



Ernie Fletcher
Governor

Teresa J. Hill, Secretary
Environmental and Public
Protection Cabinet

Timothy J. LeDonne
Commissioner
Department of Public Protection

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P. O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

Mark David Goss
Chairman

John W. Clay
Commissioner

May 8, 2007

Honorable Lindsey W. Ingram, III
Attorney at Law
STOLL KEENON OGDEN PLLC
300 West Vine Street
Suite 2100
Lexington, KY 40507-1801

CERTIFICATE OF SERVICE

RE: Case No. 2006-00418
Kentucky-American Water Company aka Kentucky American Water

I, Beth O'Donnell, Executive Director 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 addressee by U.S. Mail on May 8, 2007.

Executive Director

BOD/sh
Enclosure



Ernie Fletcher
Governor

Teresa J. Hill, Secretary
Environmental and Public
Protection Cabinet

Timothy J. LeDonne
Commissioner
Department of Public Protection

Commonwealth of Kentucky
Public Service Commission
211 Sower Blvd.
P.O. Box 615
Frankfort, Kentucky 40602-0615
Telephone: (502) 564-3940
Fax: (502) 564-3460
psc.ky.gov

Mark David Goss
Chairman

John W. Clay
Commissioner

Honorable David Edward Spenard
Assistant Attorney General
Office of the Attorney General Utility & Rate Intervention Division
1024 Capital Center Drive
Suite 200
Frankfort, KY 40601-8204

May 8, 2007

CERTIFICATE OF SERVICE

RE: Case No. 2006-00418
Kentucky-American Water Company aka Kentucky American Water

I, Beth O'Donnell, Executive Director 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 addressee by U.S. Mail on May 8, 2007.

A handwritten signature in black ink, appearing to read "Beth O'Donnell", written over a horizontal line.

Executive Director

BOD/sh
Enclosure

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN)	
WATER COMPANY FOR CONTINUED)	CASE NO. 2006-00418
PARTICIPATION WITH AMERICAN WATER)	
CAPITAL CORP.)	

ORDER

Kentucky-American Water Company (“Kentucky-American”) has applied for authorization to continue its participation in the American Water Capital Corporation (“AWCC”) borrowing program.¹ By this Order, we authorize Kentucky-American’s continued participation in the program, subject to certain conditions, and the issuance of securities in the form of notes or debentures in the amount of \$61.5 million prior to December 31, 2007.

Kentucky-American, a Kentucky corporation, owns and operates facilities that treat and distribute water to the public for compensation in Bourbon, Clark, Fayette, Gallatin, Grant, Harrison, Jessamine, Owen, Scott, and Woodford counties, Kentucky. It provides wholesale water service to Harrison County Water Association, Jessamine-South Elkhorn Water District, and the cities of Georgetown, Midway, North Middletown,

¹ Kentucky-American filed its application with the Commission on August 28, 2006. The Attorney General (“AG”) subsequently sought and was granted leave to intervene in this proceeding. On November 20, 2006, the Commission continued the period for review of this application beyond 60 days and set this matter for hearing. After completion of discovery, Kentucky-American and the AG waived a hearing in this matter. The matter stood submitted for decision on January 28, 2007.

Nicholasville, Versailles, and Winchester. It is a utility subject to Commission jurisdiction.²

American Water Works Company (“American Water”), a Delaware corporation whose operating subsidiaries provide water, wastewater and other water resource management services in 29 states and Canada, currently owns all outstanding shares of Kentucky-American stock.

In 2000 Kentucky-American sought Commission authorization to participate in a borrowing program that American Water made available to each of its subsidiaries.³ Under this program, each American Water subsidiary entered into an agreement with AWCC, a wholly owned subsidiary of American Water, for financial services. AWCC would arrange for a syndicated bank credit line to provide for short-term loans and register its own debt securities for sale in the public market by filing shelf registration with the Securities and Exchange Commission. Each participant would provide AWCC with an estimate of its future borrowing requirements. AWCC would arrange borrowing commitments and programs to meet these commitments. The liability of each participant in the program was limited to its individual debt. All loans to the program participants were unsecured.

In support of its application, Kentucky-American asserted that pooling the borrowing requirements of American Water and its subsidiaries would result in lower

² KRS 278.010(3)(d).

