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OCT 09 2014

PUBLIC SERVICE
COMMISSION

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October 9, 2014

HAND DELIVERED

Jeff Derouen
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

Re: Motion for Release of Conditions

Dear Mr. Derouen:

Enclosed please find and accept for filing American Water Works Company, Inc.'s and Kentucky-American Water Company's Motion for Release of Conditions Ordered in Case No. 2006-00197. Please establish a new case number for consideration of this motion. As always, should you have any questions or concerns, please do not hesitate to contact me.

Very truly yours,

Stoll Keenon Ogden PLLC

Lindsey W. Ingram III

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OCT 09 2014

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:)
)
THE MOTION OF AMERICAN WATER)
WORKS COMPANY, INC. AND KENTUCKY-)
AMERICAN WATER COMPANY FOR)
RELEASE OF CONDITIONS ORDERED)
IN CASE NO. 2006-00197)

Case No. 2014-_____

MOTION FOR RELEASE OF CONDITIONS ORDERED IN CASE NO. 2006-00197

Pursuant to KRS 278.390 and 807 KAR 5:001, Section 5(1), American Water Works Company, Inc. (“AWW”) and Kentucky-American Water Company (“KAW”) request that the Kentucky Public Service Commission (“Commission”) release AWW and KAW from certain conditions and requirements set forth in the Commission’s April 16, 2007 Order in Case No. 2006-00197, which is the proceeding in which the Commission approved Thames Water Aqua Holdings GmbH’s sale of AWW common stock to the public.¹ In further support of its Motion, AWW and KAW state as follows:

1. Noting concerns that the proposed stock sale could create “significant risk and uncertainty”² and have “potentially adverse effects on the quality of [KAW’s] service,”³ the Commission’s Order approving the sale of AWW’s common stock contained seventeen ordering paragraphs and imposed thirty-nine conditions. Several of these conditions contained an express sunset provision and others have been mooted by the passage of time. For example, certain conditions were imposed for a finite period, such as one year,⁴ and others were in effect only

¹ *In the Matter of: The Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holdings GmbH, RWE Aktiengesellschaft, Thames Water Aqua US Holdings, Inc., and American Water Works Company, Inc. for Approval of a Change in Control of Kentucky-American Water Company* (Case No. 2006-00197).

² Order at 19.

³ *Id.* at 32.

⁴ *Id.* at Appendix A, Paragraph 14.

until completion of a future event, such as when all divestiture costs were provided to the Commission.⁵

2. Several requirements and conditions, however, did not contain an express or implied sunset provision. KAW will thus be required to comply with these conditions forever unless released by the Commission.⁶ While the Commission intended these conditions to ensure a smooth transition of control, to guard against drastic and sudden changes in the provision of service, and to eliminate uncertainty and regulatory and customer apprehension, some of these conditions have outlived their usefulness. Seven years later, it is clear that the public interest has been served and that KAW continues to be the same efficient and reliable utility with the same excellent customer service record it was prior to the change of control. Therefore, it is appropriate to terminate the conditions that would remain effective for eternity absent Commission action.

3. KAW requests release from the following seven conditions which KAW believes are no longer necessary, and in some instances, could become detrimental to customers. The conditions are as follows:

⁵ *Id.* at 35, Ordering Paragraph 11 and Appendix A, Paragraph 22.

⁶ KRS 278.390 (“Every order entered by the commission shall continue in force until the expiration of the time, if any, named by the commission in the order, or until revoked or modified by the commission, unless the order is suspended, or vacated in whole or in part, by order or decree of a court of competent jurisdiction.”).

