the public interest, the definitive exchange agreement must be submitted for PUC approval, and certain aspects of the exchange will have to be approved by, among other agencies, the FERC, the NRC and the Department of Justice. The power station exchange is expected to occur simultaneously with the anticipated closing of the sale of Duquesne's generation through the auction at the end of 1999 or in early 2000.

Termination of the AYE Merger

On July 28, 1998, DQE's Board of Directors concluded that it could not consummate the merger with AYE, toward which the Company had been working. The Company believes that AYE suffered a material adverse effect as a result of the PUC's final restructuring order regarding AYE's utility subsidiary, West Penn Power Company. More information regarding this decision is set forth in the Company's Current Report on Form 8-K dated July 28, 1998. On July 30, 1998, AYE informed DQE that it would continue to work toward consummation of the merger, and also pursue all remedies available to protect the legal and financial interests of AYE and its shareholders.

On September 17, 1998, the PUC issued an order stating that, unless the parties jointly agreed to an extension of time to consummate the merger beyond October 5, 1998 (the relevant date under the merger agreement), their merger application with the PUC would be considered withdrawn. On October 5, 1998, the Company announced its unilateral termination of the merger agreement. More information regarding this termination is set forth in the Company's Current Report on Form 8-K dated October 5, 1998. In a letter dated February 24, 1999, the PUC informed the Company that the merger application was deemed withdrawn and the docket was closed.

AYE filed suit in the United States District Court for the Western District of Pennsylvania, seeking to compel the Company to proceed with the merger and seeking a temporary restraining order and preliminary injunction to prevent the Company from certain actions pending a trial, or in the alternative seeking an unspecified amount of money damages. On October 28, 1998, the judge denied AYE's motion for the temporary restraining order and preliminary injunction. AYE appealed to the United States Court of Appeals for the Third Circuit, asking for an injunction pending the appeal and expedited treatment of the appeal. On November 6, 1998, the Third Circuit denied the motion for an injunction and granted the motion to expedite the appeal. Argument was held on January 15, 1999, and a decision is pending. The ultimate outcome of this suit cannot be determined at this time.

G. SHORT-TERM BORROWING AND REVOLVING CREDIT ARRANGEMENTS

At December 31, 1998, the Company had two extendible revolving credit arrangements, including a $125 million facility expiring in June 1999 and a $150 million facility expiring in October 1999. Interest rates can, in accordance with the option selected at the time of the borrowing, be based on prime, Eurodollar or certificate of deposit rates. Commitment fees are based on the unborrowed amount of the commitments. Both credit facilities contain two-year repayment periods for any amounts outstanding at the expiration of the revolving credit periods. At December 31, 1998 and December 31, 1997, there were no short-term borrowings outstanding.

H. INCOME TAXES

The annual federal corporate income tax returns have been audited by the Internal Revenue Service (IRS) for the tax years through 1992. The IRS is reviewing the Company's 1993 and 1994 returns, and the tax years 1995, 1996, 1997 and 1998 remain subject to IRS review. The Company does not believe that final settlement of the federal income tax returns for the years 1990 through 1998 will have a materially adverse effect on its financial position, results of operations or cash flows.

Deferred Tax Assets (Liabilities) at December 31,

	(Thousands of Dollars)	
	1998	1997
Tax benefit – long-term investments	$ 221,277	$ 235,957
BV lease liability	167,440	—
Unbilled revenue	16,589	19,637
Investment tax credits unamortized	9,990	40,573
Gain on sale/leaseback of BV Unit 2	—	58,137
Other	116,525	65,210
Deferred tax assets	531,821	419,514
Transition costs	(664,810)	—
Property depreciation	(285,783)	(712,247)
Leveraged leases	(185,639)	(115,383)
Deferred coal and energy costs	(16,525)	(15,910)
Loss on reacquired debt unamortized	(12,976)	(31,360)
Regulatory assets	(9,620)	(125,171)
Other	(133,485)	(87,095)
Deferred tax liabilities	(1,308,838)	(1,087,166)
Net Deferred Tax Liabilities	$ (777,017)	$ (667,652)

Income Taxes

		(Thousands of Dollars) Year Ended December 31,		
		1998	1997	1996
Currently payable:	Federal	$ 2,245	$ 3,911	$ 85,976
	State	26,946	31,083	44,582
Deferred – net:	Federal	80,104	69,324	(18,737)
	State	2,072	(93)	(14,874)
Investment tax credits deferred – net		(10,385)	(8,420)	(9,559)
Income Taxes		$100,982	$ 95,805	$ 87,388

Total income taxes differ from the amount computed by applying the statutory federal income tax rate to income before income taxes.

Income Tax Expense Reconciliation

	(Thousands of Dollars) Year Ended December 31,		
	1998	1997	1996
Computed federal income tax at statutory rate	$104,185	$103,217	$ 93,284
Increase (decrease) in taxes resulting from:			
State income taxes, net of federal income tax benefits	18,370	20,143	19,310
Investment tax benefits – net	(14,884)	(17,831)	(15,116)
Amortization of deferred investment tax credits	(10,385)	(8,420)	(9,559)
Other	3,696	(1,304)	(531)
Total Income Tax Expense	$100,982	$ 95,805	$ 87,388

I. LEASES

The Company leases nuclear fuel, a portion of a nuclear generating plant, certain office buildings, computer equipment, and other property and equipment.

Capital Leases at December 31,

	(Thousands of Dollars)	
	1998	1997
Nuclear fuel	**$100,756**	$ 92,901
Electric plant	**19,923**	20,761
Other	**2,695**	—
Total	**123,374**	113,662
Less: Accumulated amortization	**(63,604)**	(50,725)
Property Held Under Capital Leases – Net (a)	**$ 59,770**	$ 62,937

(a) Includes $2,037 in 1998 and $2,874 in 1997 of capital leases with associated obligations retired.

In 1987, the Company sold and leased back its 13.74 percent interest in BV Unit 2; the sale was exclusive of transmission and common facilities. The Company subsequently leased back its interest in the unit for a term of 29.5 years. The lease provides for semi-annual payments and was accounted for as an operating lease. In conjunction with the PUC restructuring order, it was determined that the costs related to the lease were transition costs to be recovered through the CTC. The Company recorded the lease liability and a corresponding regulatory asset for the present value of the future lease payments. The Company is responsible under the terms of the lease for all costs related to its interest in the unit. In December 1992, the Company participated in the refinancing of collateralized lease bonds to take advantage of lower interest rates, thus reducing the annual lease payments. The bonds were originally issued in 1987 to partially fund the lease of BV Unit 2. The associated letter of credit securing the lessor's equity interest in the unit is $194 million and the term of the letter of credit extends to 1999. The Company currently anticipates terminating the lease in connection with the power station exchange with FirstEnergy, in which case the lease liability recorded on the consolidated balance sheet would no longer be an obligation of the Company. The underlying collateralized lease bonds ($371.0 million at December 31, 1998) would become direct obligations of the Company and be recorded as debt on the consolidated balance sheet. (See "Rate Matters," Note F, on page 60.)

Leased nuclear fuel is amortized as the fuel is burned and charged to fuel and purchased power expense on the statement of consolidated income. The amortization of all other leased property is based on rental payments made (except the BV Unit 2 lease). These lease-related expenses are charged to operating expenses on the statement of consolidated income.

Summary of Rental Payments

	(Thousands of Dollars) Year Ended December 31,		
	1998	1997	1996
Operating leases	**$57,324**	$60,684	$59,503
Amortization of capital leases	**12,943**	16,847	19,378
Interest on capital leases	**4,386**	3,435	3,703
Total Rental Payments	**$74,653**	$80,966	$82,584

Future Minimum Lease Payments

	(Thousands of Dollars)		
Year Ended December 31,	BV Unit 2 Lease	Operating Leases	Capital Leases
1999	$ 45,476	$ 8,846	$ 24,839
2000	45,670	8,610	13,516
2001	45,643	8,552	10,028
2002	47,305	8,441	5,132
2003	53,100	—	3,085
2004 and thereafter	756,994	—	16,919
Total Minimum Lease Payments	$994,188	$34,449	$ 73,519
Less: Amount representing interest			(15,786)
Present value of minimum lease payments for capital leases (a)			$ 57,733

(a) Includes current obligations of $21.1 million at December 31, 1998.

Future minimum lease payments for operating leases are related principally to certain corporate offices. Future minimum lease payments for capital leases are related principally to the estimated use of nuclear fuel financed through leasing arrangements expiring in 1999 and building leases.

Future payments due to the Company, as of December 31, 1998, under subleases of certain corporate office space are approximately $6.0 million in 1999, $6.0 million in 2000 and $12.7 million thereafter.

J. COMMITMENTS AND CONTINGENCIES

The Company anticipates divesting itself of its generation assets through the auction and the power station exchange by early 2000 and, depending on the regulatory approvals of the final agreements regarding the divestiture, expects certain obligations related to the divested assets will be transferred to the future owners. (See "Restructuring Plan" discussion, Note F, on page 61.)

Construction, Investments and Acquisitions

The Company estimates that it will spend, excluding AFC and nuclear fuel, approximately $110 million in 1999 (including $30 million for generation), $75 million in 2000 (excluding generation) and $70 million in 2001 (excluding generation) for electric utility construction.

Nuclear-Related Matters

The Company has an interest in three nuclear units, two of which it operates. The operation of a nuclear facility involves special risks, potential liabilities, and specific regulatory and safety requirements. Specific information about risk management and potential liabilities is discussed below.

Nuclear Decommissioning. The Company expects to decommission BV Unit 1, BV Unit 2 and Perry Unit 1 no earlier than the expiration of each plant's operating license in 2016, 2027 and 2026, respectively. At the end of its operating life, BV Unit 1 may be placed in safe storage until BV Unit 2 is ready to be decommissioned, at which time the units may be decommissioned together.

Based on site-specific studies conducted in 1997 for BV Unit 1 and BV Unit 2, and a 1997 update of the 1994 study for Perry Unit 1, the Company's approximate share of the total estimated decommissioning costs, including removal and decontamination costs, is $170 million, $55 million and $90 million, respectively. The amount currently used to determine the Company's cost of service related to decommissioning all three nuclear units is $224 million.

Funding for nuclear decommissioning costs is deposited in external, segregated trust accounts and invested in a portfolio of corporate common stock and debt securities, municipal bonds, certificates of deposit and United States government securities. The market value of the aggregate trust fund balances at December 31, 1998, totaled approximately $62.7 million.

As part of the power station exchange, FirstEnergy has agreed in principle to assume the decommissioning liability for each of the nuclear plants in exchange for the balance in the decommissioning trust funds, plus the decommissioning costs expected to be collected through the CTC.

Nuclear Insurance. The *Price-Anderson Amendments* to the *Atomic Energy Act of 1954* limit public liability from a single incident at a nuclear plant to $9.8 billion. The maximum available private primary insurance of $200 million has been purchased by the Company. Additional protection of $9.6 billion would be provided by an assessment of up to $88.1 million per incident on each licensed nuclear unit in the United States. The Company's maximum total possible assessment, $66.1 million, which is based on its ownership or leasehold interests in three nuclear generating units, would be limited to a maximum of $7.5 million per incident per year. This assessment is subject to indexing for inflation and may be subject to state premium taxes. If assessments from the nuclear industry prove insufficient to pay claims, the United States Congress could impose other revenue-raising measures on the industry.

The Company's share of insurance coverage for property damage, decommissioning and decontamination liability is $1.2 billion. The Company would be responsible for its share of any damages in excess of insurance coverage. In addition, if the property damage reserves of Nuclear Electric Insurance Limited (NEIL), an industry mutual insurance company that provides a portion of this coverage, are inadequate to cover claims arising from an incident at any United States nuclear site covered by that insurer, the Company could be assessed retrospective premiums totaling a maximum of $7.3 million.

In addition, the Company participates in a NEIL program that provides insurance for the increased cost of generation and/or purchased power resulting from an accidental outage of a nuclear unit. Subject to the policy deductible, terms and limit, the coverage provides for a weekly indemnity of the estimated incremental costs during the three-year period starting 17 weeks after an accident, with no coverage thereafter. If NEIL's losses for this program ever exceed its reserves, the Company could be assessed retrospective premiums totaling a maximum of $2.6 million.

Beaver Valley Power Station (BVPS). BVPS's two units are equipped with steam generators designed and built by Westinghouse Electric Corporation (Westinghouse). Similar to other Westinghouse nuclear plants, outside diameter stress corrosion cracking (ODSCC) has occurred in the steam generator tubes of both units. BV Unit 1, which was placed in service in 1976, has removed approximately 17 percent of its steam generator tubes from service through a process called "plugging." However, BV Unit 1 still has the capability to operate at 100 percent reactor power and has the ability to return tubes to service by repairing them through a process called "sleeving." No tubes at either BV Unit 1 or BV Unit 2 have been sleeved to date. BV Unit 2, which was placed in service 11 years after BV Unit 1, has not yet exhibited the degree of ODSCC experienced at BV Unit 1. Approximately 3 percent of BV Unit 2's tubes are plugged; however, it is too early in the life of the unit to determine the extent to which ODSCC may become a problem at that unit.

The Company has undertaken certain measures, such as increased inspections, water chemistry control and tube plugging, to minimize the operational impact of and reduce susceptibility to ODSCC. Although the Company has taken these steps to allay the effects of ODSCC, the inherent potential for future ODSCC in steam generator tubes of the Westinghouse design still exists. Material acceleration in the rate of ODSCC could lead to a loss of plant efficiency, significant repairs or the possible replacement of the BV Unit 1 steam generators. The total replacement cost of the BV Unit 1 steam generators is currently estimated at $125 million. The Company would be responsible for $59 million of this total, which includes the cost of equipment removal and replacement steam generators, but excludes replacement power costs. The earliest that the BV Unit 1 steam generators could be replaced during a currently scheduled refueling outage is the fall of 2001.

The Company continues to explore all viable means of managing ODSCC, including new repair technologies, and plans to continue to perform 100 percent tube inspections during future refueling outages. However, the Company may be required to perform an earlier inspection of BV Unit 1's tubes and other equipment during a mid-cycle outage in 1999, to comply with NRC requirements to conduct such inspections at BV Unit 1 at least every 20 months. The Company has requested permission from the NRC to postpone these inspections until BV Unit 1's next refueling outage, currently scheduled to begin in the spring of 2000, and expects to receive such permission early in 1999. The Company completed its inspection of BV Unit 2's tubes during a forced outage in 1998 to comply with NRC requirements to conduct such inspections at BV Unit 2 at least every 24 months. The next refueling outage for BV Unit 2 is currently scheduled to begin at the end of February 1999. No steam generator tube inspections will be performed until the subsequent refueling outage, currently scheduled for the fall of 2000. The Company will continue to monitor and evaluate the condition of the BVPS steam generators.

BV Unit 1 went off-line on January 30, 1998, due to an issue identified in a technical review completed by the Company. BV Unit 2 went off-line on December 16, 1997, to repair the emergency air supply system to the control room. BV Unit 2 remained off-line due to other issues identified by a technical review, similar to that performed at BV Unit 1. These technical reviews, held in response to a 1997 commitment made by the Company to the NRC, have been completed. The Company was one of many utilities faced with similar issues, some of which date back to the initial start-up of BVPS. BV Unit 1 returned to service on August 15, 1998, and BV Unit 2 returned to service on September 28, 1998.

