

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. 2012-00393
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 \$20 million prior to December 31, 2014.

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, East Clark Water District, Jessamine-South Elkhorn Water District, Peaks Mill Water District, and

¹ On August 30, 2012, Kentucky-American requested a deviation from 807 KAR 5:001, Section 8(2), to permit the filing and service of all documents in this proceeding by electronic means only. The Commission granted this request on August 31, 2012. Kentucky-American filed its Application on August 31, 2012. No persons have sought intervention in this matter.

the cities of Georgetown, Midway, North Middletown, Nicholasville, and Versailles.² It is a utility subject to Commission jurisdiction.³

American Water Works Company (“American Water”), a Delaware corporation whose operating subsidiaries provide water, wastewater, and other water resource management services in 30 states and Canada, currently owns all outstanding shares of Kentucky-American stock. AWCC is a wholly-owned subsidiary of American Water and is a corporation organized under the laws of Delaware.

In 2000, Kentucky-American sought Commission authorization to participate in a borrowing program that American Water made available to each of its subsidiaries.⁴ Under this program, each American Water subsidiary enters into an agreement with AWCC 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

² *Annual Report of Kentucky-American Water Company for the Calendar Year Ended December 31, 2011* at 5, 33.

³ KRS 278.010(3)(d).

⁴ Case No. 2000-189, *The Application of Kentucky-American Water Company for Approval of Participation in the Borrowing Program* (Ky. PSC received Apr. 24, 2000).

in lower capital costs. Because the issuance costs⁵ 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 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, 2005.⁶ In Cases No. 2006-00418,⁷ No. 2009-00156,⁸ and No. 2011-00115,⁹ the Commission authorized Kentucky-American's continued participation in the AWCC borrowing program.

AWCC has in place a \$700 million Commercial Paper Program with a committed revolving facility backstop of \$840 million (collectively, the "Working Capital Facility").¹⁰ The \$840 million Working Capital Facility will be used to fund the working capital needs of American Water, its regulated subsidiaries, and American Water Works Service

⁵ Placement fees and legal fees are examples of issuance costs.

⁶ Case No. 2000-00189, Order of July 21, 2000 at 3.

⁷ Case No. 2006-00418, *Application of Kentucky-American Water Company for Continued Participation with American Water Capital Corp.* (Ky. PSC May 8, 2007).

⁸ Case No. 2009-00156, *Application of Kentucky-American Water Company for Issuance of Indebtedness and Continued Participation with American Water Capital Corp.* (Ky. PSC May 29, 2009).

⁹ Case No. 2011-00115, *Application of Kentucky-American Water Company for Issuance of Indebtedness and Continued Participation with American Water Capital Corp.* (Ky. PSC May 26, 2011).

¹⁰ App. ¶ 8.

Company.¹¹ Of the committed revolving credit facility, \$150 million is available to AWCC for letters of credit.¹² AWCC has obtained funds from a syndicated bank credit line for short-term loans and from its own debt securities, all with the support of American Water.¹³

Kentucky-American's continued participation in the AWCC borrowing program will include support of the short-term debt issuances. As of July 31, 2012, Kentucky-American reported outstanding short-term debt in the amount of \$10,908,133 payable to AWCC.¹⁴

Kentucky-American plans five long-term debt issuances prior to December 31, 2014. The total sum of these debt issuances will be \$20 million. The proceeds of these debt issuances will be used to refinance the short-term debt used to fund various construction projects,¹⁵ and to meet other internal cash requirements.

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. Kentucky-American's projected financing and equity requirements for the calendar years 2012 through 2014 are set forth in Table I.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at ¶ 9.

¹⁵ Kentucky-American's Response to Commission Staff's First Request for Information, Item 1 (filed Oct. 12, 2012).

TABLE I		
<u>Projected Month of Debt Issuance or Equity Infusion</u>	<u>Financing</u>	<u>Equity¹⁶</u>
November 2012	\$ 8 Million	\$ 4 Million
March 2013	\$ 3 Million	
November 2013	\$ 3 Million	\$ 2 Million
March 2014	\$ 3 Million	
November 2014	\$ 3 Million	\$ 2 Million

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.¹⁷ Its continued participation should result in similar reductions.

2. Kentucky-American's continued participation in the borrowing program with AWCC under the terms of the Financial Service Agreement that it 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 \$20 million for the purposes of refinancing the short-term debt used to fund various construction 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

¹⁶ Kentucky-American did not state a target month for the projected equity infusions for calendar years 2013 and 2014. The projected equity infusion for 2012 will occur in the month of December.

¹⁷ Kentucky-American's Response to Commission Staff's First Request for Information, Item 3 (filed Oct. 12, 2012).

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 Financial Services 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 \$20 million refunding or refinancing.

6. No determination is made in this Order regarding the need for or reasonableness of the proposed Northern Division Connection, nor is use of any proceeds from the proposed debt issuances for the construction of the Northern Division Connection authorized until and unless Kentucky-American is granted a Certificate of Public Convenience and Necessity to construct such project.

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. a. Kentucky-American is authorized to issue to AWCC securities in the form of notes or debentures in an aggregate amount of \$20 million from time to time, prior to December 31, 2014, for the purpose of refinancing the short-term debt used to fund various construction expenditures and to meet other internal cash requirements.

b. Kentucky-American shall obtain an interest rate from AWCC that is no greater than the lowest available rate to Kentucky-American or the average rate available on bonds issued by AWCC.

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 two years and that are issued under the Financial Services 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 analysis shall also include a comparison of the interest rate obtained to the lowest rate available to Kentucky-American and the average interest rate on bonds issued by AWCC. 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 \$20 million approved herein.

6. The proceeds from the financing authorized herein shall be used only for the lawful purposes set out in the Application. None of proceeds, however, shall be used for the construction of the Northern Division Connection until and unless Kentucky-

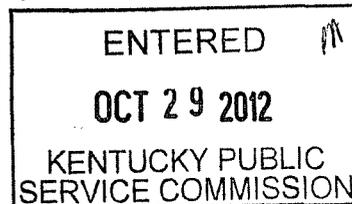
American is granted a Certificate of Public Convenience and Necessity to construct such project.

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).

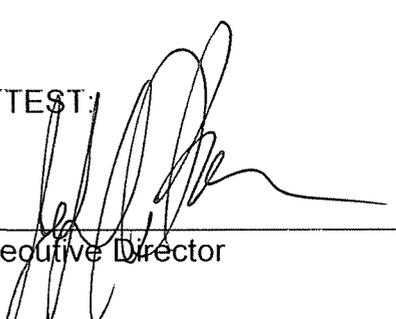
8. Any documents filed pursuant to ordering paragraphs 3 and 4 of this Order shall reference the number of this case and shall be retained in the utility's general correspondence file.

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

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