

COMMONWEALTH OF KENTUCKY  
FRANKLIN CIRCUIT COURT  
DIVISION I  
CIVIL ACTION NO. 02-CI-01012

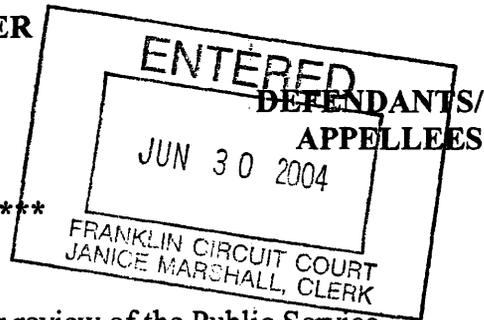


COMMONWEALTH OF KENTUCKY, ex rel.  
A.B. CHANDLER, III, ATTORNEY GENERAL, et al.

PLAINTIFFS/  
APPELLANTS

OPINION & ORDER

PUBLIC SERVICE COMMISSION  
OF KENTUCKY, et al.



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This matter involves consolidated actions for review of the Public Service Commission's decisions in PSC Case Nos. 2002-00018 and 2002-00317. The Commission's Orders approved the transfer of control of Kentucky-American Water Company to a wholly owned subsidiary of RWE Aktiengesellschaft. The Commonwealth of Kentucky Office of the Attorney General, by three separate actions, moves to vacate the Commission's Orders and void the transfer of control. This Court has considered the parties' arguments and the applicable law, and now **AFFIRMS** the Commission's Orders.

INTRODUCTION

The parties involved in this transaction include RWE Aktiengesellschaft, a corporation formed under the laws of the Federal Republic of Germany, Thames Water Aqua Holdings GmbH, a wholly owned subsidiary of RWE, the Apollo Acquisition Company, a wholly owned subsidiary of Thames. RWE, through its subsidiary Thames, sought control over the American Water Works Company, a Delaware corporation, that owns all of the common stock of Kentucky-American

Water Company. These corporations executed an Agreement and Plan of Merger that transferred ownership of American Water Works Company. Under the Agreement and Plan, American merges into Apollo. As a result RWE, through its ownership of Thames, gains complete ownership and control of American including ownership of Kentucky-American.

The transfer of Kentucky-American, a utility service, requires the approval of the Public Service Commission of Kentucky pursuant to KRS 278.020. On January 31, 2002, Kentucky-American and Thames filed a Joint Application seeking approval of the transfer of control of Kentucky-American to RWE and Thames. PSC Case No. 2002-00018. RWE, Apollo and American were not parties to this proceeding. The Joint Application reveals that American would be owned by an intermediary holding company owned by Thames. During the original proceeding this intermediary holding company did not exist and there was no final plan for post-merger structure.

The Office of the Attorney General, the Lexington-Fayette Urban County Government (“LFUCG”) and Bluegrass FLOW, Inc., were granted intervention into PSC Case No. 2002-00018. The Joint Applicants, the Intervenors and the Commission engaged in discovery and public hearings concerning the Application. The Commission’s May 30, 2002, Order provided for the approval of the transaction upon the written acknowledgment on behalf of RWE, Thames, American and Kentucky-American of the acceptance of 56 commitments (conditions) set forth in an accompanying Appendix. The Joint Applicants acknowledged by writing their acceptance of these conditions.

The Attorney General, LFUCG and Bluegrass FLOW each applied for rehearing of the May 30<sup>th</sup> Order. The Attorney General also included a motion to establish a separate docket to monitor compliance with the 56 commitments. The Commission entered an Order on July 10<sup>th</sup> amending three conditions and again requiring the Joint Applicants including RWE and American to accept and agree to be bound by all of the Order's provisions. The four parties accepted the conditions as amended. The Commission accepted the Attorney General's request to establish a separate docket to monitor RWE, American and the Joint Applicants' compliance with the imposed conditions. Case No. 2002-00277. The Attorney General, LFUCG and FLOW sought judicial review of the Commission's May 30<sup>th</sup> and July 10<sup>th</sup> Orders by appealing these decisions to this Court.