Spent Nuclear Fuel Disposal. The *Nuclear Waste Policy Act of 1982* established a federal policy for handling and disposing of spent nuclear fuel and a policy requiring the establishment of a final repository to accept spent nuclear fuel. Electric utility companies have entered into contracts with the United States Department of Energy (DOE) for the permanent disposal of spent nuclear fuel and high-level radioactive waste in compliance with this legislation. The DOE has indicated that its repository under these contracts will not be available for acceptance of spent nuclear fuel before 2010. The DOE has not yet established an interim or permanent storage facility, despite a ruling by the United States Court of Appeals for the District of Columbia Circuit that the DOE was legally obligated to begin acceptance of spent nuclear fuel for disposal by January 31, 1998. Existing on-site spent nuclear fuel storage capacities at BV Unit 1, BV Unit 2 and Perry Unit 1 are expected to be sufficient until 2018, 2012 and 2011, respectively.

In early 1997, the Company joined 35 other electric utilities and 46 states, state agencies and regulatory commissions in filing suit in the United States Court of Appeals for the District of Columbia Circuit against the DOE. The parties requested the court to suspend the utilities' payments into the Nuclear Waste Fund and to place future payments into an escrow account until the DOE fulfills its obligation to accept spent nuclear fuel. The DOE had requested that the court delay litigation while it pursued alternative dispute resolution under the terms of its contracts with the utilities. The court ruling, issued November 14, 1997, and affirmed on rehearing May 5, 1998, denied the relief requested by the utilities and states and permitted the DOE to pursue alternative dispute resolution, but prohibited the DOE from using its lack of a spent fuel repository as a defense. The United States Supreme Court declined to review the decision. The utilities' remaining remedy is to sue the DOE in federal court for money damages caused by the DOE's delay in fulfilling its obligations.

Uranium Enrichment Obligations. Nuclear reactor licensees in the United States are assessed annually for the decontamination and decommissioning of DOE uranium enrichment facilities. Assessments are based on the amount of uranium a utility had processed for enrichment prior to enactment of the National Energy Policy Act of 1992, and are to be paid by such utilities over a 15-year period. At December 31, 1998, the Company's liability for contributions was approximately $6.2 million (subject to an inflation adjustment), which will be recovered through the CTC as part of transition costs.

Fossil Decommissioning

Based on studies conducted in 1997, the amount for fossil decommissioning is currently estimated to be $130 million for the Company's interest in 17 units at six sites. Each unit is expected to be decommissioned upon the cessation of the unit's final operations. The Company was not permitted to recover these costs as part of its restructuring plan. (See "Rate Matters," Note F, on page 60.)

Guarantees

The Company and the other owners of Bruce Mansfield Power Station (Bruce Mansfield) have guaranteed certain debt and lease obligations related to a coal supply contract for Bruce Mansfield. At December 31, 1998, the Company's share of these guarantees was $10.4 million.

As part of the Company's investment portfolio in affordable housing, the Company has received fees in exchange for guaranteeing a minimum defined yield to third-party investors. A portion of the fees received has been deferred to absorb any required payments with respect to these transactions. Based on an evaluation of and recent experience with the underlying housing projects, the Company believes that such deferrals are ample for this purpose.

Residual Waste Management Regulations

In 1992, the Pennsylvania Department of Environmental Protection (DEP) issued Residual Waste Management Regulations governing the generation and management of non-hazardous residual waste, such as coal ash. The Company is assessing the sites it utilizes and has developed compliance strategies that are currently under review by the DEP. Based on information currently available, $4.5 million will be spent in 1999 to comply with these DEP regulations. The additional capital cost of compliance is estimated, based on current information, to be approximately $4.8 million per year for the next three years. This estimate is subject to the results of groundwater assessments and DEP final approval of compliance plans.

Employees

Duquesne is party to a labor contract expiring in September 2001 with the International Brotherhood of Electrical Workers (IBEW), which represents approximately 2,000 of Duquesne's employees. The contract provides, among other things, employment security, income protection and 3 percent annual wage increases through September 2000. Duquesne and the IBEW have agreed on a package of additional benefits and protections for union employees affected by the divestiture of generation assets. Any buyer of generation assets currently owned by Duquesne will be required to offer work to current IBEW employees on a seniority basis, recognize the IBEW as the exclusive bargaining representative, establish comparable employee benefit plans, and assume the current labor contract.

In connection with the anticipated divestiture, Duquesne has developed early retirement programs and enhanced separation packages available for eligible IBEW and management employees. Duquesne expects to recover related costs through the divestiture proceeds.

Other

The Company is involved in various other legal proceedings and environmental matters. The Company believes that such proceedings and matters, in total, will not have a materially adverse effect on its financial position, results of operations or cash flows.

K. LONG-TERM DEBT

The pollution control notes arise from the sale of bonds by public authorities for the purposes of financing construction of pollution control facilities at the Company's plants or refunding previously issued bonds. The Company is obligated to pay the principal and interest on these bonds. For certain of the pollution control notes, there is an annual commitment fee for an irrevocable letter of credit. Under certain circumstances, the letter of credit is available for the payment of interest on, or redemption of, all or a portion of the notes.

Long-Term Debt at December 31,

			(Thousands of Dollars)	
			Principal Outstanding	
	Interest Rate	Maturity	1998	1997
First mortgage bonds	5.90%-8.375%	1999-2038	$743,000 (a)	$ 778,000 (b)
Pollution control notes	Adjustable (c)	2009-2030	417,985	417,985
Sinking fund debentures	5.00%	2010	2,791	2,791
Term loans	6.47%-7.47%	2000-2001	150,000	150,000
Economic development revenue bonds	5.5%-8.75%	1999-2024	10,760	—
Term notes	Adjustable (d)	2008	9,500	—
Miscellaneous			34,271	31,017
Less: Unamortized debt discount and premium – net			(3,428)	(3,672)
Total Long-Term Debt			$1,364,879	$1,376,121

(a) Excludes $75.0 million related to current maturities during 1999.
(b) Excludes $75.0 million related to current maturities during 1998.
(c) The pollution control notes have adjustable interest rates. The interest rates at year-end averaged 3.9 percent in 1998 and 3.9 percent in 1997.
(d) Term notes have variable rates, adjusted quarterly. The interest rate at December 31, 1998, was 5.5 percent.

At December 31, 1998, sinking fund requirements and maturities of long-term debt outstanding for the next five years were $82.4 million in 1999, $167.1 million in 2000, $86.3 million in 2001, $1.2 million in 2002, and $101.1 million in 2003.

Total interest and other charges were $110.2 million in 1998, $115.6 million in 1997, and $110.3 million in 1996. Interest costs attributable to long-term debt and other interest were $95.6 million, $101.2 million and $99.4 million in 1998, 1997 and 1996, respectively. Of these amounts, $2.2 million in 1998, $2.3 million in 1997 and $1.2 million in 1996 was capitalized as AFC. Debt discount or premium and related issuance expenses are amortized over the lives of the applicable issues.

At December 31, 1998, the fair value of the Company's long-term debt, including current maturities and sinking fund requirements, estimated on the basis of quoted market prices for the same or similar issues or current rates offered to the Company for debt of the same remaining maturities, was $1,467.6 million. The principal amount included in the Company's consolidated balance sheet is $1,443.3 million.

At December 31, 1998 and 1997, the Company was in compliance with all of its debt covenants.

L. PREFERRED AND PREFERENCE STOCK

Preferred and Preference Stock at December 31,

		(Thousands of Dollars)			
		1998		1997	
	Call Price Per Share	Shares	Amount	Shares	Amount
Preferred Stock of DQE:					
Series A Preferred Stock (a)	—	**352,742**	**$35,274**	15,480	$1,548
Preferred Stock Series of Subsidiaries:					
3.75% (b) (c)	$51.00	**148,000**	**7,407**	148,000	7,407
4.00% (b) (c)	51.50	**549,709**	**27,486**	549,709	27,486
4.10% (b) (c)	51.75	**119,860**	**6,012**	119,860	6,012
4.15% (b) (c)	51.73	**132,450**	**6,643**	132,450	6,643
4.20% (b) (c)	51.71	**100,000**	**5,021**	100,000	5,021
$2.10 (b) (c)	51.84	**159,000**	**8,039**	159,400	8,039
9.00% (d)	—	**10**	**3,000**	10	3,000
8.375% (e)	—	**6,000,000**	**150,000**	6,000,000	150,000
6.5% (f)	—	**15**	**1,500**	10	1,000
6.5% (g)	—	**10**	**500**	—	—
Total Preferred Stock of Subsidiaries			**215,608**		214,608
Preference Stock Series of Subsidiaries:					
Plan Series A (c) (h)	36.90	779,394	26,914	799,456	28,295
Deferred ESOP benefit			**(14,240)**		(16,400)
Total Preferred and Preference Stock			**$263,556**		$228,051

(a) Preferred Stock: 4,000,000 authorized shares; no par value; Convertible; $100 liquidation preference per share
(b) Preferred stock: 4,000,000 authorized shares; $50 par value; cumulative; $50 per share involuntary liquidation value
(c) Non-redeemable
(d) 500 authorized shares; $300,000 par value; involuntary liquidation value $300,000 per share; mandatory redemption beginning August 2000
(e) Cumulative Monthly Income Preferred Securities, Series A (MIPS): 6,000,000 authorized shares; $25 involuntary liquidation value
(f) 1,500 authorized shares; $100,000 par value; $100,000 involuntary liquidation value
(g) Preferred stock: 100 authorized shares; $50,000 par value; $50,000 per share involuntary liquidation value
(h) Preference stock: 8,000,000 authorized shares; $1 par value; cumulative $35.50 per share involuntary liquidation value

In July 1997, the Company authorized and registered 1,000,000 shares of DQE Preferred Stock. As of December 31, 1998, 352,742 shares of DQE Preferred Stock had been issued and were outstanding. An additional 29,928 shares of DQE Preferred Stock were issued in January and February 1999. The DQE Preferred Stock ranks senior to the Company's common stock as to the payment of dividends and the distribution of assets on liquidations, dissolution or winding-up of the Company. Holders of DQE Preferred Stock are entitled to vote on all matters submitted to a vote of the holders of DQE common stock, voting together with the holders of common stock as a single class. Each share of DQE Preferred Stock is entitled to three votes. Each share of DQE Preferred Stock is convertible at the Company's option into the number of shares of DQE common stock computed by dividing the DQE Preferred Stock's $100 liquidation value by the five-day average closing sales price of DQE common stock for the five trading days immediately prior to the conversion date. Each unredeemed share of DQE Preferred Stock will automatically be converted on the first day of the first month commencing after the sixth anniversary of its issuance.

Dividends on DQE Preferred Stock are paid quarterly on each January 1, April 1, July 1 and October 1. 11,720 shares of DQE Preferred Stock are entitled to an annual dividend of 4.3 percent, comprising a quarterly dividend of $1.075 per share. 3,760 shares are entitled to an annual dividend of 4.2 percent, comprising a quarterly dividend of $1.05 per share. 250,400 shares are entitled to an annual dividend of 4.0 percent, comprising a quarterly dividend of $1.00 per share. 3,120 shares are entitled to an annual dividend of 3.4 percent, comprising a quarterly dividend of $.85 per share. 107,543 shares (including 23,960 shares issued in January 1999) are entitled to an annual dividend of 3.6 percent, comprising a quarterly dividend of $.90 per share. 5,968 shares issued in February 1999 are entitled to an annual dividend of 3.8 percent, comprising a quarterly dividend of $.95 per share.

In June 1998, a DQE subsidiary issued 10 shares of preferred stock, par value $50,000 per share. The holders of such shares are entitled to a 6.5 percent annual dividend to be paid each September.

A Duquesne subsidiary has 15 shares of preferred stock, par value $100,000 per share outstanding. The holders of such shares are entitled to a 6.5 percent annual dividend to be paid each September 30. In 1995, another Duquesne subsidiary issued 10 shares of preferred stock, par value $300,000 per share. The holders of such shares are entitled to a 9.0 percent annual dividend paid quarterly.

In May 1996, Duquesne Capital L.P. (Duquesne Capital), a special-purpose limited partnership of which Duquesne is the sole general partner, issued $150.0 million principal amount of 8⅜ percent Monthly Income Preferred Securities (MIPS), Series A, with a stated liquidation value of $25.00. The holders of MIPS, are entitled to annual dividends of 8⅜ percent, payable monthly. The sole assets of Duquesne Capital are Duquesne's 8⅜ percent debentures, with a principal amount of $151.5 million. These debt securities may be redeemed at Duquesne's option on or after May 31, 2001. Duquesne has guaranteed the payment of distributions on, and redemption price and liquidation amount in respect of the MIPS, to the extent that Duquesne Capital has funds available for such payment from the debt securities. Upon maturity or prior redemption of such debt securities, the MIPS will be mandatorily redeemed. The Company's consolidated balance sheet reflects only the $150.0 million of MIPS.

Holders of Duquesne's preferred stock are entitled to cumulative quarterly dividends. If four quarterly dividends on any series of preferred stock are in arrears, holders of the preferred stock are entitled to elect a majority of Duquesne's board of directors until all dividends have been paid. Holders of Duquesne's preference stock are entitled to receive cumulative quarterly dividends if dividends on all series of preferred stock are paid. If six quarterly dividends on any series of preference stock are in arrears, holders of the preference stock are entitled to elect two of Duquesne's directors until all dividends have been paid. At December 31, 1998, Duquesne had made all dividend payments. Preferred and preference dividends of subsidiaries included in interest and other charges were $16.7 million, $16.7 million and $12.1 million in 1998, 1997 and 1996. Total preferred and preference stock had involuntary liquidation values of $278.4 million and $244.4 million, which exceeded par by $26.9 million and $27.6 million at December 31, 1998 and 1997.

In December 1991, the Company established an Employee Stock Ownership Plan (ESOP) to provide matching contributions for a 401(k) Retirement Savings Plan for Management Employees. (See "Employee Benefits," Note N, on page 73.) The Company issued and sold 845,070 shares of preference stock, plan series A to the trustee of the ESOP. As consideration for the stock, the Company received a note valued at $30 million from the trustee. The preference stock has an annual dividend rate of $2.80 per share, and each share of the preference stock is exchangeable for one and one-half shares of DQE common stock. At December 31, 1998, $14.2 million of preference stock issued in connection with the establishment of the ESOP had been offset, for financial statement purposes, by the recognition of a deferred ESOP benefit. Dividends on the preference stock and cash contributions from the Company are used to fund the repayment of the ESOP note. The Company was not required to make a cash contribution for 1998. The Company made cash contributions of approximately $1.1 million for 1997 and $1.4 million for 1996. These cash contributions were the difference between the ESOP debt service and the amount of dividends on ESOP shares ($2.2 million in 1998, $2.3 million in 1997 and 1996). As shares of preference stock are allocated to the accounts of participants in the ESOP, the Company recognizes compensation expense, and the amount of the deferred compensation benefit is amortized. The Company recognized compensation expense related to the 401(k) plans of

$1.6 million in 1998, $3.2 million in 1997 and $2.3 million in 1996. Although outstanding preferred stock is generally callable on notice of not less than 30 days, at stated prices plus accrued dividends, the outstanding MIPS and preference stock are not currently callable. None of the remaining Duquesne preferred or preference stock issues has mandatory purchase requirements.