³ Case No. 2000-00189, The Application of Kentucky-American Water Company for Approval of Participation in the Borrowing Program (Ky. PSC July 21, 2000).

capital costs. Because the issuance costs⁴ associated with debt instruments will generally remain constant regardless of the size of the issuance, the pooling of long-term debt requirements would produce a reduced pro rata share of issuance costs for the program participants. Kentucky-American further asserted that larger sized debt issuances in the public market produced more favorable terms because lenders of larger loans are able to share their risk with others.

After considering Kentucky-American's application, the Commission found that Kentucky-American's entry into the proposed Financial Services Agreement ("Agreement") was appropriate for its provision of utility service and authorized Kentucky-American to enter into the Agreement and to issue securities in the form of notes or debentures in the amount of \$41.5 million prior to December 31, 2005.

In January 2003, RWE Aktiengesellschaft ("RWE") acquired indirect control of American Water through the purchase of American Water's common stock.⁵ While Kentucky-American has continued to participate in the AWCC's borrowing program, AWCC ceased obtaining funds through outside sources and instead obtained its funding through direct loans from RWE.⁶

⁴ Placement fees and legal fees are examples of issuance costs.

⁵ See Case No. 2002-00317, The Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holdings GmbH, RWE Aktiengesellschaft, Thames Water Aqua US Holdings, Inc., Apollo Acquisition Company and American Water Works Company, Inc. for Approval of a Change of Control of Kentucky-American Water Company (Ky. PSC Dec. 20, 2002).

⁶ Application at ¶ 10.

RWE now intends to divest itself of its holdings in American Water⁷ and to terminate its support of AWCC. Once RWE has secured the necessary regulatory approvals for the sale of the American Water common stock, it will call the notes that support AWCC short-term debt; Kentucky-American's 5.65 percent Long-term Debt Series; and Kentucky-American's 4.75 percent Long-term Debt Series.

To address RWE's actions and to meet additional capital requirements, Kentucky-American plans several debt issuances prior to December 31, 2007. Kentucky-American's projected financing requirements for the calendar year 2007 are set forth in Table 1. Kentucky-American proposes to refinance those debt instruments affected by RWE's withdrawal of support with a \$41 million long-term debt issuance in May 2007. To maintain a reasonable relationship between long-term debt and common equity, it expects to make capital issuances in November 2006 and September 2007 of \$8 million and \$5.6 million, respectively.

TABLE 1

Projected Month of Debt Issuance	Subject of Refinancing	Principal Amount
May 2007	Short-term Debt 5.65% Series of Long-term Debt 4.75% Series of Long-term Debt	\$ 41.1 Million
November 2007	Short-term Debt	\$ 12.0 Million
September 2007	Short-term Debt	\$ 8.4 Million

In addition to the long-term borrowings, Kentucky-American's participation in the AWCC borrowing program will include support of the short-term debt issuances. AWCC

⁷ Case No. 2006-00197, The Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holdings GmbH, RWE Aktiengesellschaft, Thames Water Aqua U.S. Holdings, Inc. and American Water Works Company, Inc. for Approval of a Change in Control of Kentucky-American Water Company (Ky. PSC April 16, 2007).

has closed on an \$800 million revolving credit facility to serve as a back-up to its commercial paper program and plans to begin issuing the new commercial paper in the near future. The new commercial paper program is expected to have average outstanding borrowing of \$450 million with maturities between one day and 90 days. AWCC expects this program to result in \$158,000 in annual savings to AWCC over the present arrangement.⁸

The record in this proceeding clearly demonstrates that Kentucky-American's continued participation in the AWCC borrowing program will result in a reduction to the cost of Kentucky-American's short-term and long-term debt, which will ultimately benefit Kentucky-American's ratepayers. Kentucky-American estimates that, as a result of its past participation in the AWCC borrowing program, it will realize future annual net savings of \$286,159.⁹ From 2001 through 2006 Kentucky-American realized net cumulative savings of \$1.23 million.¹⁰

The Commission finds that Kentucky-American's past actions require greater Commission oversight of Kentucky-American's future participation in the AWCC Borrowing Program: During the period from July 21, 2001, to the present, Kentucky-American issued \$53,000,000¹¹ - \$12,500,000 more than we authorized.¹² To avoid

⁸ Kentucky-American's Response to AG Request for Information, Item 1-2.

⁹ Kentucky-American's Response to Commission Staff's First Information Request, Item 1.

¹⁰ Id.