On July 26<sup>th</sup> 2002, Thames Water Aqua US Holdings, Inc. (TWUS) was established. This subsidiary of RWE was established in order to create a corporate structure that allows the filing of a United States consolidated tax return by inserting TWUS into the ownership chain to hold all the stock of the survivor American-Water and Apollo merger activity. The Commission acknowledges that the insertion of TWUS into the merger structure constitutes a transfer of control under KRS 278.020(5).

On August 28, 2002, RWE, Thames, TWUS, Apollo, American and Kentucky-American jointly filed a "Motion and Petition to Modify Order." PSC Case No. 2002-00317. Using the doctrine of res judicata, the Commission considered only issues that were not litigated and addressed during PSC Case No. 2002-00018. In

PSC Case No. 2002-00317 the Commission reviewed the transfer of control to the newly formed TWUS.

On December 20, 2002, the Commission entered an Order determining that the new proposal could not be approved unless the applicants agreed to make 61 commitments, consisting of previous conditions agreed upon and a set of new conditions. On January 8, 2003, the Joint Applicants gave written notice of their acceptance of the conditions. On January 9, 2003, the Attorney General, LFUCG and FLOW filed petitions for rehearing. On January 10, 2003, RWE, Thames, Apollo, TWUS and American filed a Notice of Closing in PSC Case No. 2002-00277, the compliance case. The Attorney General then filed a Response to the Notice, a Motion for reestablishment of Kentucky-American's pre-closing status and a Request for Findings of Facts and Conclusions of Law regarding the closing of the transaction.

On January 29<sup>th</sup>, the Commission entered an Order denying all pending requests for rehearing. The Attorney General, LFUCG and Bluegrass FLOW have individually sought judicial review of the December 20<sup>th</sup> and January 29<sup>th</sup> PSC Orders. A March 13<sup>th</sup> Order entered by the Commission denied all motions entered by the Attorney General, LFUCG and Bluegrass FLOW concerning the closing of the transaction. The Intervenors appealed the Commission's Final Orders.

On June 9<sup>th</sup> 2003, this Court consolidated these various actions into this Appeal.

## DISCUSSION

### A. *The Standard of Review*

A PSC order can be vacated or set aside only if it is unlawful or unreasonable. KRS 278.410(1). A PSC order is unlawful if it violates a state or federal statute or constitutional provision. *National-Southwire Aluminum Co. v. Big Rivers Elec. Corp.*, Ky. App., 785 S.W.2d 503, 510 (1990). A PSC order is unreasonable “only when it is determined that the evidence presented leaves no room for difference of opinion among reasonable minds.” *Energy Regulatory Comm’n v. Ky. Power Co.*, Ky. App., 605 S.W.2d 46, 50 (1980) (citing *Thurman v. Meridian Mut. Ins. Co.*, Ky., 345 S.W.2d 635 (1961)). This Court cannot “pass on the credibility of witnesses and the weight of the evidence” because those functions lie solely with the PSC. *Ky. Power*, 605 S.W.2d at 50. The party challenging the Commission's order “[s]hall have the burden of proof to show by clear and satisfactory evidence that the determination, requirement, direction or order is unreasonable and unlawful.” KRS 278.430 and *Forest Hills Developers, Inc. v. Public Service Commission*, Ky., 936 S.W.2d 94, 97 (1996).

However, when dealing with issues of law, this Court may review them *de novo* without any deference to the agency. *Mill Street Church of Christ v. Hogan*, Ky. App. 785 S.W.2d 263, 266 (1990). Interpretation of a statute is a question of law and a reviewing court is not bound by the agency’s interpretation of the statute. See *Halls Hardwood Floor Co. v. Stapleton*, Ky. App. 16 S.W.3d 327, 330 (1996).