M.
EQUITY

Changes in the Number of Shares of DQE Common Stock Outstanding as of December 31,

	(Thousands of Shares)		
	1998	1997	1996
Outstanding as of January 1	**77,680**	77,273	77,556
Reissuance from treasury stock	**70**	408	157
Repurchase of common stock	**(377)**	(1)	(440)
Outstanding as of December 31	77,373	77,680	77,273

The Company has continuously paid dividends on common stock since 1953. The Company's annualized dividends per share were $1.52, $1.44 and $1.36 at December 31, 1998, 1997 and 1996. During 1998, the Company paid a quarterly dividend of $0.36 per share on each of January 1, April 1, July 1 and October 1. The quarterly dividend declared in the fourth quarter of 1998 was increased from $0.36 to $0.38 per share payable January 1, 1999. During 1997, the Company paid a quarterly dividend of $0.34.

Once all dividends on the DQE Preferred Stock have been paid, dividends may be paid on the Company's common stock to the extent permitted by law and as declared by the board of directors. However, payments of dividends on Duquesne's common stock may be restricted by Duquesne's obligations to holders of preferred and preference stock pursuant to Duquesne's Restated Articles of Incorporation and by obligations of Duquesne's subsidiaries to holders of their preferred securities. No dividends or distributions may be made on Duquesne's common stock if Duquesne has not paid dividends or sinking fund obligations on its preferred or preference stock. Further, the aggregate amount of Duquesne's common stock dividend payments or distributions may not exceed certain percentages of net income if the ratio of total common shareholder's equity to total capitalization is less than specified percentages. As all of Duquesne's common stock is owned by the Company, to the extent that Duquesne cannot pay common dividends, the Company may not be able to pay dividends on its common stock or DQE Preferred Stock. No part of the retained earnings of the Company was restricted at December 31, 1998.

Effective December 31, 1998, the Company adopted *SFAS No. 130, Reporting Comprehensive Income* (SFAS No. 130). This statement establishes standards for reporting and display of comprehensive income and its components (revenues, expenses, gains, and losses) in a full set of general-purpose financial statements. The objective of the statement is to report a measure of all changes in equity of a business enterprise that result from recognized transactions and other economic events of the period other than transactions with owners in their capacity as owners (comprehensive income).

Accumulated Other Comprehensive Income Balances as of December 31,

	(Thousands of Dollars)		
	1998	1997	1996
Balance at beginning of year	$ 4,717	$ (2,551)	$ (2,551)
Unrealized gains on securities, net of tax	637	7,268	—
Balance at end of year	$ 5,354	$ 4,717	$ (2,551)

In accordance with *SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities* (SFAS No. 115), these investments are classified as available-for-sale and are stated at market value. The amount of unrealized holding gains related to marketable securities was $8.9 million ($5.4 million net of tax) at December 31, 1998, and $8.1 million ($4.7 million net of tax) at December 31, 1997.

N.
EMPLOYEE
BENEFITS

Pension and Postretirement Benefits

The Company maintains retirement plans to provide pensions for all eligible employees. Upon retirement, an employee receives a monthly pension based on his or her length of service and compensation. The cost of funding the pension plan is determined by the unit credit actuarial cost method. The Company's policy is to record this cost as an expense and to fund the pension plans by an amount that is at least equal to the minimum funding requirements of the *Employee Retirement Income Security Act of 1974* (ERISA), but which does not exceed the maximum tax-deductible amount for the year. Pension costs charged to expense or construction were $12.2 million for 1998, $12.7 million for 1997, and $11.9 million for 1996.

In addition to pension benefits, the Company provides certain health care benefits and life insurance for some retired employees. Participating retirees make contributions, which may be adjusted annually, to the health care plan. The life insurance plan is non-contributory. Company-provided health care benefits terminate when covered individuals become eligible for Medicare benefits or reach age 65, whichever comes first. The Company funds actual expenditures for obligations under the plans on a "pay-as-you-go" basis. The Company has the right to modify or terminate the plans.

The Company accrues the actuarially determined costs of the aforementioned postretirement benefits over the period from the date of hire until the date the employee becomes fully eligible for benefits. The Company has elected to amortize the transition obligation over a 20 year period.

In 1998, the Company adopted *SFAS No. 132, Employers' Disclosures about Pensions and Other Postretirement Benefits* (SFAS No. 132). This statement revises employers' disclosures about pension and other postretirement benefit plans.

The Company sponsors several qualified and nonqualified pension plans and other postretirement benefit plans for its employees. The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of plan assets over the two-year period ending December 31, 1998, a statement of the funded status as of December 31, 1998 and 1997, and summary of assumptions used in the measurement of the Company's benefit obligation:

Funded Status of the Pension and Postretirement Benefit Plans at December 31,

	(Thousands of Dollars)			
	Pension		Postretirement	
	1998	1997	1998	1997
Change in benefit obligation:				
Benefit obligation at beginning of year	$ 554,302	$ 497,098	$ 46,330	$ 39,021
Service cost	14,042	12,340	1,832	1,603
Interest cost	37,723	36,571	3,078	3,048
Actuarial loss (gain)	26,231	26,117	(3,003)	2,299
Benefits paid	(26,592)	(25,612)	(1,879)	(1,424)
Curtailments	—	2,923	—	1,783
Settlements	(109)	(544)	—	—
Special termination benefits	—	5,409	—	—
Benefit obligation at end of year	605,597	554,302	46,358	46,330
Change in plan assets:				
Fair value of plan assets at beginning of year	605,457	525,871	—	—
Actual return on plan assets	91,561	95,444	—	—
Employer contributions	10,706	9,675	—	—
Benefits paid	(26,480)	(25,533)	—	—
Fair value of plan assets at end of year	681,244	605,457	—	—
Funded status	75,647	51,155	(46,358)	(46,330)
Unrecognized net actuarial loss (gain)	(173,974)	(153,682)	(1,795)	1,208
Unrecognized prior service cost	36,285	39,800	—	—
Unrecognized net transition obligation	10,227	12,039	23,607	25,294
Accrued benefit cost	$ (51,815)	$ (50,688)	$ (24,546)	$ (19,828)

Weighted-Average Assumptions as of December 31,

	Pension		Postretirement	
	1998	1997	**1998**	1997
Discount rate used to determine projected benefits obligation	**6.50%**	7.00%	**6.50%**	7.00%
Assumed rate of return on plan assets	**7.50%**	8.00%	—	—
Assumed change in compensation levels	**4.25%**	4.75%	—	—
Ultimate health care cost trend rate	—	—	**5.00%**	5.50%

All of the Company's plans for postretirement benefits, other than pensions, have no plan assets. The aggregate benefit obligation for those plans was $46.4 million as of December 31, 1998, and $46.3 million as of December 31, 1997. The accumulated postretirement benefit obligation comprises the present value of the estimated future benefits payable to current retirees, and a pro rata portion of estimated benefits payable to active employees after retirement.

Pension assets consist primarily of common stocks, United States obligations and corporate debt securities.

Components of Net Pension Cost as of December 31,

	(Thousands of Dollars)		
	1998	1997	1996
Components of net pension cost:			
Service cost	**$ 14,042**	$ 12,340	$ 12,209
Interest cost	**37,723**	36,571	32,597
Actual return on plan assets	**(91,561)**	(95,444)	(58,173)
Net amortization and deferrals	**52,032**	65,800	25,312
Net Pension Cost	**$ 12,236**	$ 19,267	$ 11,945

Components of Postretirement Cost as of December 31,

	(Thousands of Dollars)		
	1998	1997	1996
Components of postretirement cost:			
Service cost	**$ 1,832**	$ 1,603	$ 1,182
Interest cost	**3,078**	3,048	2,046
Amortization of the transition obligation	**1,687**	1,686	1,700
Other	**—**	218	(812)
Total Postretirement Cost	**$ 6,597**	$ 6,555	$ 4,116

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans.

Effect of a One Percent Change in Health Care Cost Trend Rates as of December 31, 1998

	(Thousands of Dollars)	
	1 Percent Increase	1 Percent Decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	$ 602	$ (521)
Effect on the health care component of the accumulated postretirement benefit obligation	$ 4,819	$(4,202)

Retirement Savings Plan and Other Benefit Options

The Company sponsors separate 401(k) retirement plans for its management and bargaining unit employees.

The 401(k) Retirement Savings Plan for Management Employees provides that the Company will match employee contributions to a 401(k) account up to a maximum of 6 percent of an employee's eligible salary. The Company match consists of a $0.25 base match per eligible contribution dollar and an additional $0.25 incentive match per eligible contribution dollar, if Board-approved targets are achieved. The 1998 incentive target for management was not accomplished. The Company is funding its matching contributions to the 401(k) Retirement Savings Plan for Management Employees with payments to an ESOP established in December 1991. (See "Preferred and Preference Stock," Note L, on page 70.)

The 401(k) Retirement Savings Plan for IBEW Represented Employees provides that the Company will match employee contributions to a 401(k) account up to a maximum of 4 percent of an employee's eligible salary. The Company match consists of a $0.25 base match per eligible contribution dollar and an additional $0.25 incentive match per eligible contribution dollar, if certain targets are met. In 1998, the incentive target for bargaining unit employees was not accomplished.

The Company's shareholders have approved a long-term incentive plan through which the Company may grant management employees options to purchase, during the years 1987 through 2006, up to a total of 9.9 million shares of the Company's common stock at prices equal to the fair market value of such stock on the dates the options were granted. At December 31, 1998, approximately 3.8 million of these shares were available for future grants.

As of December 31, 1998, 1997 and 1996, active grants totaled 1,230,946; 1,084,041; and 1,698,000 shares. Exercise prices of these options ranged from $15.8334 to $43.4375 at December 31, 1998; $15.8334 to $33.7813 at December 31, 1997; and from $8.2084 to $30.875 at December 31, 1996. Expiration dates of these grants ranged from 2000 to 2008 at December 31, 1998; 2000 to 2007 at December 31, 1997; and from 1997 to 2006 at December 31, 1996. As of December 31, 1998, 1997 and 1996, stock appreciation rights (SARs) had been granted in connection with 867,104; 635,995; and 984,000 of the options outstanding. During 1998, 233,532 SARs were exercised; 170,476 options were exercised at prices ranging from $15.8334 to $31.5625; and no options were cancelled. During 1997, 694,984 SARs were exercised; 638,494 options were exercised at prices ranging from $8.2084 to $30.75; and no options were cancelled. During 1996, 715,000 SARs were exercised; 267,000 options were exercised at prices ranging from $8.2084 to $20.3334; and 150 options were cancelled. Of the active grants at December 31, 1998, 1997 and 1996, 750,463; 402,816; and 668,000 were not exercisable.

O. BUSINESS SEGMENTS AND RELATED INFORMATION

Effective December 31, 1998, the Company adopted *SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information* (SFAS No. 131). This statement establishes standards for the way that public business enterprises report information about operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. This statement also establishes standards for related disclosures about products and services, geographic areas, and major customers.

Historically, Duquesne has been treated as a single integrated business segment due to its regulated operating environment. The PUC authorized a combined rate for supplying and delivering electricity to customers which was cost-based and was designed to recover the Company's operating expenses and investment in electric utility assets and to provide a return on the investment. As a result of the Customer Choice Act, generation of electricity will be deregulated and charged at a separate rate from the delivery of electricity beginning in 1999 (5 percent of customers chose alternative generation suppliers in 1998). For the purposes of complying with SFAS No. 131 the Company is required to disclose information about its business segments separately. Accordingly, the Company has used the PUC-approved separate rates for 1999 to develop the financial information of the business segments for the periods ended December 31, 1998, 1997 and 1996.

Beginning in 1999, the Company's principal business segments (determined by products and services) will consist of the transmission and distribution by Duquesne of electricity (electricity delivery business segment) and the generation by Duquesne of electricity and collection of the CTC (electricity generation business segment). To comply with SFAS No. 131, the Company has reported the results for 1998, 1997 and 1996 by these business segments and an "all other" category. The all other category in the following table includes the expanded business lines and Duquesne investments below the quantitative threshold for separate disclosure. These expanded business lines include water utilities, energy products and services, electronic commerce, and other activities. Intercompany eliminations primarily relate to intercompany sales of electricity, property rental, management fees and dividends. Upon the anticipated completion of the auction of the Company's generation assets and provider of last resort services, the electricity generation business segment will be comprised solely of the collection of the CTC.

Financial data for business segments is provided as follows:

Business Segments as of December 31,

	(Thousands of Dollars)				
	Electricity Delivery	Electricity Generation	All Other	Eliminations	Consolidated
1998					
Operating revenues	$ 321,484	$ 855,310	$ 106,432	$ (13,628)	$1,269,598
Operating expenses	147,373	536,964	113,830	(17,591)	780,576
Depreciation and amortization expense	47,388	160,243	9,525	—	217,156
Operating income (loss)	126,723	158,103	(16,923)	3,963	271,866
Other income	5,284	9,020	128,883	(7,182)	136,005
Interest and other charges	37,711	58,637	14,730	(877)	110,201
Income before taxes and extraordinary item	94,296	108,486	97,230	(2,342)	297,670
Income taxes	37,141	36,616	28,197	(972)	100,982
Income before extraordinary item	57,155	71,870	69,033	(1,370)	196,688
Extraordinary item, net of tax	—	(82,548)	—	—	(82,548)
Net income (loss) after extraordinary item	$ 57,155	$ (10,678)	$ 69,033	$ (1,370)	$ 114,140
Assets	$1,314,266	$2,711,533	$1,221,764	$ —	$5,247,563
Capital expenditures	$ 71,699	$ 41,629	$ 77,220	$ —	$ 190,548

	(Thousands of Dollars)				
	Electricity Delivery	Electricity Generation	All Other	Eliminations	Consolidated
1997					
Operating revenues	$ 316,938	$ 859,003	$ 64,769	$ (10,536)	$1,230,174
Operating expenses	137,425	522,531	62,748	(16,110)	706,594
Depreciation and amortization expense	45,652	192,592	4,599	—	242,843
Operating income (loss)	133,861	143,880	(2,578)	5,574	280,737
Other income	6,844	12,723	119,185	(8,945)	129,807
Interest and other charges	38,612	63,805	14,093	(872)	115,638
Income before taxes	102,093	92,798	102,514	(2,499)	294,906
Income taxes	40,195	32,252	24,395	(1,037)	95,805
Net income	$ 61,898	$ 60,546	$ 78,119	$ (1,462)	$ 199,101
Assets	$1,476,133	$2,201,229	$1,017,040	$ —	$4,694,402
Capital expenditures	$ 57,646	$ 32,763	$ 25,595	$ —	$ 116,004

1996	Electricity Delivery	Electricity Generation	All Other	Eliminations	Consolidated
	(Thousands of Dollars)				
Operating revenues	$ 308,826	$ 878,581	$ 58,894	$ (9,524)	$1,236,777
Operating expenses	138,384	532,190	54,455	(14,186)	710,843
Depreciation and amortization expense	45,415	172,870	4,643	—	222,928
Operating income (loss)	125,027	173,521	(204)	4,662	303,006
Other income	5,209	9,806	71,152	(12,377)	73,790
Interest and other charges	37,197	63,359	11,056	(1,342)	110,270
Income before taxes	93,039	119,968	59,892	(6,373)	266,526
Income taxes	36,436	42,389	11,207	(2,644)	87,388
Net income	$ 56,603	$ 77,579	$ 48,685	$ (3,729)	$ 179,138
Assets	$1,407,529	$2,355,294	$ 876,169	$ —	$4,638,992
Capital expenditures	$ 52,514	$ 35,371	$ 13,265	$ —	$ 101,150

P. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summary of Selected Quarterly Financial Data (Thousands of Dollars, Except Per Share Amounts)

[The quarterly data reflect seasonal weather variations in the electric utility's service territory.]