Requirement or Condition	Description
Ordering Paragraph 9	Kentucky-American shall report with its annual report to the Commission its actual expenditure levels for economic development activities and civic and charitable activities for the past calendar year.
Condition 4	AWWC and Kentucky-American will obtain Commission approval prior to the transfer of any Kentucky-American asset with an original book value in excess of \$1 million or real property or real estate with a net original book value in excess of \$200,000.
Condition 16	Kentucky-American's equity-to-capital ratio will be maintained between 35 to 45 percent. If the equity-to-capital ratio falls outside this range, AWWC and Kentucky-American will notify the Commission in writing within 30 days of this development and will submit to the Commission a detailed plan of action to return Kentucky-American's equity-to-capital ratio to this range.
Condition 17	AWWC and Kentucky-American will notify the Commission in writing within 30 days of any downgrading of the bonds of AWWC or any AWWC subsidiary and will include with such notice the complete report of the issuing bonding agency.
Condition 20	If AWWC issues new debt or equity in excess of \$100 million, it will notify the Commission in writing 30 days prior to such issuance.
Condition 21	Kentucky-American will file with its annual report to the Commission a report of its dividend payments and other funds transfers to AWWC. This report will list the date of each dividend payment or other funds transfer made to AWWC during the calendar year, the amount of each payment, and the amount of net income available at the time of each payment.
Condition 26	At least 30 days prior to any planned reduction of 5 percent or more in Kentucky-American's workforce, AWWC or Kentucky-American will notify the Commission in writing of the planned reduction and will include with such notice a written study of the reduction's expected effects on service and Kentucky-American's plan for maintaining service quality at the reduced workforce level.

4. Many of the reporting requirements, such as those filed contemporaneously with KAW's annual report, require additional effort to prepare and impose an obligation on KAW that has become unnecessary. The information KAW has provided over the last seven years demonstrates that KAW has adhered to both the letter and spirit of these conditions. For example, with regard to Ordering Paragraph 9, KAW's economic development and civic and

charitable activities over the last seven years demonstrate that it strives to partner meaningfully with the communities it serves. This remained constant before and after the public sale of AWW's stock because, although the ownership of stock changed, KAW's management maintained control over these activities.

5. Conditions 4, 16, 17, and 20 pertain to financial transactions and events of KAW and AWW. As with its civic matters, the information KAW has provided in the last seven years demonstrates that KAW's management has retained and exercises control over the Company's finances. If these conditions are released, KAW will remain subject to the statutes and regulations regarding affiliate transactions, issuing securities or evidence of indebtedness, and the filing of annual reports that contain thorough financial information. KAW respectfully submits that the oversight and reporting requirements provided for in the Commission's statutes and regulations are sufficient to monitor all regulated utilities in Kentucky, including KAW.⁷ The additional oversight imposed on KAW by the change of control conditions has, due to the passage of time, become unnecessary.

6. Condition 21 was intended to detect quickly any large transfer of funds from KAW to AWW within a relatively short period and to safeguard against any attempt by the new shareholders to deprive KAW of necessary financial resources. The information KAW has provided over the last seven years demonstrates that KAW management has not unnecessarily or irresponsibly transferred funds to AWW. KAW's demonstrated record clearly shows the need

⁷ For example, any transactions between KAW and AWW or AWW affiliates are subject to statutory restrictions and reporting requirements. KRS 278.2201-.2214. KAW must still file a financial and statistical report and its financial statement audit report with the Commission annually. 807 KAR 5:006, Section 4(2); 807 KAR 5:006, Section 4(3). The Commission retains access to all company records, KRS 278.230, and may conduct informal and formal investigations of any transaction that may affect the quality of service. KRS 278.250; KRS 278.260.

for enhanced reporting and monitoring no longer exists. Of course, the Commission will retain other means to monitor such transfers.⁸

7. Condition 16, which prohibits KAW from having an equity-to-capital ratio greater than 45%, is of special concern to KAW because of its possible detrimental impact on customers. This condition unduly restricts KAW's ability to optimize its capital structure in a manner that could prohibit KAW from lowering its weighted cost of capital under the right conditions. Under certain market conditions, it is prudent for a utility to lower its financial risk by reducing its leverage through an offsetting increase in equity. Condition 16 denies this flexibility and could force KAW to incur a higher weighted cost of capital.