*B. The Commission's Orders*

Upon approval of the transfer, the Commission found that Thames and RWE had the managerial, technical, financial and managerial ability needed to provide reasonable utility service. The Commission also held that the transfer of control was consistent with the public interest provided that the Joint Applicants, RWE and American-Water accept 61 conditions. The Joint Applicants accepted these conditions.

*C. The Commission Maintained Jurisdiction over the Transfer*

The Attorney General premises this challenge on the basis that RWE and American were necessary parties and were not named as the applicants during the change of control proceedings. PSC Case No. 2002-00018. Accordingly, the Attorney General argues the Orders should be vacated as void. This argument concerns a question of law arising out of the Commission's proceedings and is therefore reviewable *de novo* by this Court.

*Cabe v. Toler*, Ky., 411 S.W.2d 41, 43 (1967). The Attorney General relies upon KRS 278.020(4):

No person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission by sale of assets, transfer of stock, or otherwise, or abandon the same, without prior approval by the commission.

Here, the legislature mandated a regulatory inquiry into whether "the person" acquiring the utility has the financial, technical and managerial abilities to provide reasonable service. Because RWE will possess ultimate control over Kentucky-American by virtue of being Thames' parent corporation, the Attorney General argues the Commission lacked jurisdiction to approve the transfer of control since only the subsidiary corporation

was named as a party to the transaction. The Attorney General also cites KRS

278.020(5). This Subsection states,

No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, *either directly or indirectly*, of any utility furnishing utility service in this state, without having first obtained the approval of the commission. Any acquisition of control without prior authorization shall be void and of no effect.

(Emphasis added). The Attorney General argues the Commission's Order is invalid since it did not recognize RWE as the "acquirer" that will possess control over Kentucky-American either directly or indirectly. Essentially, the Attorney General argues the statutes at issue preclude subsidiary corporations, acting independently, from obtaining control over public utilities. However, no legal authority supports this proposition.

"If the words of the statute are plain and unambiguous, the statute must be applied to those terms without resort to any construction or interpretation." *Vandertoll v. Com.*, Ky., 110 S.W.3d 789, 796 (2003) (Citations Omitted). A plain reading of the statute does not explicitly require the presence of a parent corporation when transferring a public utility. The cardinal rule of statutory construction is that the intention of the legislature should be ascertained and given effect. *Fiscal Court Com'rs of Jefferson County v. Jefferson County Judge/Executive*, Ky.App., 614 S.W.2d 954 (1981). A statute should not be interpreted so as to bring about an absurd or unreasonable result. *Kentucky Industrial Utility Customers, Inc. v. Kentucky Utility Company*, 983 S.W.2d 493, 500 (1993). The General Assembly enacted the statutes intending the Commission review the acquiring entity's financial, technical and managerial abilities to provide

reasonable service. The legislature also intended that parties applying for a transfer of control of a public utility identify themselves before the PSC.

The initial application filed by “Petitioners Kentucky-American Water Company and Thames Water Aqua Holdings GmbH, on behalf of itself and its parent holding company RWE Aktiengesellschaft,” specifically identified all of the parties involved in the merger. Based upon the Application, the Commission investigated and found Thames and its parent RWE possessed the requisite ability to provide reasonable service and that the proposed transfer of control was made in accordance with law, for a proper purpose and within the public interest. The Commission fulfilled the underlying legislative intent of the statute.

The Appellants present a structural argument centered on a jurisdictional deficiency. They argue the Commission’s Orders are unlawful because the real parties in interest were not attached. The Appellants do not address what harm exists by the Commission’s failure to attach the parent corporations. The acquisition of control of a public utility is within the jurisdiction of the Commission. KRS 278.020. The legislature empowered the Commission with broad jurisdiction regarding the transfer of public utilities. The Commission has the statutory authority to commence transfer of control proceedings upon its own initiative. The Appellants have failed to show by clear and satisfactory evidence that the Commission’s determinations are unlawful for lack of jurisdiction. This Court must affirm the Orders. *National-Southwire Aluminum Co. v. Big Rivers Electric Corp.*, Ky. App., 785 S.W.2d 503, 510 (1990).