1998	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating revenues (a)	$298,775	$303,510	$347,770	$319,543
Operating income	61,817	64,949	83,242	61,858
Income before extraordinary item	45,130	40,204	62,069	49,285
Extaordinary item	—	(82,548)	—	—
Net income after extraordinary item	45,130	(42,344)	62,069	49,285
Basic earnings per share:				
Before extraordinary item	0.58	0.52	0.80	0.62
Extraordinary item	—	(1.06)	—	—
After extraordinary item	0.58	(0.54)	0.80	0.62
Diluted earnings per share:				
Before extraordinary item	0.57	0.51	0.78	0.62
Extraordinary item	—	(1.04)	—	—
After extraordinary item	0.57	(0.53)	0.78	0.62
Stock price:				
High	37 1/4	37 5/16	39 1/4	43 15/16
Low	32 5/16	31 5/8	34 1/4	37 3/4

1997	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Operating revenues (a)	$306,334	$287,850	$334,714	$301,276
Operating income	76,817	55,631	97,209	51,080
Net income	45,097	46,778	58,665	48,561
Basic earnings per share	0.58	0.61	0.75	0.63
Diluted earnings per share	0.57	0.60	0.75	0.62
Stock price:				
High	29 7/8	29	33 9/16	35 1/8
Low	27 3/4	26 7/8	31 7/16	30 7/16

(a) Restated to conform with 1998 presentation.

GLOSSARY OF TERMS

Competitive Transition Charge (CTC) — During the electric utility restructuring from the traditional regulatory framework to customer choice, electric utilities will have the opportunity to recover transition costs from customers through a per kilowatt-hour charge.

Customer Choice — The Pennsylvania Electricity Generation Customer Choice and Competition Act (see "Rate Matters" on page 39) gives consumers the right to contract for electricity at market prices from PUC-approved electric generation suppliers.

Decommissioning Costs — Decommissioning costs are expenses to be incurred in connection with the entombment, decontamination, dismantling, removal and disposal of structures, systems and components of a power plant that has permanently ceased the production of electric energy.

Deferred Energy Costs — In conjunction with the Energy Cost Rate Adjustment Clause, the Company historically recorded deferred energy costs to offset differences between actual energy costs and the level of energy costs currently recovered from its rate-regulated electric utility customers.

Distribution/Transmission — The Company's "electricity delivery" business segment. Transmission is the flow of electricity from generating stations over high voltage lines to substations where voltage is reduced. Distribution is the flow of electricity over lower voltage facilities to the ultimate customer (businesses and homes).

Divestiture — The selling of major assets. The Company currently anticipates divestiture of its generation assets through an auction and the power station exchange.

Energy Cost Rate Adjustment Clause (ECR) — Until May 29, 1998, the Company historically recovered through the ECR, to the extent that such amounts were not included in base rates, the cost of nuclear fuel, fossil fuel and purchased power costs.

Federal Energy Regulatory Commission (FERC) — The FERC is an independent five-member commission within the United States Department of Energy. Among its many responsibilities, the FERC sets rates and charges for the wholesale transportation and sale of electricity.

Market Power — When one company owns a sufficiently large percentage of generation, transmission, or distribution capabilities in a region allowing it to set the market price of electricity.

Obligation to Serve — Under traditional regulation, the duty of a regulated utility to provide service to all customers in its service territory on a non-discriminatory basis.

Pennsylvania Public Utility Commission (PUC) — The governmental body that regulates all utilities (electric, gas, telephone, water, etc.) that do business in Pennsylvania.

Power Station Exchange — Duquesne and FirstEnergy Corporation have an agreement in principle to exchange ownership interests in certain power plants. (See "Rate Matters" on page 39.)

Price to Compare — The Company will provide a credit to a customer for the PUC-determined market price of electric generation. Customers will experience savings to the extent that they can purchase power at a lower price from an alternative electric generation supplier than the amount of the credit.

Provider of Last Resort — The local distribution utility is required to provide electricity for customers who cannot or do not choose an alternative generation supplier, or whose supplier fails to deliver. (See "Rate Matters" on page 39.)

Rate Base — The amount representing the value of assets approved by a regulatory agency for recognition in the rates charged to rate-regulated customers.

Regulatory Assets — Historical ratemaking practices granted exclusive geographic franchises in exchange for the obligation to serve all customers. Under this system, certain prudently-incurred costs were approved by the PUC and the FERC for deferral and future recovery with a return from customers. These deferred costs were capitalized as regulatory assets by the regulated utility.

Restructuring Plan — The Company's plan, approved by the PUC, for restructuring and recovery of transition costs under Pennsylvania's Customer Choice Act.

Stranded Costs — Stranded costs are the net present value of a utility's known or measurable costs related to electric generation that are not recoverable through the CTC.

Tariff — Public schedules that detail a utility's rates, rules, service territory and terms of service; tariffs are filed for official approval with a regulatory agency.

Transition Costs — Transition costs are the net present value of a utility's known or measurable costs related to electric generation that are recoverable through the CTC.

Watt — A watt is the rate at which electricity is generated or consumed. A kilowatt (KW) is equal to 1,000 watts. A kilowatt-hour (KWH) is a measure of the quantity of electricity generated or consumed in one hour by one kilowatt of power. A megawatt (MW) is 1,000 kilowatts or one million watts.

Common Stock

Trading Symbol: DQE
Stock Exchanges Listed and Traded:
New York, Philadelphia, Chicago
Number of Common Shareholders of Record
at Year-End: 68,270

DQE Internet Home Page

A variety of shareholder, customer service and economic development information is available on DQE's home page on the World Wide Web. You also can interact with us via electronic mail. Our address is www.dqe.com.

Shareholder Information Line

Shareholders and potential investors are invited to call 1-888-247-0401 for the latest information on earnings and dividends.

Shareholder Services/Assistance

You can write to us at:

DQE Shareholder Relations
Box 68, Pittsburgh, PA 15230-0068

or call us at:

Toll-free: 1-800-247-0400
In Pittsburgh: 1-412-393-6167
Fax: 1-412-393-6087

By telephone, representatives are available from 7:30 a.m. to 4 p.m. (Eastern time) to assist you with the following services:

- Direct purchase of initial shares
- Direct deposit of dividends
- Automatic cash contributions
- Dividend reinvestment
- Stock transfer requirements
- Dividend payment inquiries
- Change of address
- Lost stock certificate

Please feel free to call at other times. Our Message Center is available 24 hours a day. You can record a message, and our staff will follow up on the next business day.

Financial Community Inquiries

Analysts, investment managers and brokers should direct their inquiries to 1-412-393-4133;
Fax: 1-412-393-4394. Written inquiries should be sent to the Investor Relations Department at Box 68, Pittsburgh, PA 15230-0068.

The DQE logo is a registered trademark of the Company.

E-Fuel® is a registered trademark of Duquesne Energy.

DQE and its affiliated companies are Equal Opportunity Employers.

Stock Certificate Transfers

Individuals who are not participants in the dividend reinvestment plan and who want to transfer stock certificates should send their certificates and related documents to our transfer agent:

First National Bank of Boston
c/o Boston EquiServe
P.O. Box 8040
Boston, MA 02266-8040

Dividend reinvestment plan participants who want to transfer their shares should send their certificates and related documents to DQE Shareholder Relations.

Direct Deposit of Dividends

Your DQE quarterly dividends can be deposited automatically into a personal checking or savings account. Call Shareholder Relations toll-free for more information.

Dividend Tax Status

The Company estimates that all common stock dividends paid in 1998 are taxable as dividend income. This estimate is subject to audit by the Internal Revenue Service.

ElectriStock

The following investor services are available through DQE's dividend reinvestment and stock purchase plan:

Direct Purchase of DQE Stock
DQE offers non-shareholders the ability to purchase common stock directly through the Company. Call, write, or visit our home page at www.dqe.com for a prospectus on this popular program.

Automatic Cash Contributions
Through this program, current reinvestment plan participants can make regular cash contributions to purchase additional shares of DQE common stock by having funds automatically withdrawn from their bank accounts.

Other Features and Services

- Purchase and sale of plan shares at nominal commissions
- Acceptance of certificates for safekeeping
- Re-registration of some or all of a shareholder's holdings
- Creation of new accounts as gifts for family, friends or institutions you support, including a complimentary gift

DQE

Shareholder Relations
Box 68
Pittsburgh, PA 15230-0068

The 1998 DQE Annual Report was printed entirely on recycled paper and is 100% recyclable.

STOCK PURCHASE AGREEMENT

among

AQUASOURCE UTILITY, INC.

and

GOSHEN UTILITIES, INC.

and

THE SHAREHOLDERS OF GOSHEN UTILITIES, INC.

EXHIBIT

C

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STOCK PURCHASE AGREEMENT

THIS STOCK PURCHASE AGREEMENT ("Agreement"), dated as of May 18, 1999, is by and among AquaSource Utility, Inc., a Texas corporation ("Buyer"), Goshen Utilities, Inc., a Kentucky corporation (the "Target Company") and the shareholders of the Target Company set forth on the signature page hereto (the "Shareholders").

ARTICLE I

DEFINITIONS

1.1 Definitions. In this Agreement:

"Agreed Net Working Capital" shall mean the Net Working Capital as agreed to by the parties or as determined by the firm of accountants in accordance with Section 2.4;

"Benefit Plans" shall have the meaning set out in Section 3.12(B);

"Closing" shall mean the consummation of the transactions contemplated by this Agreement;

"Closing Date" shall mean the date on which the Closing occurs;

"Environmental Claim," shall mean any and all administrative, regulatory or judicial actions, suits, demands, demand letters, claims, liens, notices of noncompliance or violation, investigations or other adversarial proceedings relating to any Environmental Law or Environmental Permit including, without limitation (i) any and all claims by governmental, territorial or regulatory authorities for enforcement, cleanup, removal, response, remedial or other similar actions or damages pursuant to any applicable Environmental Law and (ii) any and all claims by a third party seeking damages, contribution, indemnification, cost recovery, compensation or injunctive relief resulting from Hazardous Substances or arising from alleged injury or threat of injury to human health, property, or the environment resulting from exposures to or releases of Hazardous Substances. An

"Environmental Claim" includes, but is not limited to, a common law action, as well as a proceeding to issue, modify, terminate or enforce the provisions of an Environmental Permit or requirement of Environmental Law, or to adopt or amend a regulation to the extent that such a proceeding attempts to redress violations or alleged violations of the applicable permit, license, or regulation;

"Environmental Law" shall mean any federal, state, territorial, local or foreign statute, law, rule, regulation, ordinance, code, policy (compliance with which is required by law or if the failure to comply therewith would be reasonably foreseeable to result in adverse administrative action) or rule of common law in effect and in each case as amended, and any judicial or administrative interpretation thereof, including any judicial or administrative order, consent decree or judgment, relating to the delivery of public drinking water, the environment or Hazardous Substances, including, without limitation to the extent applicable under the circumstances, Kentucky Revised Statutes Chapter 224, The Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986, 42 U.S.C. § 9601 *et seq.*; the Emergency Planning and Community Right-to-Know Act, 42 U.S.C. § 11001 *et seq.*; the Resource Conservation and Recovery Act, 42 U.S.C. § 6901 *et seq.*; the Federal Water Pollution Control Act, 33 U.S.C. § 1251 *et seq.*; the Clean Air Act, 42 U.S.C. § 7401 *et seq.*; the Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. § 136 *et seq.*; the Safe Drinking Water Act, 42 U.S.C. § 300f *et seq.*; the Toxic Substance Control Act, 15 U.S.C. § 2601 *et seq.*; the Oil Pollution Act of 1990, 33 U.S.C. § 2701 *et seq.*; the Hazardous Materials Transportation Act, as amended, 49 U.S.C. § 5101 *et seq.*; the Atomic Energy Act, as amended, 42 U.S.C. § 2011 *et seq.*; any laws regulating the use of biological agents or substances including medical or infectious wastes;

and the corresponding foreign, territorial or state laws, regulations and local ordinances, which may be applicable, as any such acts may be amended;

"Environmental Permits" shall mean all permits, approvals, identification numbers, licenses and other authorizations required under any applicable Environmental Law;

"Financial Statements" shall have the meaning set out in Section 3.5;

"Hazardous Substances" shall mean (i) any chemicals, materials or substances defined as or included in the definition of "hazardous substances," "hazardous wastes," "hazardous materials," "restricted hazardous wastes," "toxic substances," "toxic pollutants," "hazardous air pollutants," "pollutants," "contaminants," "toxic chemicals," "toxics," "hazardous chemicals," "extremely hazardous substances," "regulated substances" or "pesticides" as defined as such in any applicable Environmental Law, (ii) any radioactive materials, asbestos-containing materials; urea formaldehyde foam insulation, and radon in harmful quantities or concentration that are regulated by any governmental authority having jurisdiction in the location of such materials and (iii) any other chemical, material or substances, exposure to which is prohibited, limited or regulated by any governmental authority having jurisdiction in the location of such substances on the basis of potential hazards;

"Intellectual Property Rights" shall have the meaning set out in Section 3.9;

"Knowledge", with respect to Lloyd Eades, shall mean his actual knowledge after making due and reasonable inquiries of the employees of the Company; and, with respect to all other persons, shall mean the actual knowledge of such person;

"Material Adverse Effect" shall mean a material adverse effect on the business, operations, prospects, properties or assets or in the condition (financial or otherwise) of the Target Company;

"Net Working Capital" means the sum of the total current assets of the Target Company, comprising (a) cash, certificates of deposit and cash equivalents held by the Target Company as of the opening of business on the Closing Date, (b) all receivables of the Target Company as of the opening of business on the Closing Date, (c) prepayments made by the Target Company in the ordinary course of business relating to any period following the opening of business on the Closing Date, (d) other current assets of the Target Company as of the opening of business on the Closing Date, minus (i) the value of all current payables, accrued expenses and other current liabilities of the Target Company as of the opening of business on the Closing Date and (ii) any amount of any debt of the Target Company as of the opening of business on the Closing Date, other than indebtedness to First Capital Bank of Kentucky;

"Regulatory Consent" shall mean the consent of the Regulatory Commission to the sale of the Shares hereunder.

"Release" shall mean any release, spill, emission, leaking, pumping, injection, deposit, disposal, discharge, dispersal, leaching or migration of any Hazardous Substance into the environment or into or out of any property, including the movement of any Hazardous Substance through or in the air, soil, surface water, groundwater or property;

"Shares" shall mean all of the issued and outstanding shares of capital stock of the Target Company;

"Taxes" shall mean all income, gross receipts, profits, franchise, sales, use, occupation, property, capital, wealth, environmental, employment, severance, production, excise, stamp, transfer, workers' compensation, social security, withholding, or similar taxes, motor vehicle registration fees, customs or import duties, and all other taxes or all other governmental fees or charges of any nature whatsoever and however denominated, imposed by any country or political subdivision thereof, together with any interest, additions, or penalties with respect thereto; and

"Regulatory Commission" shall mean the Kentucky Public Service Commission.

ARTICLE II

THE ACQUISITION

2.1 Agreement to Purchase and Sell. Upon the terms and subject to the conditions of this Agreement, at the Closing, the Shareholders hereby agree to sell, convey, transfer, assign and deliver to Buyer, and Buyer hereby agrees to purchase from the Shareholders, all of the Shares.