¹¹ Issuance of 3/29/2001	\$15,500,000
Issuance of 6/12/2002	\$24,000,000
Issuance of 3/1/2004	<u>\$14,000,000</u>
Total Issuances	<u>\$53,500,000</u>

¹² \$53,500,000 - \$41,000,000 = \$12,500,000.

any repetition of this conduct, we condition our approval of Kentucky-American's continued participation in the AWCC Borrowing Program upon Kentucky-American providing at least 15 days prior written notice to the Commission of the issuance of any long-term debt in conjunction with the AWCC Borrowing Program. In such notice, Kentucky-American's President and Treasurer shall certify under oath the amount of the issuance and that the debt issuance does not exceed the total amount authorized in this Order.

The Commission, having reviewed the evidence of record and being otherwise sufficiently advised, finds that:

1. Kentucky-American's entry into the Agreement and participation in the borrowing program with AWCC are for a lawful object within the corporate purposes of its utility operation, are necessary and appropriate for and consistent with the proper performance of the utility's service to the public and will not impair its ability to perform that service, and are reasonable, necessary, and appropriate for such purposes.

2. Kentucky-American's proposed issuance of securities in the form of notes or debentures in an aggregate amount of \$61,500,000 for the purpose of refunding or refinancing existing short-term and long-term debt is for a lawful object within the corporate purposes of its utility operation, is necessary and appropriate for and consistent with the proper performance of the utility's service to the public and will not impair its ability to perform that service, and is reasonable, necessary, and appropriate for such purposes and should be approved.

3. At least 15 days prior to Kentucky-American's issuance of any notes or debentures that have been authorized herein, Kentucky-American should notify the Commission in writing of the proposed issuance. In this notice, Kentucky-American's

President and Treasurer should certify under oath the amount of the issuance and that the debt issuance does not exceed the total amount authorized in this Order.

4. The specific terms and conditions of each issuance under the borrowing program set forth in the Agreement are not known at this time. Therefore, Kentucky-American should be required to inform the Commission of the terms and conditions of each issuance covered by the borrowing program.

5. Kentucky-American should obtain Commission approval prior to the issuance of any security or long-term evidences of indebtedness not specifically set forth in its application and included in the \$61,500,000 refunding or refinancing.

IT IS THEREFORE ORDERED that:

1. Kentucky-American is authorized to enter into the Agreement with AWCC and to participate in its borrowing program.

2. Kentucky-American is authorized to issue securities in the form of notes or debentures in an aggregate amount of \$61,500,000 from time to time prior to December 31, 2007 for the purpose of refunding or refinancing existing short-term and long-term debt.

3. At least 15 days prior to Kentucky-American's issuance of any notes or debentures that have been authorized herein, Kentucky-American shall notify the Commission in writing of the proposed issuance. In this notice, Kentucky-American's President and Treasurer shall certify under oath the amount of the issuance and that the debt issuance does not exceed the total amount authorized in this Order.

4. For all securities or evidences of indebtedness that have a term exceeding 2 years and that are issued under the Agreement's borrowing program, Kentucky-American shall file a report detailing the terms and conditions of the particular securities issued. It shall include an analysis showing that the interest rate for the securities was the most reasonable under the circumstances at the time of the issuance. This report shall be filed with the Commission within 10 days of the completion of the issuance.

5. Kentucky-American shall obtain Commission approval prior to the issuance of any security or long-term evidences of indebtedness not specifically set forth in its application and included in the \$61,500,000 refunding or refinancing.

6. The proceeds from the financing authorized herein shall be used only for the lawful purposes set out in the application.

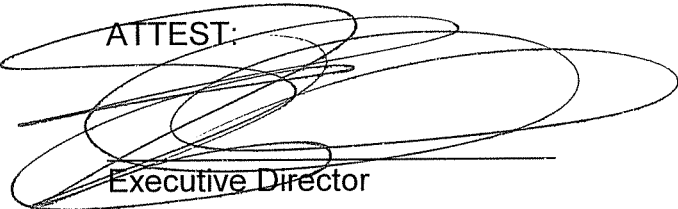
7. Kentucky-American's failure to comply with Ordering Paragraph 3 of this Order when issuing any security or long-term evidences of indebtedness as part of the AWCC Borrowing Program shall be deemed an issuance of a security or long-term evidences of indebtedness without prior Commission authorization and shall subject Kentucky-American and its officials to the penalties of KRS 278.990(1).

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein authorized.

Done at Frankfort, Kentucky, this 8th day of May, 2007.

By the Commission

ATTEST:



Executive Director

Case No. 2006-00418