COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AMERICAN WATER WORKS COMPANY, INC. AND KENTUCKY AMERICAN WATER COMPANY MOTION FOR RELEASE OF CONDITIONS	)))	CASE NO. 2014-00362

ORDER

On October 9, 2014, Kentucky-American Water Company ("Kentucky-American") and American Water Works Company, Inc. ("AWWC") (jointly "Movants") filed a motion for release from seven conditions set forth in the Final Order in Case No. 2006-00197, dated April 16, 2007 ("2006-00197 Order"), which is the proceeding whereby the Commission approved the change in control of Kentucky-American.[1] As a basis for this motion, Movants assert that the conditions at issue are no longer necessary, and, in one case, impose an obligation that is inconsistent with the Commission's regulation of other utilities.

On December 2, 2014, the Commission notified Lexington-Fayette Urban County Government, an intervenor in Case No. 2006-00197, that Movants filed a motion for release of several conditions set forth in the Order in that matter. There are no intervenors in this matter.

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[1] Case No. 2006-00197, *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* (Ky. PSC Apr. 16, 2007), Final Order.

BACKGROUND

Kentucky-American is a water and sewer utility subject to Commission jurisdiction and regulation.[2] AWWC, a Delaware corporation, currently owns all outstanding shares of Kentucky-American stock. AWWC neither conducts nor is authorized to conduct business within the Commonwealth.

In the 2006-00197 Order, the Commission imposed certain requirements as conditions to approving the change in control of Kentucky-American. Kentucky-American's then ultimate parent company, RWE Aktiengesellschaft ("RWE"), sought Commission approval to sell all of AWWC's common stock ("stock sale"). After the stock sale, AWWC became an independent entity. Because AWWC owned all outstanding shares of Kentucky-American, the stock sale effectively transferred indirect control of Kentucky-American from RWE to persons who acquired AWWC common stock.

In the 2006-00197 Order, the Commission found that the transaction created significant financial risk and uncertainty, and thus, the transaction was in the public interest only if approval was conditioned upon certain protections for Kentucky-American ratepayers. Many of the conditions imposed in the 2006-00197 Order were similar to conditions imposed in the Commission's approval of RWE's acquisition of AWWC and Kentucky-American in Case Nos. 2002-00018 and 2002-00317.[3]

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[2] KRS 278.010(3)(d) and (f).

[3] Case No. 2002-00018, *Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings Gmbh* (Ky. PSC May 30, 2002), Final Order ("2002-00018 Order"); and 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), Final Order ("2002-00317 Order").

The conditions set forth in the 2006-00197 Order were designed to ensure that Kentucky-American's service and operations were adequately funded and maintained, and thus safeguard Kentucky-American ratepayers from any adverse effect that might result from the transaction. AWWC and Kentucky-American agreed to be bound by the conditions set forth in the 2006-00197 Order. Kentucky-American now requests to be released from certain of the conditions on the basis that the conditions are no longer necessary and, in some instances, could become detrimental to customers.

DISCUSSION

In the 2006-00197 Order, as in other cases approving the transfer of control for similarly situated investor-owned utilities, the Commission imposed conditions upon Kentucky-American and AWWC for the purpose of safeguarding public interest and service quality by preserving utility resources, and establishing reporting requirements to assist the Commission in monitoring the corporate activities of the utility and its holding company.[4] The conditions were set forth in the ordering paragraphs and Appendix A to the Order. Twenty-three conditions expired due to express or implied terminating events. Thirty-two conditions continue in force until revoked or modified by the Commission pursuant to KRS 278.390.

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[4] *See* Case No. 2010-00204, *Joint Application of PPL Corporation, E.On Ag, E.On US Investments Corp., E.On U.S. LLC, Louisville Gas and Electric Company, and Kentucky Utilities Company for Approval of an Acquisition of Ownership and Control of Utilities* (Ky. PSC Sept. 30, 2010); Case No. 2005-00228, *Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., the Cincinnati Gas & Electric Company, and the Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control* (Ky. PSC Nov. 29, 2005); Case No. 2000-00129, *Joint Application of NiSource Inc., New NiSource Inc., Columbia Energy Group and Columbia Gas of Kentucky for Approval of a Merger* (Ky. PSC June 30, 2000).

Kentucky-American is requesting release from seven of the 32 conditions that did not contain express or implied termination dates or events.