2.2 Purchase Price. The purchase price for the Shares shall, subject to adjustment under Section 2.3, be $3,500,000. The purchase price shall be paid as follows:

(a) At Closing $1,500,000 (less the value of Preferred Stock elected to be received under Section 2.5) shall be paid to The Nance Realty Company by wire transfer of immediately available funds in accordance with wiring instructions to be provided at least two days before the Closing Date;

(b) At Closing, $1,500,000 (less the value of Preferred Stock elected to be received under Section 2.5) shall be paid to Lloyd Eades by wire transfer of immediately available funds in accordance with wiring instructions to be provided at least two days before the Closing Date; and

(c) After Closing, $500,000 shall be paid to Lloyd Eades, without interest, in annual installments of $125,000 on the first, second, third and fourth anniversary of the date of this Agreement. Each such installment shall be paid by wire transfer of immediately available funds in accordance with wiring instructions previously provided by Lloyd Eades.

2.3 Adjustment. The aggregate consideration payable to the Shareholders in cash pursuant to Section 2.2 (the "Cash Consideration") shall be adjusted as follows: If the Agreed Net Working Capital of the Target Company shall be less than $0, the Cash Consideration shall be reduced by such deficit and the Shareholders shall be liable to pay such amount to Buyer within 30 days of the determination of such Agreed Net Working Capital in accordance with Section 2.4. If the Agreed Net Working Capital of the Target Company shall be more than $0, the Cash Consideration shall be increased by such excess and Buyer shall be liable to pay such amount to the Shareholders within 30 days of the determination of such Agreed Net Working Capital in accordance with Section 2.4.

2.4 Net Working Capital.

(a) No later than 30 days after the Closing Date, the Shareholders shall cause the preparation and delivery to Buyer of a statement of Net Working Capital as of the opening of business of the Target Company on the Closing Date (the "Statement"). The Statement shall be prepared in accordance with generally accepted accounting principles consistently applied by the Target Company.

(b) No later than 45 days after receipt of the Statement, Buyer shall notify the Shareholders of any items in the Statement the accuracy and fairness of which it disputes. If Buyer shall have failed to notify the Shareholders within such period of any dispute with respect to the Statement, then the Statement shall be conclusively considered to be true and correct. If Buyer disputes any items of the Statement, Buyer and the Shareholders shall attempt to resolve the disputed items. If such disputed items are not resolved within 60 days after receipt by Buyer of the Statement, Buyer and the Shareholders shall promptly instruct a nationally recognized independent firm of accountants agreed to by the parties to resolve such disputed items. The decision of such firm shall be binding upon the parties, and the fees and expenses of such firm shall be borne one-half by the Shareholders and one-half by Buyer.

2.5 Option. No fewer than 10 days before the Closing Date, either Shareholder may notify Buyer in writing that it wishes to receive a portion of the consideration for the Shares in the form of fully paid and nonassessable shares of Preferred Stock, Series A (Convertible), $100 liquidation preference per share of DQE, Inc., a Pennsylvania corporation, as more particularly described in the Prospectus dated August 22, 1997 (the "Preferred Stock"). The written notice of either Shareholder to the Buyer must specify the percentages of cash and shares of Preferred Stock to be distributed. For this purpose, each such share shall be valued at $100 and the number of shares issued shall be such that the effective dividend rate on such shares shall be 5%. The issuance of any such shares shall be conditional upon such Shareholder making the representations and warranties set out in Exhibit C attached hereto. If either Shareholder makes such an election, the cash payable to such Shareholder under Section 2.2 shall be correspondingly reduced.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF THE SHAREHOLDERS

The term "Disclosure Schedule" means the Disclosure Schedule attached hereto as Exhibit A, and the phrase "set forth in the Disclosure Schedule" means expressly referred to in the Disclosure Schedule or in any of the documents referred to in the Disclosure Schedule. The Shareholders represent and warrant to Buyer the following:

3.1 Corporate Existence and Qualification. The Target Company is a corporation duly organized, validly existing and in good standing under the laws of its state of incorporation, and is duly qualified to do business and is in good standing as a foreign corporation in each state where the character of its properties or the nature of its business requires it to be so qualified. The Target Company has the corporate power to own, operate and lease its properties and to carry on its business as presently conducted.

3.2 Power and Authority; Enforceability. The Target Company has all requisite corporate power and authority to enter into this Agreement and all other documents to be entered into by the Target Company in connection with the consummation of the transactions contemplated hereby and to perform its obligations hereunder and thereunder. The Shareholders have all requisite authority and capacity to enter into this Agreement and all other documents to be entered into by the Shareholders in connection with the consummation of the transactions contemplated hereby. This Agreement and all other documents entered into by the Target Company and the Shareholders in connection with the consummation of the transactions contemplated hereby have been duly authorized, executed and delivered on behalf of the Target Company and the Shareholders and, assuming due authorization, execution and delivery by Buyer, constitutes a legal, valid and binding obligation of the Target Company and the Shareholders enforceable in accordance with its terms, except that (a) such enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or affecting creditors' rights generally and (b) the remedy of specific performance and injunction and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought.

3.3 Capitalization and Ownership. Details of the capital stock of the Target Company are set forth in the Disclosure Schedule. All of the issued and outstanding shares of the Target Company are owned of record and beneficially by the Shareholders, subject to no lien or other encumbrance. All of the issued and outstanding shares of the Target Company are duly authorized, validly issued, fully paid and nonassessable and were not issued in violation of any preemptive or other rights of any person to acquire securities of the Target Company. Except for this Agreement, there are no outstanding options, convertible securities, rights (preemptive or other), warrants, calls or agreements relating to any capital stock of the Target Company.

3.4 No Default or Consents. Neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated herein (a) conflicts with or result in (or with giving of notice or passage of time would result in) a breach, default or violation of (i) any of the terms, provisions or conditions of the charter or bylaws of the Target Company or (ii) any agreement, document, instrument, judgment, decree, order, governmental permit, certificate or license to which the Target Company or such Shareholder is a party or to which it is subject or by which its property is bound, (b) results in the creation of any lien, charge or other encumbrance on any material property or asset of the Target Company or the Shareholders, or (c) requires the Target Company or the Shareholders to obtain the consent of any private non-governmental third party. Except for the Regulatory Consent, no consent, action, approval or authorization of, or registration, declaration or filing with, any governmental department, commission, agency or other instrumentality having jurisdiction over the Target Company or either of Shareholders is required by the Target Company or the Shareholders to authorize the execution and delivery of this Agreement by the Target Company or the Shareholders or the performance of its terms by the Target Company or the Shareholders.

3.5 Financial Statements. The Target Company has delivered to Buyer copies of the unaudited balance sheet of the Target Company as of December 31, 1998, and the related unaudited statement of income of the Target Company for the year then ended (true, complete and accurate copies of which are included in the Disclosure Schedule) (together the "Financial Statements"). The Financial Statements fairly present (i) the financial position of the Target Company as of the date of the Financial Statements and (ii) the results of the operations of the Target Company for the fiscal period ended on such date, all in conformity with generally accepted accounting principles applied on a consistent basis with prior periods (except as otherwise stated therein or in the notes thereto) throughout the period involved. The Target Company does not own any stock or any other equity interest in any other corporation, association or business entity and is not a party to any joint venture or partnership agreement. There are no liabilities, contingent or otherwise, of the Target Company not reflected in the Financial Statements or the Disclosure Schedule.

3.6 No Adverse Changes. Except as set forth in the Disclosure Schedule, since December 31, 1998 there has been (a) no change in (i) the assets, liabilities or financial condition of the Target Company from that set forth in the Financial Statements or (ii) the condition (other than financial) or business of the Target Company, other than, with respect to clauses (i) and (ii) hereof, changes in the ordinary course of business the effect of which changes has not caused, individually or in the aggregate, a Material Adverse Effect, (b) no damage, destruction or loss, whether or not covered by insurance, having a Material Adverse Effect, (c) no labor dispute, other than routine grievances by individual employees, that has caused, individually or in the aggregate, a Material Adverse Effect, (d) no declaration or payment by the Target Company of any dividend or other distribution, in cash or property or other assets, (e) no transfer of any Intellectual Property Rights, (f) no mortgage or pledge of any assets of the Target Company, (g) no contractual obligation entered into by the Target Company providing for obligations of a party thereto of $10,000 or more,

(h) no agreement by the Target Company to borrow money or incur or guarantee indebtedness, or (i) no notice received regarding the termination or cancellation of any contract, to which the Target Company is a party.

3.7 Title to Properties. The Target Company has good and indefeasible title to all of its real properties purported to be owned in fee, and good and merchantable title to all of its personal properties and assets reflected in the Financial Statements, or purported to have been acquired after the date of such Financial Statements (excepting, however, property and other assets, in the aggregate not material to the Target Company, sold or otherwise disposed of subsequent to such date in the ordinary course of business), free of any mortgage, pledge, lien, charge, security interest or other encumbrance, subordination or adverse claim, except as reflected in the Financial Statements, set forth in the Disclosure Schedule or for such imperfections of title and encumbrances as do not individually or in the aggregate materially detract from the value of such property or impair the business or property of the Target Company. The Target Company enjoys peaceful and undisturbed possession under all permits or leases under which it is operating, and all such leases are valid, subsisting and in full force and effect. The Target Company has not been advised of a breach of any such permit or lease and to the Knowledge of the Shareholders there is no basis for any such breach to be threatened. Except as set forth in the Disclosure Schedule, neither any director or officer of the Target Company nor either of the Shareholders owns or has any interest (other than as shareholder) in any property, real or personal, tangible or intangible, used in the business of the Target Company.

3.8 Litigation, Judgments, Etc. Except as set forth in this Disclosure Schedule, there are no actions, claims, suits, investigations or proceedings to which the Target Company is a party pending or, to the Knowledge of the Shareholders, threatened in any court or before or by any federal, state or other governmental department, commission, agency or other instrumentality (excluding any rulemaking, investigation or similar proceeding of general applicability and any appeal or petition for review relating thereto), or before any arbitrator, that may have a Material Adverse Effect or which seeks to prohibit, restrict or delay consummation of the transactions contemplated hereby. The Target Company is not in default with respect to any judgment, order, writ, injunction, decree or award applicable to it of any court or other governmental instrumentality or arbitrator having jurisdiction over it. The Target Company has all permits, certificates, licenses, approvals, and other authorizations which are required in connection with the operation of its business, all such permits, certificates, licenses, approvals and other authorizations are in full force and effect and, to the Knowledge of the Shareholders, there is no basis for any breach thereof to be threatened. The Target Company is exercising reasonable efforts, to the extent customary in its businesses, to comply with all statutes, rules and regulations applicable to it of governmental authorities having jurisdiction over it, and is not in violation of or in default with respect to any statute, or any rule or regulation applicable to it of any governmental authority having jurisdiction over it, which violation or default individually or in the aggregate may have a Material Adverse Effect.

3.9 Intellectual Property Rights. The Disclosure Schedule sets forth a list of all patents, patent applications, trademarks (whether registered or not), trademark applications, trade names, copyrights, patent or know-how licenses (wherein the Target Company is either licensee or licensor), used in the ordinary course of business of the Target Company (the "Intellectual Property Rights"). The Intellectual Property Rights are owned, lawfully possessed or used by the Target Company. No past due royalties or other payments subsequent to the Closing Date are or will be required to be paid to any person, firm or corporation who is the licensor under any license agreements as they presently exist. The Target Company is not in default in any material respect of any obligation with respect to any agreement with others concerning the Intellectual Property Rights. There is no existing or, to the Knowledge of the Shareholders, threatened infringement, misuse or misappropriation by others of the Intellectual Property Rights. There is no pending or, to the Knowledge of the Shareholder, threatened claim by the Target Company against others for any such infringement, misuse or misappropriation and there is no pending judicial proceeding involving any claim. The Target Company has not received any written notice or claim of any infringement, misuse or misappropriation by the Target Company of any patent, trademark, trade name, copyright, intellectual property rights license or similar right owned by any third party.

3.10 Contractual Obligations.

(A) Except as set forth in the Disclosure Schedule or the Financial Statements, the Target Company is not a party to any of the following, whether written or oral:

(i) express or implied contract for the employment of any individual employee that cannot be terminated by the Target Company without penalty within 30 days;

(ii) collective bargaining agreement or other contract with any labor union;

(iii) lease under which it is the lessee of real or personal property which lease (a) is not terminable without penalty on less than 30 days' notice and (b) provides for annual base rental payments in excess of $10,000;

(iv) contract for the future purchase or sale of materials, supplies, equipment or services that is not terminable without penalty on less than 30 days' notice;

(v) agreement that purports to limit its freedom to compete in any line of business or in any geographic area or to borrow money or incur or guarantee indebtedness;

(vi) tax sharing agreement that will survive the Closing Date; and

(vii) agreement with either or both of the Shareholders or any person or entity controlled, directly or indirectly, by either or both of the Shareholders.

(B) Except as set forth in the Disclosure Schedule, the Target Company is not a party to any written or oral contract relating to the borrowing of money or the guaranty of any obligation for the borrowing of money.

(C) The Target Company is not in default, or but for a requirement that notice be given or that a period of time elapse or both, would be in default, under any contract, agreement, lease or other instrument to which it is a party or by which it or its properties is bound which default may have a Material Adverse Effect.

(D) The Shareholders have no Knowledge of any default in any obligation to be performed by any party to any material contract to which the Target Company is a party.

3.11 Taxes.

(A) All returns of Taxes, information and other reports required to be filed in any jurisdiction by the Target Company (collectively, "Tax Returns") have been timely filed and all such Tax Returns are true, correct and complete in all material respects. All Taxes applicable to the Target Company or any of its properties which are due and payable have been paid. The Shareholders have no Knowledge of any proposed assessment of Taxes, interest or penalties against the Target Company. The Target Company has not given or been requested to give waivers or extensions (or is or would be subject to a waiver or extension given by any other entity) of any statute of limitations relating to payment of any Taxes with respect to the Target Company or for which the Target Company may be liable. All Taxes that the Target Company is or was required by law to withhold or collect through the Closing Date, have been duly withheld or collected, and, to the extent required, have been paid to the proper taxing authority or other person.

(B) No audits or other administrative proceedings or court proceedings are presently pending with regard to any Taxes or Tax Returns of the Target Company, nor has the Target Company received a ruling from the Internal Revenue Service or entered into any agreement regarding Taxes with any taxing authority that may, individually or in the aggregate, have a Material Adverse Effect after the date hereof.

3.12 Employee Benefit Plans.

(A) Except as set forth in the Disclosure Schedule, the Target Company does not maintain, sponsor, participate in or contribute to, and is not required to contribute to, directly or indirectly, or have any obligation under:

(i) Any employee benefit plan, employee pension benefit plan, employee welfare benefit plan (including any medical, dental, disability, accident or sickness, salary continuation or life insurance plan or arrangement), or multiemployer plan, all as defined in the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), regardless of whether or not a plan is exempt from some or all of the otherwise applicable requirements of ERISA; or

(ii) Any bonus, deferred compensation, incentive compensation, restricted stock, stock purchase, stock option, stock appreciation right, debenture, supplemental pension, profit sharing, royalty pool, severance or termination pay plan, supplemental unemployment benefits plan, loan guarantee, relocation assistance, employee loan or other extensions of credit, or other similar plan, program, agreement, policy, commitment, arrangement or benefit currently in effect under which current or former employees or their dependents, beneficiaries, representatives or estates are currently or will in the future be entitled to benefits.

(B) With respect to each plan, program, policy or benefit referred to in the Disclosure Schedule (each, a "Benefit Plan"):

(i) Each Benefit Plan has been operated and administered in accordance with its terms and applicable laws, including but not limited to ERISA and the Internal Revenue Code of 1986, as amended (the "Code"). Each Benefit Plan that is intended to be qualified under the Code either has received from the Internal Revenue Service, or timely applied for, a determination letter on such Benefit Plan's qualified status.