8. Because KAW is currently not allowed to have an equity ratio above 45%, its debt ratio likewise cannot fall below 55%. The level of financial risk represented by a 55% debt ratio can be assessed by examining the indicative ratios for the debt-to-total-capital financial benchmark published by Standard & Poor's, shown in the table below:

Table 1
Financial Benchmarks

Financial Risk Indicative Ratios
(Corporates)

	Debt/Capital (%)
Minimal	less than 25
Modest	25-35
Intermediate	35-45
Significant	45-50
Aggressive	50-60
Highly Leveraged	greater than 60

Source: Standard & Poor's, RatingsDirect, September 18, 2012, page 3.

⁸ KAW must report the amount of dividends paid on an annual basis in its annual financial and statistical report and five years of such information whenever required to submit a financial exhibit as part of an application to the Commission. See 807 KAR 5:006, Section 4(2); 807 KAR 5:001, Section 12. This information also appears in KAW's financial statement audit reports that KAW must file annually with the Commission. 807 KAR 5:006, Section 4(3).

9. Based on this criterion, which is one of only three financial risk indicators considered by Standard & Poor's, Condition 16 places KAW's financial risk in the "Aggressive" category. The significance of this can be determined when examining Standard & Poor's business and financial risk matrix, which plays a significant role in determining credit ratings. The matrix is shown in the table below:

Table 2
Business and Financial Risk Profile Matrix

Business Risk Profile	- Financial Risk Profile -					
	<u>Minimal</u>	<u>Modest</u>	<u>Intermediate</u>	<u>Significant</u>	<u>Aggressive</u>	<u>Highly Leveraged</u>
Excellent	AAA/AA+	AA	A	A-	BBB	--
Strong	AA	A	A-	BBB	BB	BB-
Satisfactory	A-	BBB+	BBB	BB+	BB-	B+
Fair	--	BBB-	BB+	BB	BB-	B
Weak	--	--	BB	BB-	B+	B-
Vulnerable	--	--	--	B+	B	B- or below

Source: Standard & Poor's, RatingsDirect, September 18, 2012, page 2.

10. As shown in Table 2, falling in the "Aggressive" financial risk category would require KAW to achieve an "Excellent" business risk rating just to obtain a BBB rating. A BBB rating is the lowest investment grade rating assigned by Standard & Poor's. Assuming that KAW's business risk profile would be rated "Excellent" by Standard & Poor's, the Company would need to attain at least a "Significant" financial risk profile to achieve an A- rating. Under Table 1, a "Significant" financial risk profile is only achieved by a debt ratio in the 45%-50% range, rather than KAW's current *minimum* requirement of 55%. Although KAW is not independently rated, it is prudent to attain the financial strength that would support a Standard &

Poor's credit rating of A-. That rating is consistent with the rating currently assigned by Standard & Poor's to KAW's parent, AWW.

11. In addition to potentially lowering KAW's weighted cost of capital and improving its capital structure, there are additional benefits to releasing KAW from the equity ratio restriction. These include protection from declining revenues, as a highly leveraged company must rely on consistent revenues to cover its debt interest payments and operating expenses. Having more flexibility can also help avoid high interest rate periods by issuing equity instead of debt financing.

12. In reviewing the capital structure of other investor-owned utilities in Kentucky, it is clear that KAW's mandated equity ratio falls well below that of its peers. Filings made by peer utilities demonstrate the following equity ratios at year-end:

Water Service Corporation of Kentucky⁹

2012: 47.56%

2011: 49.75%

2010: 49.69%

2009: 47.71%

2008: 46.70%

Columbia Gas of Kentucky¹⁰:

2012: 52.82%

2011: 52.40%

2010: 52.14%

2009: 55.16%

⁹ Case No. 2013-00237, Staff DR 2-18.

¹⁰ Case No. 2013-00167, Staff Set 1 DR No. 003, Attachment A.