*D. The Commission Applied a Reasonable Public Interest Standard*

The Intervenors dispute whether the Public Service Commission employed the correct standard when determining whether the transfer of Kentucky-American was consistent with the public interest. KRS 278.020(5). The decision will be reversed only if the Appellants can demonstrate that the Commission's application of the standard was unreasonable or unlawful. KRS 278.410(1).

The Commission is responsible for ensuring service of the public utility is adequate. *Public Service Commission v. Cities of Southgate Highland Heights*, 268 S.W.2d 19, 21 (1954). And where an existing utility proposes to sell its system, the commission must have the opportunity to determine whether the purchaser is *ready, willing and able* to continue providing adequate service to prevent the practical equivalent of a discontinuance of service. *Id.*

In addition to the *Southgate* standard, the Commission used the following standard for gauging public interest. KRS 278.020(5). The Commission examined whether benefits include (1) enhanced service reliability (2) improved service quality (3) availability of additional service (4) lower rates and (5) reduction in utility expenses. After weighing these factors, the Commission concluded the acquisition of Kentucky-American by RWE would not result in any increase in utility rates or degradation of service level. The Commission outlined additional benefits that would be derived from the acquisition in its May 30<sup>th</sup> 2002 Order:

By placing [Kentucky-American] into a larger company system, the proposed merger will increase [Kentucky-American's] access to capital, cutting edge technologies and enhanced [research and development]. It will allow [Kentucky-American] to draw upon Thames' experience in the area of security practices and to better protect its facilities at lower cost. It

will permit greater employee training opportunities and should result in better trained-work force.

Based upon these findings, the Commission approved the transfer as consistent with the public interest.

The Appellants contend the Commission applied the incorrect standard. The Appellants advance arguments that the standard employed was arbitrary, vague, insufficient and unlawful because no actual and immediate benefit to customers was demonstrated. These arguments are unpersuasive and unfounded.

It is clear that the Commission expended considerable efforts to determine whether benefits would be conferred upon Kentucky-American's customers. By examining the five factors above, the Commission addresses and answers everyday customer concerns regarding the new management of their water service. Moreover, the Commission conditioned its approval upon RWE and American's acceptance of 61 commitments, guaranteeing that the acquisition would benefit the public. These commitments conferred jurisdictional, ratepayer, employee and community benefits on Kentucky-American customers.

The Attorney General argues KRS Chapter 278 requires the Commission to find a "quantifiable and immediate" benefit to ratepayers before approving a utility transfer. This proposition is unsupported by case law or statute.<sup>1</sup> Furthermore, adoption of this proposed standard may be imprudent. Most transfers in the Commonwealth involve small, marginally operated facilities. Typically, the only benefit conferred upon

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<sup>1</sup> Even in the event that a quantifiable and immediate benefit would be required, the Commission argues that it met this standard. As a condition of its approval of the transfer, the Commission excluded \$18.5 million in transaction-related costs from future rate-making treatment. The Commission claims this is an immediate benefit to Kentucky-American customers. This Court disagrees.

ratepayers is the assurance of the continued operation of the utility by the new owner. Requiring new utility owners to demonstrate a “quantifiable and immediate benefit” superior to the ability to provide immediate and reasonable service is too arduous for most prospective utility owners to meet. The imposition of such a standard does not serve consumer interests.

The LFUCG cites authority that it alleges would require the Commission to balance the benefits of the utility company shareholders, ratepayers and the community in the transfer of control proceedings. *National Southwire Aluminum Company v. Big Rivers Corporation*, Ky. App., 785 S.W.2d 503, 511 (1990), *Kentucky Industrial Customers, Inc. v. Kentucky Utilities Company*, Ky., 983 S.W.2d 493 (1998). The City argues the “public interest” standard contained within KRS 278.020(5) is completely undermined without a fair balancing of interests between shareholders and ratepayers before control of a utility is transferred. However, the cases cited by the City concern the ratemaking process. The Commission has a responsibility to balance commercial and public interest while ensuring that ratepayers have a right to expect reasonable utility rates. The balancing test within *Big Rivers Corporation* and *Kentucky Utilities Company* does not apply to the current transfer of control case.