(ii) Neither the Target Company nor any other party in interest (within the meaning of ERISA) has engaged in any non-exempt prohibited transaction with respect to any Benefit Plan under ERISA, the Code, and, to the Knowledge of the Shareholder, there is no pending assertion of the occurrence of any such transaction.

(iii) All contributions required under applicable law or the terms of any Benefit Plan, collective bargaining agreement or other agreement relating to a Benefit Plan to be paid by the Target Company for all periods prior to the Closing Date have been completely and timely made to each Benefit Plan when due, and the Target Company has established adequate reserves on its books to meet liabilities for contributions accrued but that have not been made because they are not yet due and payable.

(iv) There is no current or pending investigation or audit by the Internal Revenue Service, the Department of Labor or any other governmental entity of any Benefit Plan, nor has the Target Company received notification from any such governmental entity of such a pending audit or investigation, and there are no actions, suits or claims pending (other than routine claims for benefits) or threatened, with respect to any Benefit Plan or against the assets of any such Benefit Plan.

(v) No Benefit Plan is or ever has been a plan subject to Title IV of ERISA, Part 3 of Subtitle B of Title I of ERISA or Section 412 of the Code, or is or ever has been a multiemployer plan as defined in Section 3(37) of ERISA or Section 414(f) of the Code.

(vi) The Target Company has substantially complied with all notice and continuation coverage requirements applicable to group health plans under the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA"), with respect to all medical and health benefits provided by the Target Company that are subject to COBRA.

(C) There are no members of a "controlled group" of organizations (as defined in Section 414(b), (c), (m) or (o) of the Code) with the Target Company which sponsor or maintain any employee benefit plan within the meaning of Section 3(3) of ERISA which under Title IV of ERISA or any section of the Code or ERISA would subject the Target Company or any of its employee benefit plans or the fiduciaries thereof or their respective assets to any taxes, encumbrances, penalties or other liabilities.

3.13 Charter Documents. The Target Company has delivered to Buyer complete, true and accurate copies of its charter documents and bylaws as currently in effect.

3.14 Insurance. The Disclosure Schedule sets forth the issuers of and the amounts of coverage of all insurance policies which are owned by the Target Company and complete, true and accurate copies of such policies have been supplied to Buyer. All of such insurance policies are in full force and effect.

3.15 Environmental Matters.

(A) Except as set forth in the Disclosure Schedule, (i) the Target Company has obtained all Environmental Permits that are required in connection with the business, operations and properties of the Target Company, (ii) the Target Company has been, and the Target Company is, in compliance with all terms and conditions of all applicable requirements of Environmental Law and Environmental Permits, (iii) the Target Company has not received any written notice from a governmental authority of any violation, alleged violation, or liability arising under any requirements of Environmental Law or Environmental Permits, (iv) no Environmental Claims have ever been threatened or asserted or are presently pending against the Target Company attributable to present or past operations on premises owned, leased or operated by the Target Company, and (v) to the Knowledge of the Shareholders no condition or set of facts or circumstances exists that could reasonably be expected to give rise to an Environmental Claim against either Company.

(B) Except as set forth in the Disclosure Schedule, the Target Company has not disposed, treated, or arranged for the disposal or treatment of any toxic or hazardous waste, materials or substances at a site or location, or has leased, used, operated or owned a site or location which (i) has been placed on the National Priorities List or its state equivalent pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act, as amended ("CERCLA"), or similar foreign, territorial or state law, (ii) the Environmental Protection Agency or relevant foreign, territorial or state authority has proposed, or is proposing, to place on the National Priorities List or foreign, territorial or state equivalent, (iii) is subject to a lien, administrative order or other demand either to take response or other action under CERCLA or other Environmental Law, or to develop or implement a "Corrective Action Plan" or "Compliance Plan," as each is defined in regulations promulgated pursuant to the Resource Conservation and Recovery Act, as amended, or to reimburse any person who has taken response or other action in connection with that site, (iv) is on any Comprehensive Environmental Response Compensation Liability Information System List, (v) has been the site of any Release from present or past operations of the Target Company (or any of its predecessors) which would be either reportable under any requirements of Environmental Law or which has caused at such site or any third party site any condition that has resulted in or could reasonably be expected to result in a claim against the Target Company under Environmental Law, or (vi) to the Knowledge of the Shareholders, is located within one mile of a property described in any of subclauses (i) through (iv) above.

(C) Except as set forth in the Disclosure Schedule, (i) the Target Company has never owned or operated any underground storage tanks (USTs) containing petroleum products or wastes or other substances regulated by 40 CFR Part 280 or other applicable requirements of Environmental Law, or has owned or operated any real estate having any USTs, (ii) to the Knowledge of the Shareholders, there are no polychlorinated biphenyl or asbestos in or on premises currently owned, leased or operated by the Target Company, and (iii) no entities or sites owned or operated by third parties have been used by the Target Company in connection with the treatment, storage, disposal or transportation of Hazardous Substances, except in compliance with applicable Environmental Law and except for such violations that have been remedied.

(D) Except as set forth in the Disclosure Schedule, the plants, structures, equipment and other properties currently owned or used by the Target Company are adequate and sufficient for the current operations of the Target Company in conformance with all applicable requirements of Environmental Law.

3.16 Personnel. The Disclosure Schedule sets forth a list of all officers, directors, employees, and consultants and agents with whom the Target Company has agreements not terminable at the will of the Target Company (by type or classification) and their respective rates of compensation (including the portions thereof attributable to bonuses), including any other salary, bonus or other payment arrangement made with any of them.

3.17 Accounts and Notes Receivable. All accounts receivable of the Target Company are (a) bona fide claims against debtors for work performed or other charges, (b) to the Knowledge of the Shareholders, subject to no defenses, set-offs or counterclaims, and (c) collectible subject to the Target Company's normal reserve for bad debts. The Disclosure Schedule sets forth a list of all notes receivable of the Target Company not shown in the Financial Statements.

3.18 Condition of Assets. Since December 31, 1998, the Target Company has operated, maintained and repaired its tangible assets in the ordinary course of business in a manner consistent with past practice. Such assets are capable of being used without the present need for repair or replacement except in the ordinary course of business in a manner consistent with the Target

Company's past practice. Complete and accurate details of such assets are set forth in the Disclosure Schedule.

3.19 Real Property. Except as set forth on the Disclosure Schedule, the Target Company's ownership and use of its real properties and the location, construction, occupancy, operation and use thereof are in compliance with (a) all applicable laws, rules and regulations of any governmental authority (including, without limitation, those regulating the environment, health and safety), (b) all applicable decrees, orders, injunctions and other decisions of any court, arbitrator, governmental authority or administrative agency with jurisdiction over the Target Company, (c) all leases, easements, rights-of-way and other instruments creating or establishing any rights over such properties, and (d) all agreements, contracts, leases, deed restrictions and restrictive covenants, whether or not recorded in the public records, affecting the same. None of such real properties has been condemned, requisitioned or otherwise taken by any governmental authority, and no such condemnation, requisition or other taking is pending or, to the Knowledge of the Shareholders, contemplated.

3.20 Accurate and Complete Records. The books, ledgers, financial records and other records of the Target Company for the period of time which is not less than three years prior to the date hereof or any such longer period as may be required by applicable laws or regulations:

(a) are in the possession of the Target Company;

(b) have been, in all material respects, maintained in accordance with all applicable laws, rules and regulations and generally accepted standards of practice; and

(c) are accurate and complete and do not contain or reflect any material discrepancies.

3.21 Brokerage Arrangements. Neither the Target Company nor either of the Shareholders have entered (directly or indirectly) into any agreement with any person, firm or corporation that would obligate Buyer to pay any commission, brokerage or "finder's fee" in connection with the transactions contemplated herein.

3.22 No Misleading Statements. The representations and warranties of the Shareholders contained in this Agreement, the Disclosure Schedule and all other documents and information furnished to Buyer and its representatives pursuant hereto do not and will not include any untrue statement of a material fact.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES OF BUYER

Buyer hereby represents and warrants to the Shareholders as follows:

4.1 Organization. Buyer is a corporation duly organized, validly existing and in good standing under the laws of the State of Texas with corporate power to carry on its business as now being conducted.

4.2 Power and Authority; Enforceability. Buyer has all requisite corporate power and authority to enter into this Agreement and all other documents to be entered into by Buyer in connection with the consummation of the transactions contemplated hereby and to perform its obligations hereunder and thereunder. This Agreement and all other documents entered into by Buyer in connection with the consummation of the transactions contemplated hereby have been duly authorized, executed and delivered on behalf of Buyer and, assuming due authorization, execution and delivery by the Target Company and the Shareholder, constitutes a legal, valid and binding obligation of Buyer enforceable in accordance with its terms, except that (a) such enforcement may be limited by bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or affecting creditors' rights generally and (b) the remedy of specific performance and injunction and other forms of equitable relief may be subject to equitable defenses and to the discretion of the court before which any proceeding therefor may be brought.

4.3 No Default or Consents. Neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated herein (a) conflict with or result in (or with giving of notice or passage of time would result in) a breach, default or violation of (i) any of the terms, provisions or conditions of the charter or bylaws of Buyer or (ii) any material agreement, document, instrument, judgment, decree, order, governmental permit, certificate or license to which Buyer is a party or to which it is subject or by which its property is bound, or (b) result in the creation of any lien, charge or other encumbrance on any material property of Buyer, or (c) require Buyer to obtain the consent of any private non-governmental third party. Except for the Regulatory Consent, no consent, action, approval or authorization of, or registration, declaration or filing with, any governmental department, commission, agency or other instrumentality having jurisdiction over Buyer is required by Buyer to authorize the execution and delivery of this Agreement by Buyer or the performance of its terms by Buyer.

ARTICLE V

AGREEMENTS THROUGH CLOSING

From the date of this Agreement through the Closing:

5.1 Access. The Target Company shall keep Buyer informed regarding the continuing operation of the business of the Target Company and shall permit Buyer and its authorized employees, agents, accountants, legal counsel and other representatives to have access to the books, records, plants, facilities, properties, personnel and officers of the Target Company for the purpose of conducting an investigation of its financial condition, corporate status, business properties and assets; provided, however that such investigation shall be conducted in a manner that does not interfere with normal operations of the Target Company.

5.2 Restrictions. Except as otherwise contemplated in this Agreement, without the consent of Buyer, the Target Company shall not:

(a) increase the rate or form of compensation payable to any employee or increase any employee benefits, except increases in compensation and benefit changes made in the ordinary course of business in accordance with established policies and past practice;

(b) declare or pay any dividend or make a distribution in cash, property or other assets (not including distributions in the ordinary course of business of cash in the course of paying obligations owed by the Target Company) provided the Net Working Capital shall not thereby be reduced below $zero;

(c) acquire or dispose of any properties or assets, except in the ordinary course of business;

(d) engage in any one or more activities or transactions outside the ordinary course of business;

(e) transfer any Intellectual Property Rights, except in the ordinary course of business;

(f) create, incur, assume, guarantee or otherwise become liable or obligated with respect to any indebtedness, or make any loan or advance to, or any investment in, any person or entity;

(g) enter into a contractual obligation providing for obligations of a party thereto of $10,000 or more;

(h) file any motions, orders, briefs, settlement agreements or other papers in any proceeding before any court of any federal, state or other governmental department, commission or agency or any arbitrator except with respect to pending proceedings where positions advanced are substantially consistent with previous positions;

(i) issue any securities relating to its capital stock; grant, or enter into any agreement to grant, any options, convertibility rights, other rights, warrants, calls or agreements relating to its capital stock; or redeem, repurchase or otherwise reacquire any of its capital stock;

(j) maintain its books of account other than in the usual, regular and ordinary manner and on a basis consistent with prior periods or make any change in any of its accounting methods or practices;

(k) allow the expiration, termination or cancellation of any of the insurance policies listed in the Disclosure Schedule, unless it is replaced, with no loss of coverage, by a comparable insurance policy; or

(l) agree or commit to do any of the foregoing.

5.3 <u>Regulatory Compliance</u>. Prior to the Closing, the Target Company will comply in all material respects with all applicable local, state and federal laws, rules and regulations, judgments, decrees, orders, governmental permits, certificates and licenses, including without limitation those relating to the filing of reports and the payment of income, franchise and other taxes due to be paid prior to the Closing.

5.4 Continued Operation of Business. Prior to the Closing, the Target Company shall use, to the extent required for continued operation of its business without impairment, reasonable business efforts, (a) to preserve substantially intact its business organization, (b) to keep available the services of its employees, and (c) to preserve its present relationships with persons having significant business relations therewith.

5.5 Reasonable Business Efforts. Buyer and the Shareholders shall use their reasonable business efforts to ensure that all of the conditions to the obligations of the Shareholders and Buyer contained in Sections 6.2 and 6.3 respectively are satisfied timely (unless waived in accordance with Article VI).

ARTICLE VI

CLOSING

6.1 Closing. The Closing shall be held at the offices of Ackerson, Mosley & Yann, 1200 One Riverfront Plaza, Louisville, Kentucky 40202, within five days of the fulfillment of the conditions set out in Sections 6.2 and 6.3, or at such other place and time, or on such other date as the parties may agree.

6.2 Closing Obligations of Buyer. The obligation of Buyer to consummate the transactions contemplated by this Agreement is subject, at the option of Buyer, to the satisfaction or waiver of the following conditions:

(a) Resolutions of the Target Company. The Shareholders shall furnish Buyer with certified copies of resolutions duly adopted by the Board of Directors of the Target Company authorizing the execution, delivery and performance of this Agreement;

(b) The Target Company's Corporate Documents. The Shareholders shall deliver to Buyer (i) the Stock and Minute Books and Corporate Seal of the Target Company, (ii) certified copies of the certificate of incorporation and bylaws of the Target Company, and (iii) certificates of good standing from the state of incorporation of the Target Company and all states where it is qualified to do business as a foreign corporation;

(c) Stock Certificates. The Shareholders shall surrender his and its Target Company stock certificates to Buyer duly endorsed or with a blank stock power attached thereto;

(d) Directors and Officers. The Shareholders shall furnish Buyer with written resignations of all directors and officers of the Target Company in form reasonably acceptable to Buyer;

(e) Representations and Warranties of the Shareholder. The representations and warranties of the Shareholders contained herein will be accurate at and as of the Closing Date as though such representations and warranties had been made at and as of such date; all terms, covenants and conditions of this Agreement to be complied with and performed by the Shareholders and the Target Company at or prior to the Closing will have been duly complied with and performed; and the Shareholders will have delivered to Buyer a certificate dated as of the Closing Date and signed by an officer of the Target Company to the foregoing effect;

(f) Statutory Compliance. All statutory requirements for the valid consummation of the transactions contemplated herein shall have been fulfilled and all governmental consents, approvals or authorizations necessary for the valid consummation of the transactions contemplated herein shall have been obtained;

(g) No Action, Suit, etc. No action, suit or proceeding shall have been commenced, pending or threatened, and no statute, rule, regulation or order shall have been proposed, enacted, promulgated or issued or deemed applicable to the transactions contemplated by this Agreement, by any United States federal or state government or governmental agency or instrumentality or court or private non-governmental person or entity, which, in the opinion of Buyer's counsel, reasonably may be expected to, (i) prohibit Buyer's ownership or operation of all or a material portion of Buyer's or the Target Company's business or assets, or compel Buyer to dispose of or hold separate all or a material portion of Buyer's or the Target Company's business or assets, as a result of the transactions contemplated by this Agreement or (ii) render Buyer unable to consummate the transactions contemplated by this Agreement; and

(h) Due Diligence. The completion of a Phase I Report regarding the facilities of the Target Company and, if recommended, the completion of a Phase II Report, each performed at Buyer's expense pursuant to ASTM Protocol, and the contents of each such report being to the reasonable satisfaction of Buyer. The completion by Buyer of its due diligence review of the businesses of the Target Company.

