

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY-AMERICAN)
WATER COMPANY FOR ISSUANCE OF)
INDEBTEDNESS AND CONTINUED) CASE NO. 2009-00156
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 AWCC borrowing program, and the issuance of securities in the form of notes or debentures in the amount of \$104.5 million prior to November 1, 2010.

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

¹ Kentucky-American filed its application on April 13, 2009. No persons have sought intervention in this matter.

² KRS 278.010(3)(d).

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 enters into an agreement with AWCC, a wholly owned subsidiary of American Water, for financial services. AWCC arranges 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 provides AWCC with an estimate of its future borrowing requirements. AWCC then arranges borrowing commitments and programs to meet these commitments. The liability of each participant in the program is limited to its individual debt. All loans to the program participants are unsecured.

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

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).

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

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, 2005.⁵ In Case No. 2006-00418,⁶ the Commission authorized Kentucky-American's continued participation in the AWCC borrowing program.

On November 21, 2006, AWCC approved and implemented a \$700 million Commercial Paper Program with a committed revolving facility backstop of \$800 million.⁷ On December 31, 2008 AWCC committed an additional \$40 million to this line bringing the total available to \$840 million.⁸ The \$840 million of short-term financing will be used to fund the working capital needs of American Water, its regulated subsidiaries, and American Water Works Service Company.⁹ AWCC has obtained funds from a

⁵ Case No. 2000-00189, Order of July 21, 2000 at 3.

⁶ Case No. 2006-00418, *Application of Kentucky-American Water Company for Continued Participation with American Water Capital Corp.* (Ky. PSC May 8, 2007).

⁷ Application at 4.

⁸ *Id.*

⁹ Application at 4.

syndicated bank credit line for short-term loans and from its own debt securities, all with the support of American Water.¹⁰

Kentucky-American's continued participation in the AWCC borrowing program will include support of the short-term debt issuances. As of January 31, 2009, Kentucky-American reported outstanding short-term debt in the amount of \$56,383,691 payable to AWCC.¹¹ Prior to December 31, 2010, Kentucky-American will be required to obtain additional short-term borrowings primarily driven by the costs it will incur to construct the Kentucky River Station II Project ("KRS II").¹²

To refinance the short-term debt used to fund the construction of KRS II and other projects and to meet other internal cash requirements, Kentucky-American plans several long-term debt issuances prior to October 31, 2010. To maintain a reasonable relationship between long-term debt and common equity, Kentucky-American expects infusions of additional equity from American Water in the form of paid-in capital.¹³ Kentucky-American's projected financing and equity requirements for the calendar years 2009 and 2010 are set forth in Table 1 below.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.* at 5. See Case No. 2007-00134, *The Application of Kentucky-American Water Company for a Certificate of Public Convenience and Necessity Authorizing the Construction of Kentucky River Station II, Associated Facilities and Transmission Main* (Ky. PSC April 25, 2008) (granting Certificate of Public Convenience and Necessity to construct KRS II project and water transmission main).

¹³ Kentucky-American is currently required to maintain an equity-to-capital ratio between 35 to 45 percent. 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).

Table 1: Financing and Equity Requirements		
Projected Month of Debt Issuance or Equity Infusion	Financing	Equity
May 2009	\$ 45.5 Million	-0-
October 2009	-0-	\$ 10.0 Million
November 2009	\$ 26.0 Million	-0-
March 2010	-0-	\$ 16.0 Million
May 2010	\$ 14.0 Million	-0-
October 2010	\$ 19.0 Million	\$ 5.0 Million

A portion of the \$104.5 million of long-term debt that Kentucky-American intends to issue involves the proceeds of tax-exempt bonds that Owen County will issue to assist with the construction of the KRS II Project. The Commonwealth of Kentucky has approved the issuance of \$45,393,067 of its private activity bonds by Owen County for this purpose.¹⁴ Owen County will issue such bonds and loan the proceeds of the issuance to AWCC, which in turn will lend these proceeds to Kentucky-American to permanently finance a portion of the costs associated with the construction of KRS II facilities. Because interest payments from these bonds are exempt from federal taxation, the cost of this debt should be lower than that of other methods of debt financing.

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

1. Kentucky-American's previous participation in the borrowing program with AWCC has resulted in a reduction to the cost of Kentucky-American's short-term and long-term debt. Its continued participation should result in similar reductions.

¹⁴ Letter from F. Thomas Howard, Executive Director, Office of Financial Management, Finance and Administration Cabinet, to Spencer E. Harper, Jr., Bond Counsel for Kentucky-American Water Company (Mar. 27, 2009).

2. Kentucky-American's continued participation in the borrowing program with AWCC under the terms of the Financial Services Agreement that was executed with AWCC on June 15, 2000 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.

3. Kentucky-American's proposed issuance of securities in the form of notes or debentures in an aggregate amount of \$104.5 million for the purpose of refinancing the short-term debt used to fund the construction of KRS II and other projects and to meet other internal cash requirements 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.

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 advise the Commission in writing 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 evidence of indebtedness not specifically set forth in its application and included in the \$104.5 million refunding or refinancing.

IT IS THEREFORE ORDERED that:

1. Kentucky-American is authorized to continue participating in the AWCC borrowing program under the terms of the Financial Services Agreement that it executed with AWCC on June 15, 2000.

2. Kentucky-American is authorized to issue to AWCC securities in the form of notes or debentures in an aggregate amount of \$104.5 million from time to time prior to November 1, 2010 for the purpose of refinancing the short-term debt used to fund KRS II and other construction expenditures and to meet other internal cash requirements.

3. Kentucky-American is authorized to enter into any guaranty agreement or similar undertaking guaranteeing repayment of the proceeds of any private activity bonds that Owen County issues in Calendar Year 2009 for the specific purpose of defraying some or all of the costs of the KRS II Project.

4. 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.

5. For all securities or evidences of indebtedness that have a term exceeding two 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 completion of the issuance.

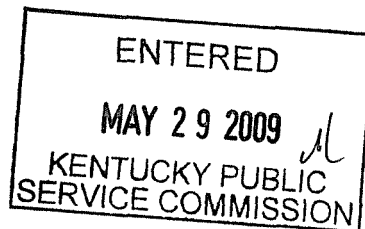
6. Kentucky-American shall obtain Commission approval prior to the issuance of any security or long-term evidences of indebtedness not specifically set forth in its application and included in the \$104.5 million approved herein.

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

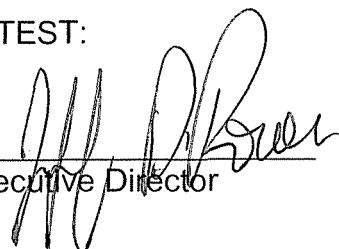
8. Kentucky-American's failure to comply with Ordering Paragraph 4 of this Order when issuing any security or long-term evidences of indebtedness as part of the AWCC Borrowing Program shall be deemed an issuance of security or long-term evidences of indebtedness without prior Commission authorization 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 accepted.

By the Commission



ATTEST:



Executive Director

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