*E. The Respondents are Precluded from Presenting New Arguments on Appeal*

The Appellants contend that the September 16, 2001, voting agreement transferred twenty-six (26%) percent voting control over American shares of stock directly to RWE/Thames without prior authorization from the Commission.

Accordingly, the Appellants contend that failure renders the transfer of control void. The Appellants did not argue this issue at the administrative level and are precluded from introducing this issue on appeal. *Personnel Board v. Heck*, Ky. App., 725 S.W.2d 13, 17 (1987).

*F. The Applicants Complied with the Conditions*

KRS 278.020(5) authorizes the Commission to impose conditions it deems necessary to ensure that a proposed transfer is in the public interest. As noted above, the Commission prescribed sixty-one (61) “merger conditions” upon RWE, TWUS, Thames and American that it considered necessary to ensure the protection of the public. The Appellants single out Condition No. 58 contained in the Commission’s December 20, 2002, Order. The Condition provides in part:

RWE, Thames, TWUS, and [American] shall appoint an agent in Kentucky for the limited purpose of accepting the service of process of any action that the Commission may bring to enforce the provisions and conditions set forth in this Order and the Commission’s Orders of May 30, 2002 and July 10, 2002 in Case No. 2002-00018.

The Appellants assert that they have no means of acquiring service of process over the non-resident Appellees should they choose to sue the non-resident Appellees on a matter unrelated to the Commission proceedings. The Appellants claim the Commission erred by not designating a registered agent to accept service of process for any actions brought by the Appellants. The Commission is not empowered to advocate the interests of individual litigants outside the context of a regulatory proceeding. KRS Chapter 278 provides no independent right in any person or entity other than the Commission to enforce a Commission Order. No error was committed.

The December 20, 2002, Order's Summary of Findings specified,

The proposed acquisition of [American] by RWE , Thames, and TWUS and the proposed transfer of control of [Kentucky American] from American to TWUS are in accordance with law and for a proper purpose; they will however, be consistent with the public interest *only under the conditions set forth in Appendix A to this Order.*

(Emphasis added). The Appellants argue that the non-resident Appellees have not fulfilled this condition and are in violation of the Commission's Order. As a consequence, the Commission's conditioned Order does not confirm the transfer of control was in the public interest. KRS 278.020. The Commission asserts that RWE has designated CT Corporation for their agent for service of process. The Appellants have not demonstrated by clear and substantial evidence that RWE has failed to fulfill the condition at issue.

*G. The Commission did not Commit a Procedural Error*

The LFUCG argues that the Commission exceeded its statutory authority by modifying a previous Order in PSC Case No. 2002-00317 after an appeal had been perfected to this Court in PSC Case No. 2002-00018. KRS 278.410 and KRS 278.440 are at issue. KRS 278.410 permits any party to a commission proceeding to bring an action against the Commission in the Franklin Circuit Court to vacate or set aside the order within thirty (30) days after service of the order, or within twenty (20) days after its application for rehearing has been denied. KRS 278.440 provides that any action brought under KRS 278.410 shall be heard and decided by the court upon the evidence submitted to the Commission on the record. The Court is not permitted to receive any other evidence. However, KRS 278.440 allows the Circuit Court to

remand an action to the Commission for reconsideration upon a demonstration that evidence has been discovered since the administrative hearing that could not have been obtained for use at that hearing by the exercise of reasonable diligence. The evidence must materially affect the merits of the case.