6.3 Closing Obligations of the Shareholders and the Target Company. The obligation of the Shareholders and the Target Company to consummate the transactions contemplated by this

Agreement is subject, at the option of the Shareholders, to the satisfaction or waiver of the following conditions:

(a) Payment of Consideration. Buyer shall pay to the Shareholders in accordance with Section 2.2;

(b) Resolutions of Buyer. Buyer shall furnish the Shareholders with certified copies of resolutions duly adopted by the Board of Directors of Buyer authorizing the execution, delivery and performance of this Agreement;

(c) Buyer's Corporate Documents. Buyer shall furnish the Shareholders with certified copies of its articles of incorporation and bylaws;

(d) Representations and Warranties of Buyer. The representations and warranties of Buyer contained herein will be accurate at and as of the Closing Date as though such representations and warranties had been made at and as of such date; all terms, covenants and conditions of this Agreement to be complied with and performed by Buyer at or prior to the Closing will have been duly complied with and performed; and Buyer will have delivered to the Shareholders a certificate dated as of the Closing Date and signed by an officer of Buyer to the foregoing effect;

(e) Statutory Compliance. All statutory requirements for the valid consummation of the transactions contemplated herein shall have been fulfilled and all governmental consents, approvals or authorizations necessary for the valid consummation of the transactions contemplated herein shall have been obtained; and

(f) No Action, Suit, etc. No action, suit or proceeding shall have been commenced, pending or threatened, and no statute, rule, regulation or order shall have been proposed, enacted, promulgated or issued or deemed applicable to the transactions contemplated by this Agreement, by any United States federal or state government or governmental agency or instrumentality or court or private non-governmental person or entity, which, in the opinion of the Shareholders' counsel, reasonably may be expected to render the Shareholders or the Target Company unable to consummate the transactions contemplated by this Agreement.

ARTICLE VII

INDEMNITY

7.1 Indemnity. Subject to the provisions of Sections 7.5 and 7.6, Buyer shall indemnify and hold harmless the Shareholders and their heirs, and permitted successors and assigns ("Seller Indemnified Parties") from and against any claim, liability, loss, cost, damage or expense (including, without limitation, court costs and reasonable attorneys' fees and expenses) (a "Claim") arising out of, resulting from or in any way related to the breach of, or the failure to perform or satisfy any of, the representations and warranties made by Buyer in this Agreement, Buyer shall reimburse Seller Indemnified Parties for any legal or other expenses reasonably incurred by Seller Indemnified Parties in connection with investigating or defending any such Claim as such expenses are incurred.

Subject to the provisions of Sections 7.5 and 7.6, the Shareholders shall, jointly and severally, indemnify and hold harmless Buyer, the Target Company and their respective officers, directors, shareholders, employees, agents and their permitted successors and assigns ("Buyer Indemnified Parties") from and against any Claim arising out of, resulting from or in any way related to :

(a) a breach of or the failure to perform or satisfy any of, the representations, warranties and covenants made by either Shareholder in this Agreement;

(b) violations or claimed violations of any Environmental Laws or Environmental Permits alleged by any party which relate in any way to the ownership, occupancy, use, operation, or conditions of present or former properties of the Target Company on or before the Closing Date;

(c) any Environmental Claim which relates in any way to the ownership, occupancy, use, operation, or conditions of present or former properties of the Target Company on or before the Closing Date;

(d) any cleanup or remediation requirement or liability respecting a Release or threatened Release of any Hazardous Substances to the extent that those Hazardous Substances are present at any present or former properties of the Target Company on or before the Closing Date;

(e) any cleanup or remediation requirement respecting a Release or threatened Release of any Hazardous Substances at any facility or location to which materials generated by the Target Company were shipped on or before the Closing Date;

(f) any cleanup or remediation requirement or liability or any other Environmental Claim or other liability which are alleged or asserted against the Target Company arising from or relating in any way to any past or present contamination or corrective action activities at, on, under, or around the location referred to as the Arelco Plastics Fabricating facility, located at 1430 North Highway 1793, Goshen, Kentucky, 40026, including without limitation any contamination or corrective action relating in any way to any current or former septic system at that facility; or

(g) any Taxes attributable to the Target Company with respect to any taxable periods or portions thereof ending on or before the Closing Date to the extent not fully accrued on the Financial Statements.

The Shareholders shall reimburse Buyer Indemnified Parties for any legal or other expenses reasonably incurred by Buyer Indemnified Parties in connection with investigating or defending any such Claim as such expenses are incurred.

7.2 Limitation with respect to Taxes. In the event of any claim for indemnification or other claim against the Shareholders for Taxes under any provision contained in this Agreement, it is agreed that the amount of such claim shall be reduced by:

(a) the present value of any actual tax benefit realized by the Target Company (less any reductions for expense incurred in determining and asserting such tax benefit), whether attributable to increased depreciation deductions or otherwise, resulting from the tax assessment which gave rise to the claim against the Shareholders; provided, however, the Target Company shall have no duty to pursue the realization of any such tax benefits until it is notified by the Shareholders of such benefits and the pursuant of such tax benefits must be consistent with all other positions taken by the Target Company for tax purposes; and

(b) the present value of any increase in tariff allowed by the Kentucky Public Service Commission as a result of the Taxes which gave rise to a claim against the Shareholders. If there appears to be a reasonable basis for a tariff increase as a result of such Taxes, the Target Company shall make a good faith effort to seek and obtain such tariff increase. If there does not appear to be a reasonable basis for a tariff increase, the Target Company shall have no obligation to seek any tariff increase.

7.3 Notice.

(a) As used in this Section 7.3, the term "Indemnified Party" shall mean any Seller Indemnified Party or any Buyer Indemnified Party, as the case may be, which is asserting a claim for indemnity hereunder. Any party against whom a claim for indemnification is asserted by an Indemnified Party pursuant to this Article VII is referred to herein as an "Indemnifying Party." In the event that any Claims are asserted against or sought to be collected from an Indemnified Party by a person who is not a Buyer Indemnified Party or a Seller Indemnified Party (a "Third Party"), such Indemnified Party shall give prompt notice to the Indemnifying Party of such event ("Claim Notice"). A Claim Notice shall specify, to the extent known by the Indemnified Party, the nature of and specific basis for any Claims or the nature of and specific basis of any suit, action, investigation or proceeding set forth therein and the amount or the estimated amount thereof to the extent then practicable. Any failure on the part of any Indemnified Party promptly to provide a Claim Notice to the Indemnifying Party shall relieve the Indemnifying Party of such party's obligation under this Article VII only to the extent that the Indemnifying Party has been prejudiced by the lack of timely and adequate notice to the Indemnifying Party.

(b) The Indemnifying Party shall have 30 days from the delivery or receipt of a Claim Notice ("Notice Period") to notify the Indemnified Party (i) whether or not it disputes the liability of the Indemnifying Party to the Indemnified Party hereunder with respect to the Claims identified in the Claim Notice, and (ii) whether or not it desires to assume the defense of the Third Party Claim identified in the Claim Notice; provided, however, that any Indemnified Party is hereby authorized during the Notice Period to file any motion, answer or other pleading that shall be necessary or appropriate to protect its interest or those of the Indemnifying Party. In the event that the Indemnifying Party notifies the Indemnified Party within the Notice Period that it desires to defend the Indemnified Party against the Claims identified in the Claims Notice, the Indemnifying Party shall have the right and obligation, at its sole cost and expense, to defend with counsel of its own choosing by all appropriate proceedings, which proceedings shall be properly and diligently settled or prosecuted to a final non-appealable order of a court of competent jurisdiction; provided, however, that (a) the Indemnified Party shall at all times have the right, at its sole option and expense, to employ separate counsel and to participate fully in the defense, compromise or settlement thereof, and (b) if the Indemnifying Party does not proceed diligently to defend the Claim within 30 days after personal delivery or receipt of a Claim Notice, the Indemnified Party shall have the right, but not the obligation, to undertake the defense of any such Claim and the Indemnifying Party shall be bound by any defense or settlement that the Indemnified Party may make as to such Claim. Upon its assumption of the defense of any such Claim, the Indemnifying Party shall have full control of such defense and proceedings including any compromise or settlement thereof. If there is more than one Indemnifying Party, then all Indemnifying Parties must coordinate the defense of the Indemnified Party against any Claims so as not adversely to affect the Indemnified Party's right to a proper defense.

(c) The parties agree reasonably to cooperate with one another and their respective counsel in contesting and defending any Third Party Claim (including granting reasonable access to the pertinent books, records and personnel in their possession or control, or in the possession or control of the Target Company) or, if appropriate and related to the Claim in question, in making (i) any counterclaim against the Third Party asserting the Claims, or (ii) any cross complaint against any person.

(d) Notwithstanding anything in this Section 7.3 to the contrary, the Indemnifying Party shall not, without the written consent of the Indemnified Party (i) settle or compromise any Claim or consent to the entry of any judgment with respect to such Claim that does not include as an unconditional term thereof the delivery by the claimant or plaintiff to the Indemnified Party of a written release from all liability in respect to such Claim, (ii) settle or compromise any Claim in any manner that may materially and adversely affect the Indemnified Party, or (iii) settle or compromise any Claim in a manner that will require the Indemnified Party to pay any money.

(e) If the Indemnifying Party fails to notify the Indemnified Party within the Notice Period that the Indemnifying Party elects to defend the Indemnified Party pursuant to Section 7.3(b), or if the Indemnifying Party elects to defend the Indemnified Party pursuant to Section 7.3(b), but fails diligently and promptly to prosecute, defend or settle any Third Party Claim, then the Indemnified Party shall have the right to defend, or compromise and settle at the sole cost and expense of the Indemnifying Party, the Third Party Claim by all appropriate proceedings, which proceedings may be prosecuted by the Indemnified Party to a final non-appealable order of a court of competent jurisdiction or settled without the consent of the Indemnifying Party. The Indemnified Party shall have full control of such defense and proceedings.

(f) In the event any Indemnified Party should have a Claim against any Indemnifying Party hereunder that does not involve damages being asserted against or sought to be collected from it by a Third Party, the Indemnified Party shall send a Claim Notice containing the same type of information required by Section 7.3(a) with respect to such Claim to the Indemnifying Party. If the Indemnifying Party does not notify the Indemnified Party within the Notice Period that it disputes such Claim, the amount of such damages shall (unless it shall not have been reasonably practicable for the Indemnifying Party to give such notification) be conclusively deemed a liability of the Indemnifying Party hereunder.

7.4 Other Indemnification Rights. To the extent other provisions of this Agreement or applicable law provide for indemnification, the indemnification rights provided for in this Article VII are in addition to those other provisions or applicable law, but no party may recover more than once for the same events or amounts.

7.5 Limitation of Liability. Notwithstanding any other provision hereof, (a) the Shareholders shall have no liability for any breaches of any representation or warranty as a result of a circumstance or fact of which the Shareholders shall have been unaware and should not reasonably have been aware ("Unknown Breaches") unless the aggregate liabilities for all such breaches exceeds \$10,000, (b) the aggregate liability of the Shareholders under this Agreement shall not exceed \$3,500,000, and (c) any liability of the Shareholders under this Agreement shall be reduced to the extent that recovery in respect thereof may be made under any liability insurance policy of the Target Company.

7.6 Survival. The representations and warranties provided under this Agreement shall survive Closing for 18 months and the Shareholders shall have no liability in relation thereto unless

Buyer shall have given the Shareholders a Claim Notice in accordance with Section 7.3 prior to the expiration of such 18 month period; provided, however, that matters involving Taxes and those under Section 3.3 shall survive until the expiration of the applicable statute of limitation. No claim for indemnification may be made by Buyer pursuant to Sections 7.1(b), (c), (d) or (e) unless notification thereof shall have been given to the Shareholders within 18 months after the Closing Date.

ARTICLE VIII

TERMINATION

8.1 Termination. This Agreement may be terminated at any time prior to the Closing Date solely:

(a) by consent of the Shareholders and Buyer;

(b) by the Shareholders or by Buyer, if the transactions contemplated by this Agreement to take place at the Closing shall not have been consummated by the last business day of the sixth month after the date hereof, unless the failure of such transactions to be consummated is due to the willful failure of the party seeking to terminate this Agreement to perform any of its obligations under this Agreement to the extent required to be performed by it prior to or on the Closing Date; or

(c) by the Shareholders or by Buyer, if a material breach or default shall be made by the other party in the observance or in the due and timely performance of any of the covenants or agreements contained herein, and the curing of such default shall not have been made within ten days after written notice thereof is delivered to the breaching or defaulting party by the other party.

8.2 Liabilities in Event of Termination. The termination of this Agreement will in no way limit any obligation or liability of any party based on or arising from a breach or default by such party with respect to any of its representations, warranties, covenants or agreements contained in this Agreement including, but not limited to, legal and audit costs and out of pocket expenses.

ARTICLE IX

MISCELLANEOUS

9.1 Non-Competition.

(a) For two years following the Closing Date (the "Restricted Period"), neither Shareholder shall in the Territory, directly or indirectly, compete with Buyer or its Affiliates in any manner, on behalf of such Shareholder or any other person, firm, business or corporation, including, without limitation, such that neither Shareholder shall (i) engage in the Business; (ii) enter the employ of, or render any services to, any Person engaged in the Business other than the Target Company, the Buyer, or an affiliate of same; (iii) become interested in any such Person engaged in the Business as an individual, partner, shareholder, officer, director, licensor, licenses, principal, agent, employee, trustee, consultant or in any other relationship or capacity; provided, however, that either Shareholder may own, directly or indirectly, solely as an investment, securities of any Person which are traded on any national securities exchange if such Shareholder (A) is not a controlling Person of, or a member of a group which controls, such person or (B) does not, directly or indirectly, own 1% or more of any class of securities of such person; or (iv) request or instigate any account or customer of Buyer or its Affiliates to withdraw, diminish, curtail or cancel any of its business with Buyer. "Business" shall mean any business conducted by Buyer or its Affiliates during the Restricted Period. "The Territory" shall mean Kentucky. An "Affiliate" of Buyer shall mean a Person directly or indirectly controlled by AquaSource, Inc. "Person" shall mean any individual, corporation, partnership, trust, limited liability company or other entity.

(b) Because of the difficulty of measuring economic losses to Buyer and its Affiliates as a result of a breach of the foregoing covenant, and because of the immediate and irreparable damage that could be caused to Buyer and its Affiliates for which they would have no other adequate remedy, the Shareholders agree that the foregoing covenant may be enforced by Buyer in the event of breach by either Shareholder, by injunctions, restraining orders and other equitable actions. The Shareholders acknowledge that the covenants set forth in this Section 9.1 are material conditions to Buyer's willingness to execute and deliver this Agreement and to consummate the transactions contemplated hereby. All of the covenants in this Section 9.1 shall be construed as an agreement independent of any other provision in this Agreement, and the existence of any claim or cause of action of the Shareholders against Buyer, whether predicated on this Agreement or otherwise, shall not constitute a defense to the enforcement by Buyer of such covenants. The period of two (2) years stated at the beginning of this Section 9.1, during which the covenants of the Shareholders made in this Section 9.1 shall be effective, shall be computed by excluding from such computation any time during which the Shareholders are in violation of any provision of this Section 9.1. The covenants contained in this Section 9.1 shall not be affected by any breach of any other provision hereof by any party hereto.