1. 2006-00197 Order, ordering paragraph 9 ("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.[5]

The Commission set forth this requirement to ensure that Kentucky-American was responsive to and involved in the communities that it served. The Commission deemed that public interest required that Kentucky-American management have sufficient authority and autonomy to address local concerns.[6]

The reporting requirement set forth in Ordering Paragraph 9 effectuates two conditions in Appendix A to the Order, Conditions 29 and 30, which require Kentucky-American to actively support economic development, civic, and charitable activities, for as long as Kentucky-American continues to serve the areas that it served at the time of the issuance of the Order at a level comparable to or greater than levels prior to the date of the transfer. In its motion, Kentucky-American requests release from the reporting requirement only, and not the expenditure requirement.

In its motion, Kentucky-American argues that it should be released from Ordering Paragraph 9 because it is no longer necessary. Kentucky-American asserts that its record of economic development, civic, and charitable activities are evidence that Kentucky-American meaningfully contributes to the communities it serves.

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[5] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[6] 2006-00197 Order at 21.

Kentucky-American further asserts that its support of these activities before and after the transaction has remained constant because its local management maintains control over these activities.

2. 2006-00197 Order, Appendix A, condition 4 ("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.[7]

The Commission set forth this requirement to ensure that Kentucky-American was adequately funded to prevent a possible degradation of service quality.[8] The provision requiring Commission approval prior to the transfer of an asset with original book value in excess of $1 million enables the Commission to monitor post-transaction activity to prevent misuse of utility resources. The provision that Kentucky-American obtain Commission approval prior to the transfer of real property or real estate with a net original book value in excess of $200,000 was related to concerns raised by Lexington-Fayette Urban County Government ("LFUCG") regarding Kentucky-American's plans for Jacobson Park.[9] LFUCG leased the property on which the park is located until 2011, when the park was transferred to LFUCG pursuant to

[7] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[8] 2006-00197 Order at 19-20.

[9] 2002-00018 Order at 25.

Commission approval.[10] LFUCG expended a great deal of resources to develop the park and was concerned it would lose the benefit if the property were sold to a third party.

In its motion, Kentucky-American argues that it should be released from Condition 4 because continuing oversight is unnecessary. Kentucky-American contends that it is subject to statutes and regulations that are sufficient for the Commission to monitor Kentucky-American's financial information. As an example, Kentucky-American points to 807 KAR 5:006, Sections 4(2) and 4(3), which require Kentucky-American to file annual financial reports and financial statement audit reports. Kentucky-American further argues that the information it has provided since the conditions were imposed demonstrate that Kentucky-American's management retained and exercises local control over finances.

3. 2006-00197 Order, Appendix A, condition 16 ("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.[11]

The Commission set forth this requirement to ensure that Kentucky-American is adequately funded to prevent a possible degradation of service quality.[12] This

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[10] Case No. 2005-00214, *Petition of Kentucky-American Water Company for Approval of the Transfer of Control and Ownership of Jacobson Park* (Ky. PSC Apr. 28, 2006). The transfer approved in 2006 did not take effect until 2011, pursuant to the terms of the transfer agreement

[11] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[12] 2006-00197 Order at 19-20.

requirement was imposed in the 2002-00018 Order as part of the suite of conditions to monitor post-transaction financial activity to prevent misuse of Kentucky-American financial resources.[13]

In its motion, Kentucky-American argues to be released from Condition 16 because it restricts Kentucky-American's ability to improve its capital structure, lower its weighted cost of capital, and reduce its level of financial risk. Kentucky-American further argues that the required equity ratio falls "well below" that of its peers.[14] Lastly, Kentucky-American asserts that it is unable to find any other jurisdictional utility for which the Commission imposed a maximum equity-to-capital ratio.

4. 2006-00197 Order, Appendix A, condition 17 ("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.[15]

The Commission set forth this requirement to ensure that Kentucky-American is adequately funded to prevent a possible degradation of service quality.[16] This requirement was first imposed in the 2002-00018 Order as part of the suite of conditions

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[13] 2002-00018 Order at 20-22.

[14] Kentucky-American reviewed the equity ratios of Water Service Corporation of Kentucky, Columbia Gas of Kentucky, Atmos Energy Corporation, Louisville Gas and Electric Company, and Kentucky Utilities Company.