2008: 52.12%

Atmos Energy Corporation¹¹

2012: 55.3%

2011: 50.7%

2010: 51.3%

2009: 51.0%

2008: 49.5%

Louisville Gas and Electric Company¹²

2011: 55.46%

2010: 58.34%

2009: 54.01%

2008: 52.47%

2007: 52.22%

Kentucky Utilities Company¹³

2011: 53.62%

2010: 52.86%

2009: 53.06%

2008: 52.97%

2007: 52.73%

13. In addition, KAW has been unable to find any other utility subject to the Commission's jurisdiction in which a maximum equity-to-capital ratio is imposed. In fact, the

¹¹ Case No. 2013-00148, Staff DR 1-03, Attachment 1 at "Method Used in Filing."

¹² Case No. 2012-00222, Attachment to Response to Staff Question No. 3.

¹³ Case No. 2012-00221, Attachment to Response to Staff Question No. 3.

only similar order KAW has found is a requirement that Duke Energy Kentucky maintain a capital structure that contains a *minimum* of 35% equity.¹⁴

14. Condition 26 requires KAW to provide at least 30 days' advance notice of a planned reduction of 5 percent or more in KAW's workforce, along with a written study explaining how KAW will maintain service quality at the reduced level. KAW has demonstrated over the last seven years that it maintains a workforce that is capable of delivering high quality finished water and customer service. The elimination of positions, where they have occurred, has been implemented in response to operational efficiencies and technological improvements, as demonstrated in KAW's last rate case.¹⁵ Moreover, releasing KAW from the requirements of Condition 26 will not prevent the Commission from effectively monitoring or investigating the level and quality of KAW's workforce (KAW does not anticipate any such workforce reduction).¹⁶

15. KAW's aim in filing this Motion is two-fold; it seeks to operate more efficiently through the removal of requirements that have been rendered unnecessary by the passage of time and, more importantly, KAW seeks to operate in a manner that optimizes its capital structure. The benefits of these twin aims inure to customers.

WHEREFORE, KAW respectfully requests pursuant to KRS 278.390 and 807 KAR 5:001, Section 5(1) that it be released from Ordering Paragraph 9, Condition 4, Condition 16,

¹⁴ Case No. 2011-00124, *In the Matter of: Joint Application of Duke Energy Corporation, Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc., Diamond Acquisition Corporation, and Progress Energy, Inc. for Approval of the Indirect Transfer of Control of Duke Energy Kentucky, Inc.* (October 28, 2011 Order at Appendix B, Commitment 22).

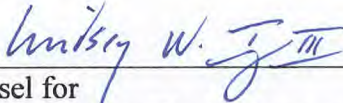
¹⁵ See Case No. 2012-00520, Direct Testimony of Melissa L. Schwarzell at 4-5 ("For example, the nine Meter Reader positions reflected at the start of the forecast year are five fewer than in 2010, as a result of the ongoing accelerated meter replacement program. Recent streamlining also resulted in the elimination of four positions, including: Operational Risk Management Supervisor (Supervisor Loss Control), Director of Governmental Affairs, Supervisor Business Process, and one Clerk of Operations.").

¹⁶ See, e.g., KRS 278.250 (authorizing an investigation and examination of the condition of a utility); KRS 278.260 (authorizing a formal proceeding into any practices that may affect or relate to the service of a utility); 807 KAR 5:006, Section 4(1) (requires annual filing of a financial and statistical report that requires utility to report the number of employees).

Condition 17, Condition 20, Condition 21, and Condition 26 of the Commission's April 16, 2007
Order in Case No. 2006-00197.

Respectfully submitted,

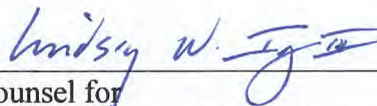
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By 
Counsel for
American Water Works Company, Inc. *and*
Kentucky-American Water Company

CERTIFICATE

This is to certify that the original and ten (10) copies of the foregoing have been filed with the Public Service Commission this the 9th day of October, 2014 and a copy e-mailed to:

Jennifer Black Hans
Gregory T. Dutton
Office of the Attorney General
1024 Capital Center Drive, Suite 200
Frankfort, KY 40601-8204



Counsel for
American Water Works Company, Inc. *and*
Kentucky-American Water Company