9.2 Employee Benefits. No employee shall receive credit for any service recognized under any Benefit Plan prior to the Closing Date for any purpose under any employee benefit plan sponsored or maintained by Buyer; provided, however, that each employee shall be credited with at least the amount of "paid time off" as such employee had accrued as an employee of the Target Company prior to the Closing Date.

9.3 Notice. Any notice, request, instruction, correspondence or other document required to be given hereunder by any party to another (herein collectively called "Notice") shall be in writing and delivered in person or by courier service requiring acknowledgment of delivery or mailed by certified mail, postage prepaid and return receipt requested, or by telecopier, as follows:

If to Buyer, addressed to:

AquaSource Utility, Inc.
16810 Barker Springs, Suite B215
Houston, Texas 77084
Attention: Edward Wallace
Telecopier No.: (281) 578-1620

If to the Shareholders, addressed to:

Mr. Lloyd Eades
Route 1
Shelbyville, Kentucky 40065

and

c/o Al J. Schneider
Home Supply Company
3720 Seventh St. Road
Louisville, Kentucky 40216

With a copy to:
Ackerson, Mosley & Yann
1200 One Riverfront Plaza
Louisville, Kentucky 40202
Attention: Mr. Jeffrey C. Sauer
Telecopier No.: (502) 589-4168

Notice given by personal delivery or courier service shall be effective upon actual receipt. Notice given by mail shall be effective five days after deposit with the United States postal service. Notice given by telecopier shall be confirmed by appropriate answer back and shall be effective upon actual receipt if received during the recipient's normal business hours, or at the beginning of the recipient's next business day after receipt if received before the recipient's normal business hours. All Notices by telecopier shall be confirmed promptly after transmission in writing by regular mail or personal delivery. Any party may change any address to which Notice is to be given to it by giving Notice as provided above of such change of address.

9.4 Public Statements. No party shall issue any public announcement or statement with respect to the transactions contemplated hereby for a period of twelve months following the Closing Date without the written consent of the other parties.

9.5 Further Assistance. The Shareholders shall execute and deliver without additional expense to Buyer such additional documents as are reasonably necessary to consummate the transactions contemplated hereby.

9.6 Governing Law. The provisions of this Agreement and the documents delivered pursuant hereto shall be governed by and construed and enforced in accordance with the laws of the Commonwealth of Kentucky.

9.7 Entire Agreement; Amendments and Waivers. This Agreement, together with all schedules and exhibits attached hereto, constitutes the entire agreement among the parties pertaining to the subject matter hereof and supersedes all prior agreements, understandings, negotiations and discussions, whether oral or written, of the parties. No supplement, modification or waiver of this Agreement shall be binding unless executed in writing by the party to be bound thereby. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a waiver of any other provision hereof (regardless of whether similar), nor shall any such waiver constitute a continuing waiver unless otherwise expressly provided.

9.8 Severability. If any one or more of the provisions contained in this Agreement or in any other document delivered pursuant hereto shall, for any reason, be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provisions of this Agreement or any other such document.

9.9 Headings and Exhibits. The headings of the several Articles and Sections herein are inserted for convenience of reference only and are not intended to be a part of or to affect the meaning or interpretation of this Agreement. The schedules and exhibits referred to herein are attached hereto and incorporated herein by this reference.

9.10 Successors Bound; Third Parties. This Agreement may not be assigned by any party (other than to an affiliate of such party) without the consent of the other parties. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the parties and their respective successors and assigns. Nothing in this Agreement, express or implied, is intended to confer upon any person or entity other than the parties hereto and their respective permitted successors and assigns, any liabilities, duties, rights, benefits or obligations hereunder.

9.11 Multiple Counterparts. - This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

[THE REMAINDER OF THIS PAGE LEFT INTENTIONALLY BLANK.]

IN WITNESS WHEREOF, the parties have signed this Agreement in multiple counterparts, all as of the date first above written.

GOSHEN UTILITIES, INC.

By: [signature]
Name: Lloyd Eades
Title: Pres.

AQUASOURCE UTILITY, INC.

By: [signature]
Name: DONALD T. CLAYTON
Title: PRESIDENT

[signature]
Lloyd Eades
No. of Shares: 500

THE NANCE REALTY COMPANY

By: [signature]
Name: AL J. SCHNEIDER
Title: PRES.

No. of Shares: 500

HUNTMJ\050129\008058
HOUSTON\923706.7

EXHIBIT B

Investor Warranties

Each Shareholder represents and warrants to Buyer and DQE, Inc. as follows:

(a) Investment Intent. Such Shareholder is acquiring the shares of Preferred Stock, Series A (Convertible), $100 liquidation preference per share ("Preferred Stock") for such Shareholder's own account and not with a view to, or for sale in connection with, directly or indirectly, any distribution thereof that would require registration under the Securities Act of 1933, as amended (the "Securities Act") or applicable state securities laws or would otherwise violate the Securities Act or such state securities laws.

(b) Accredited Investor Status; Knowledge and Experience. Such Shareholder is an "accredited investor" as defined in Rule 501(a) under the Securities Act; and such Shareholder alone or together with a "purchaser representative" as defined in Rule 501(h) under the Securities Act, has such knowledge and experience in financial and business affairs in general and with respect to the Company and is capable of determining the information necessary to make an informed investment decision with respect to the Preferred Stock, of requesting such information from DQE, Inc. and of utilizing the information that such Shareholder has received from DQE, Inc. to evaluate the merits and risks of such Shareholder's investment in the Preferred Stock.

(c) Ability to Bear Economic Risk. Such Shareholder is able to bear the economic risk of such Shareholder's investment in the Preferred Stock and understands that such Shareholder may be required to do so for an indefinite period of time.

(d) Access to Information. Such Shareholder and such Shareholder's attorneys, accountants, investment and financial advisors, if any, including such Shareholder's "purchaser representative", if any, have been provided access to such information as such Shareholder or such Shareholder's advisors, if any, have requested.

(e) No Government Approval. Such Shareholder is aware that no governmental entity has passed upon or made any finding or determination concerning the fairness of the transactions contemplated hereby and such Shareholder must forego the security, if any, that such a review would provide.

(f) Transfer Restrictions. (i) The Shareholders have been advised or are aware (A) of the provisions of Rule 145 under the Securities Act, which limits resale of securities acquired in transactions similar to that contemplated by this Agreement by an "affiliate" (as defined in Rule 405 under the Securities Act) of a party to such transaction; (B) that, if either Shareholder is an "affiliate" of the Company, such Shareholder may resell the Preferred Stock or any securities into which the Preferred Stock may be converted ("Conversion Securities") only pursuant to an effective registration statement, pursuant to Rule 145 or another exemption from the registration requirements of the Securities Act; (C) that, resales of securities pursuant to Rule 145 may be subject to certain conditions, including, among other things, the availability of public information about the issuer and requirements with respect to holding periods, the amount of securities to be sold and the manner of sale and (D) that the exemption provided by Rule 145 may not be available with respect to the resale of the Preferred Stock or Conversion Securities and (ii) the Shareholders consent and agree to DQE, Inc. giving appropriate stop transfer instructions to the transfer agent for the Preferred Stock and Conversion Securities.

AquaSource, Inc.
Consolidated Balance Sheet

	March 31, 1999	December 31, 1998
Assets		
Current Assets		
Cash	2,913,090	6,590,508
Customer accounts receivable, net	15,797,563	10,312,839
Funds held by trustee	3,873,356	4,338,356
Other	4,374,815	5,959,270
Total current assets	26,958,824	27,200,973
Fixed Assets		
Utility plant in service	98,153,317	55,917,281
Other fixed assets	32,716,094	23,017,137
	130,869,411	78,934,418
Accumulated depreciation	(2,552,786)	(1,660,371)
Construction work in progress	2,050,952	1,299,376
Total fixed assets	130,367,577	78,573,423
Other Assets and Deferred Charges		
Investments in Water Companies	36,646,827	34,492,443
Regulatory assets	32,966,537	19,421,131
Goodwill and other intangibles	71,784,553	44,731,965
Deferred tax assets	13,063,772	13,613,338
Collateral / escrow accounts	29,339,289	9,641,082
Other	4,265,127	7,656,330
Total other assets and deferred charge	188,066,105	129,556,289
Total Assets	345,392,506	235,330,685

	March 31, 1999	December 31, 1998
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts payable	9,020,629	2,438,776
Accounts payable - affiliates	250,724	250,724
Customer deposits	939,657	568,973
Current portion of long term debt	3,250,000	3,250,000
Other accrued liabilities	3,494,267	2,113,231
Total current liabilities	16,955,277	8,621,704
Non Current Liabilities		
Deferred income taxes	22,374,507	22,956,311
Long term debt	25,205,569	21,821,979
Advances from affiliated company	30,000,000	
Contributions in aid of construction	16,810,538	456,238
Other	326,387	326,387
Total noncurrent liabilities	94,717,001	45,560,915
Shareholders' Equity		
Shareholders' equity	231,580,012	180,068,016
Retained earnings	2,140,216	1,080,05[illegible]
Total shareholders' equity	233,720,228	181,148,066
Total Liabilities and Shareholders' Equit	345,392,506	235,330,685

EXHIBIT
D

AquaSource, Inc.
Consolidated Balance Sheet

(Unaudited)

	December 31, 1998	December 31, 1997
Assets		
Current Assets		
Cash	6,590,508	849,930
Accounts receivable - customers	10,312,839	236,559
Other receivables	308,437	
Income tax receivable	2,872,452	234,799
Inventory	202,350	19,100
Prepayments	342,441	
Other	6,571,946	
Total current assets	27,200,973	1,340,388
Fixed Assets		
Utility plant in service	55,461,043	1,276,975
Other fixed assets	23,017,137	733,240
	78,478,180	2,010,215
Accumulated depreciation	(1,660,371)	(65,253)
Construction work in progress	1,299,376	
Total fixed assets	78,117,185	1,944,962
Other Assets and Deferred Charges		
Investments in Water Companies	34,492,443	704,031
Regulatory assets	19,421,131	
Goodwill	20,720,016	
Customer lists and relationships	24,011,949	5,481,911
Deferred tax assets	13,613,338	
Investment in marketable securities (collateral account)	9,641,082	
Other	7,656,330	28,138
Total other assets and deferred charges	129,556,289	6,214,080
Total Assets	234,874,447	9,499,430
Liabilities and Shareholders' Equity		
Liabilities		
Current Liabilities		
Accounts payable	2,438,776	196,081
Accounts payable - affiliates	250,724	245,000
Customer deposits	568,973	
Accrued taxes	250,631	
Other accrued liabilities	5,112,600	
Total current liabilities	8,621,704	441,081
Non Current Liabilities		
Deferred income taxes	22,956,311	
Long term debt	21,821,979	
Other	326,387	
Total noncurrent liabilities	45,104,677	
Shareholders' Equity		
Contributions by the "A" Shareholders	179,142,116	9,856,645
Contributions by the "B" Shareholders	925,900	400,000
Retained earnings	1,080,050	(1,198,296)
Total shareholders' equity	181,148,066	9,058,349
Total Liabilities and Shareholders' Equity	234,874,447	9,499,430

AquaSource, Inc.

Consolidated Statement of Income

(Unaudited)

	Year Ended December , 31 1998		From Inception thru December 31, 1997
Revenues			
Sales of water and wastewater	9,455,914	$	401,633
Contract operations	11,735,972		1,166,584
Engineering and construction	10,819,254		
Operating revenues	32,011,140		1,568,217
Operating Expenses			
Operation and maintenance expenses	14,393,161		722,075
Cost of construction	8,375,350		
Depreciation and amortization	624,849		144,532
General and administrative	5,489,025		2,143,284
Operating expenses	28,882,385		3,009,891
Other Income/Expense			
Interest Income	228,002		8,578
AFUDC	46,227		
Other Income (Expense)	(308,273)		
Other income/expense	(34,044)		8,578
Income before Income Taxes	3,094,711		(1,433,096)
Income tax expsnse	1,083,140		(501,584)
Net Income	2,011,571	$	(931,512)

16810 Barker Springs, Suite B215 • Houston, Texas 77084 • 281-578-3121 • 281-578-1620 (fax)

AquaSource, Inc

Consolidated Statement of Cash Flows

(Unaudited)

		Year Ended December , 31 1998	From Inception thru December 31, 1997
Cash Flows from Operating Activities:			
Net Income	$	2,011,571	(931,512)
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization		624,849	144,532
Accounts receivable		(3,080,206)	(65,036)
Inventory		(112,951)	
Accounts payable		(441,095)	130,610
Other		335,930	(441,982)
Net Cash Used In Operating Activities		(661,902)	(1,163,388)
Cash Flows from Investing Activities:			
Capital Expenditures		(7,710,585)	(275,291)
Acquisitions of Water Companies		(122,001,053)	(6,669,818)
Proceeds from sale of land		433,847	
Net Cash Used In Investing Activities		(129,277,791)	(6,945,109)
Cash Flows from Financing Activities:			
Cash Contributions from "A" Shareholders		135,554,271	8,308,645
Cash Contributions from "B" Shareholders		226,000	400,000
Repayment of long term debt		(100,000)	245,000
Net Cash Provided by Financing Activities		135,680,271	8,953,645
Net Increase in Cash and Cash Equivalents		5,740,578	845,148
Cash and Cash Equivalents at Beginning of Period		849,930	4,782
Cash and Cash Equivalents at End of Period	$	6,590,508	849,930

FILED

AUG 23 1999

GENERAL COUNSEL

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.) CASE NO. 99-303

RECEIVED
AUG 23 1999
PUBLIC SERVICE COMMISSION

MOTION

Comes now, AquaSource Utility, Inc., by counsel, and respectfully requests an extension of time in which to file the information requested by the Commission in its Order dated August 12, 1999. As grounds for said Motion, Applicant states that it requires more than ten (10) days to compile the information requested in said Order.

Wherefore, AquaSource respectfully requests an extension of seven (7) days from the original due date of August 23, 1999. In return for granting this extension of time, AquaSource Utility, Inc. agrees to grant the Commission a thirty (30) day extension to their statutory sixty (60) day period to review this Application for Transfer of Ownership, set to expire on September 9, 1999.

Respectfully Submitted,

By: Patrick T. Schmidt

Patrick T. Schmidt
Attorney for AquaSource Utility, Inc.
1400 One Riverfront Plaza
Louisville, KY 40202

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF AQUASOURCE UTILITY, INC. FOR TRANSFER OF OWNERSHIP RIGHTS OF GOSHEN UTILITIES, INC.	)))	CASE NO. 99-303

RECEIVED
AUG 23 1999
PUBLIC SERVICE COMMISSION

ORDER

IT IS ORDERED that AquaSource Utility, Inc. be granted an extension of seven (7) days to file additional information in support of their Application for Transfer of Ownership Rights of Goshen Utilities, Inc. as required by Order of the Commission dated August 12, 1999. Such information will now be due on August 30, 1999 in the offices of the Commission. It is acknowledged that, in return for this extension of time, the statutory period of sixty (60) days for the Commission to review and rule on said Application is hereby extended thirty (30) days to October 9, 1999.

Done at Frankfort, Kentucky, this the ____ day of August, 1999.

ATTEST:

____
Executive Director