[15] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[16] 2006-00197 Order at 19-20.

to monitor post-transaction financial activity to prevent misuse of Kentucky-American financial resources.[17]

In its motion, Kentucky-American argues it should be released from Condition 17 because continuing oversight is unnecessary. Kentucky-American contends that it is subject to statutes and regulations that are sufficient to monitor Kentucky-American's financial information. As an example, Kentucky-American points to 807 KAR 5:006, Sections 4(2) and 4(3), which require Kentucky-American to file annual financial reports and financial statement audit reports. Kentucky-American further argues that the information it has provided since the conditions were imposed demonstrates that Kentucky-American's management retained and exercises local control over finances.

5. 2006-00197 Order, Appendix A, condition 20 ("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.[18]

The Commission set forth this requirement to ensure that Kentucky-American is adequately funded to prevent a possible degradation of service quality.[19] This condition was first imposed in 2002-00018 Order as part of the suite of conditions to monitor post-transaction financial activity to prevent misuse of Kentucky-American financial resources.[20]

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[17] 2002-00018 Order at 20-22.

[18] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[19] 2006-00197 Order at 19-20.

[20] 2002-00018 Order at 20-22.

In its motion, Kentucky-American argues it should be released from Condition 20 because continuing oversight is unnecessary. Kentucky-American contends that it is subject to statutes and regulations that are sufficient to monitor Kentucky-American's financial information. As an example, Kentucky-American points to 807 KAR 5:006, Section 4(2) and 4(3), which require Kentucky-American to file annual financial reports and financial statement audit reports. Kentucky-American further argues that the information it has provided since the conditions were imposed demonstrate that Kentucky-American's management retained and exercises local control over finances.

6. 2006-00197 Order, Appendix A, condition 21 ("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 transfers 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.[21]

The Commission set forth this requirement to ensure that Kentucky-American is adequately funded to prevent a possible degradation of service quality.[22] This requirement was first imposed in 2002-00018 Order as part of the suite of conditions to monitor post-transaction financial activity to prevent misuse of Kentucky-American financial resources.[23]

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[21] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[22] 2006-00197 Order at 19-20.

[23] 2002-00018 Order at 20-22.

In its motion, Kentucky-American argues it should be released from Condition 21 because it is unnecessary. Kentucky-American notes that this requirement was intended to safeguard against any attempt to deprive Kentucky-American of necessary financial resources. Kentucky-American asserts that the record since imposition of this requirement demonstrates that it has not unnecessarily transferred funds to AWWC. In addition, Kentucky-American asserts that it is subject to statutes and regulations that are sufficient for the Commission to monitor dividend payments and other funds transfers. As an example, Kentucky-American points to 807 KAR 5:001, Section 12, and 807 KAR 5:006, Sections 4(2) and 4(3), which require reporting of dividend payments.

7. 2006-00197 Order, Appendix A, condition 26 ("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.[24]

The Commission set forth these requirements to ensure that service quality was not degraded through drastic changes in workforce levels.[25] This condition was first imposed in 2002-00018 Order to address concerns regarding potential post-transaction reductions in the workforce, and the subsequent impact upon service.[26]

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[24] A similar requirement was imposed on Kentucky-American in the 2002-00018 and 2002-00317 Orders.

[25] 2006-00197 Order at 19-20.

[26] 2002-00018 Order at 20-22.

In its motion, Kentucky-American argues it should be released from Condition 26 requirements because Kentucky-American has demonstrated that it maintains a workforce that provides high-quality service. Kentucky-American further argues that any positions that were eliminated were in response to operational efficiencies and technological improvements. Lastly, Kentucky-American asserts that the Commission retains the statutory authority to monitor or investigate the level and quality of Kentucky-American's workforce. Kentucky-American notes that it does not anticipate any workforce reduction.

FINDINGS

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. Kentucky-American's request to be released from Ordering Paragraph 9, which requires Kentucky-American to report its economic development, civic, and social expenditures, should be denied. The reporting requirement was agreed to as part of the transfer case. Kentucky-American has not demonstrated that complying with the requirement is either burdensome or onerous, and it has not set forth sufficient cause to support a release of the condition imposed in Ordering Paragraph 9. Further, the reporting requirement assists the Commission in monitoring Kentucky-American's financial support for economic development, civic, and social activities pursuant to Conditions 29 and 30.