The City correctly observes that when a specific statutory procedure is provided by statute, the Commission must follow that procedure. *South Central Bell v. Utility Regulatory Commission*, Ky., 637 S.W.2d 649, 653 (1982). The Commission's powers are purely statutory. *City of Olive Hill v. Public Service Commission*, 305 Ky. 249, 203 S.W.2d 68 (1947). When a statute prescribes a precise procedure an administrative agency may not add to such provision. *Union Light Heat and Power Company v. Public Service Commission*, Ky., 271 S.W.2d 361 (1954).

After the Appellants perfected the Appeal of PSC Case 2002-00018, the Joint Applicants filed a Motion and Petition to Modify the Commission's Order. In PSC Case No. 2002-00317 the Commission docketed the application as a separate matter and established a procedural schedule for its review. The record of the earlier proceeding was incorporated by reference into the case. The Attorney General, LFUCG and Bluegrass FLOW intervened and were given a meaningful opportunity to be heard. The City claims the Commission violated KRS 278.410 and KRS 278.440 by modifying the first Order while the original case was on appeal to the Franklin Circuit Court. This is incorrect. The Commission only considered new evidence pertaining to the transfer of control of Kentucky-American. In PSC Case No. 2002-00317 the Commission made the following statement,

On October 16, 2002, after considering the parties' written memoranda on the subject, we found that this proceeding should be treated as a new application for transfer of control. We further found that the principles of *res judicata* barred our consideration of issues already litigated and addressed in Case No. 2002-00018 including Thames' and RWE's ability to provide reasonable utility service and the public interest questions relating to the transfer of control of KAWC to Thames and RWE. We limited the scope of this proceeding to the remaining issues that the new application presented-....While prohibiting the parties from relitigating issues already adjudicated, we permitted inquiry into possible changes in circumstances that occurred after May 30, 2002, as these changes may affect the findings contained in our Order of May 30, 2002.

The Commission correctly limited the scope of its second ruling using the doctrine of *res judicata*. Decisions by an administrative body acting in a quasi-judicial capacity will be treated as *res judicata* in accordance with the principles governing decisions of a court. *Godbey v. University Hospital*, Ky.App., 975 S.W.2d 104, 105 (1998). The scope of the new proceedings regarding TWUS's ability to provide reasonable utility service and public interest questions relating to the proposed transfer of Kentucky-American to TWUS are issues not addressed in PSC Case No. 2002-00018.

KRS 278.440 empowers the Circuit Court to remand cases to the administrative agency in any action where new evidence will materially affect the merits of the case. Kentucky Courts regard this statute as merely establishing that there shall be no *de novo* trial before the circuit court of matters heard by the Commission. *Utility Regulatory Commission v. Kentucky Water Service Company*, Ky. App., 642 S.W.2d 591 (1982). Judicial economy favors the Commission's action to consider new evidence pertaining to the transfer of control at the administrative level, review it in the same manner and enter an order regarding it before appeal to the Circuit Court.

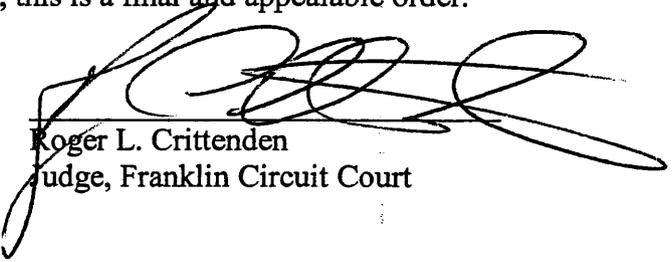
None of the evidence presented indicates that the Commission exceeded its statutory authority.

### CONCLUSION

This Court has fully considered and now rejects any other argument presented by the Plaintiffs/Appellants not addressed in this Order and Opinion. For the reasons stated above the Commission's decisions were reasonable and supported by the correct rule of law. Accordingly, this Appeal is **DISMISSED**.

**SO ORDERED** this 29<sup>th</sup> day of June 2004.

There being no just cause for delay, this is a final and appealable order.



Roger L. Crittenden  
Judge, Franklin Circuit Court

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