2. Kentucky-American's request to be released from Condition 4 should be granted in part and denied in part. The Commission finds that Kentucky-American

should be released from the requirement to obtain prior approval from the Commission for transfers of real property with a net original book value in excess of $200,000, which was imposed to monitor the sale of Jacobson Park. In 2006, the Commission approved Kentucky-American's transfer of Jacobson Park to LFUCG, which was finalized in 2011. Once the real property transfer was approved and completed, the rationale for this condition became moot and continued oversight became unnecessary. The Commission further finds that Kentucky-American's request to be released from the requirement to obtain prior approval for the transfer of any asset with an original book value in excess of $1 million should be denied. Kentucky-American has failed to set forth good cause for the Commission to release Kentucky-American from this requirement, which has been imposed upon and continues to be in effect for similarly situated utilities to monitor activity that could affect the quality of service provided to ratepayers.[27]

3. Kentucky-American's request to be released from Condition 16 should be denied without prejudice. Condition 16 imposes an equity floor and equity ceiling on Kentucky-American. The equity floor was requested by intervenors in Case No. 2006-00197 to ensure that Kentucky-American maintained a level of equity investment that was sufficient to prevent excessive debt leveraging that could limit its access to capital and increase its cost of debt. Similarly, the intervenors requested an equity ceiling to prevent excessive equity funding of capital investment that may unnecessarily increase

[27] Similar requirements were imposed in the following cases: Case No. 2010-00204, *Joint Application of PPL Corporation, E.On Ag, E.On US Investments Corp., E.On U.S. LLC, Louisville Gas and Electric Company, and Kentucky Utilities Company* (Ky. PSC Sept. 30, 2010), Final Order, Appendix C, Regulatory Commitments, Item 6; and 2000-00129, *Joint Application of NiSource Inc., New NiSource Inc., Columbia Energy Group, and Columbia Gas of Kentucky* (Ky. PSC June 30, 2000), Final Order, Appendix A, Item 13.

Kentucky American's revenue requirement and, thus, increase consumer rates. The Commission recognizes that Kentucky-American agreed to Condition 16 at the request of the intervening parties in that case. Because those parties did not intervene in this proceeding and have not stated their position on Kentucky-American's request, and because removal of the condition may impact rates, Kentucky-American's request for removal of Condition 16 could be included in its next rate case filing where the impact to its rates and capital structure can be addressed by all stakeholders.

4. Kentucky-American's request to be released from Condition 17 should be granted. The filing of information regarding the downgrade of the bonds of AWWC or any AWWC subsidiary is no longer necessary.

5. Kentucky-American's request to be released from Condition 20 should be denied. Kentucky-American has not set forth sufficient cause to support a release of the requirement that Kentucky-American notify the Commission of significant issuances of securities by AWWC, Kentucky-American's parent company. These capital additions are not detailed in other reports filed with the Commission by Kentucky-American as suggested by Kentucky-American. Significant issuances of securities by a parent company are of particular interest to the Commission as the financial health of a parent company has a direct impact on its subsidiaries. Absent this condition, the Commission cannot reliably track and monitor significant capital additions of AWWC.

6. Kentucky-American's request to be released from Condition 21 should be denied. This condition was imposed to monitor financial activity that could affect the

quality of service provided to ratepayers. Kentucky-American has failed to set forth good cause for the Commission to release Kentucky-American from the requirement to report dividend payments or other funds transferred to AWWC.

7. Kentucky-American's request to be released from Condition 26 should be denied. This condition is neither burdensome nor onerous, and was agreed to as part of the transfer case. If, as Kentucky-American states in its motion, it does not anticipate any workforce reduction, then it will never have to file such a notice and study. However, if Kentucky-American ever does intend to reduce its workforce by 5 percent or more, the Commission should have the ability to review the anticipated impacts on service and service quality before the reduction takes place.

IT IS THEREFORE ORDERED that:

1. Kentucky-American's request to be released from Ordering Paragraph 9 of the 2006-00197 Order, and Conditions 16, 20, 21, and 26 in Appendix A to that Order, are denied without prejudice.

2. Kentucky-American's request to be released from Condition 4 in Appendix A of the 2006-00197 Order is granted to the extent that the requirement to obtain prior approval for transfers of real property or real estate with a net original book value in excess of $200,000 is terminated and is denied to the extent that the requirement to obtain prior approval for transfers of any asset with an original book value in excess of $1 million shall remain in full force and effect.

3. Kentucky-American's request to be released from Condition 17 in Appendix A of the 2006-00197 Order is granted.

By the Commission

ENTERED

MAY 15 2015

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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