

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

JOINT FILING SEEKING AUTHORITY FOR)
KENTUCKY WATER SERVICE COMPANY, INC.,)
TO TRANSFER ITS WATER PLANTS LOCATED)
AT MIDDLESBORO AND AT CLINTON TO THE) CASE NO. 9431
AQUA CORPORATION AND FOR THE AQUA)
CORPORATION TO ISSUE COMMON STOCK)
AND TO ASSUME OBLIGATIONS TO MEET)
INDUSTRIAL REVENUE BONDS DEBT SERVICE)

O R D E R

On August 1, 1985, the Aqua Corporation ("Aqua") filed an application in Case No. 9392, The Application of the Aqua Corporation ("Aqua") for Authority to Acquire 100 Percent of the Common Stock of Kentucky Water Service Company, Inc., ("Kentucky Water"). Kentucky Water currently owns and operates three plants in the cities of Somerset, Middlesboro and Clinton. When the application in Case No. 9392 was filed, the plan was for Aqua to purchase all the stock of Kentucky Water and then, in a separate proceeding before the Commission, request approval for Aqua to direct Kentucky Water to sell the Middlesboro and Somerset plants to the respective cities. Kentucky Water would still own and operate the Clinton plant. An Order issued on September 9, 1985, granted approval for the transfer of ownership of Kentucky Water to Aqua. However, since the original filing, the City of Middlesboro has changed positions and does not currently intend to purchase the Middlesboro plant. On September 27, 1985, Kentucky

Water filed two additional joint applications, Case No. 9431 and Case No. 9432, a Joint Filing Seeking Authority for Kentucky Water to Transfer its Water Plant and Associated Facilities Located at Somerset to the City of Somerset ("Somerset").

In this proceeding, Case No. 9431, Kentucky Water and Aqua are requesting approval for Kentucky Water to transfer the Middlesboro and Clinton water plants to Aqua, in addition to requesting approval for Aqua to issue common stock in the amount of \$200,000, and further authorization for Aqua to assume the debt service on Industrial Revenue Bonds to be issued by the cities of Middlesboro and Clinton in the amounts of \$3,000,000 and \$400,000 respectively.

In summary, the current plans for the change in ownership of Kentucky Water is for Aqua to purchase the Middlesboro and Clinton facilities, Case No. 9431, to enact the Order of Case No. 9392 by having Aqua purchase 100 percent of the outstanding stock of Kentucky Water, and then have Aqua direct Kentucky Water to sell all the Somerset facilities, including inventory, to Somerset in Case No. 9432.

This Order addresses the Commission's findings and determinations on issues presented and disclosed in its examination of Case No. 9431, which is Kentucky Water's proposal for Aqua to purchase the Middlesboro and Clinton facilities from Kentucky Water, in addition to Aqua's proposal of issuing common stock and Aqua assuming the debt service on Industrial Revenue Bonds to be issued by the cities of Middlesboro and Clinton.

On October 30 and 31, 1985, informal conferences were held at the Commission's offices to discuss the proposals of Kentucky Water, Aqua, and Somerset. No motions to intervene in this matter were filed, nor were there any requests for a public hearing.

COMMENTARY

Kentucky Water is owned by 65 shareholders and operates three plants in the counties of Pulaski, Bell and Hickman. The three plants serve the following number of customers:

<u>Plant</u>	<u>No. of Customers</u>
Somerset	6,375
Middlesboro	5,139
Clinton	777

DISCUSSION OF ISSUES

Aqua entered into an option to purchase the Middlesboro and Clinton plants with Kentucky Water on September 26, 1985. The Middlesboro and Clinton facilities to be purchased by Aqua include the following: all land, buildings, structures, easements, plant facilities, equipment, furniture and fixtures, vehicles and tools, water lines, supply lines and, with the exception of materials and supplies (inventory), all other miscellaneous tangible property. The option expires on December 31, 1985.¹

The Inducement Contracts entered into by the City of Middlesboro and Aqua and the City of Clinton and Aqua on October 3, 1984, state that the respective cities will make the financing possible through the issuance of bonds and will lend the proceeds to Aqua. Aqua agrees to pay the respective cities the

¹ Exhibit C of the Application.

principal of and interest on the bonds, as and when the same become due and payable, until all of the bonds have been retired. The proposed bonds would not be a general obligation debt of the respective cities, but would be secured only by a first pledge of the revenues of the Middlesboro and Clinton facilities.²

Under the proposed reorganization, the Middlesboro and Clinton facilities would be under the management of the president of Aqua, J. David Whitehouse. However, since the proposal includes Kentucky Water becoming a wholly-owned subsidiary of Aqua, substantially the same employees who operate the plants now will continue to operate them under the direction of Aqua.

During the informal conference held on October 31, 1985, the accountant for Aqua and Kentucky Water, Charles Stivers with the firm Eskew and Gresham PSC, stated that he was aware of the Commission's general practice in the past of not allowing amortization of the acquisition adjustment for rate-making purposes. If Aqua chooses to proceed with the purchase, it must do so with no assurance that the amortization of the acquisition adjustment or capital cost associated with the acquisition adjustment will be allowed for rate-making purposes. In the next rate case, if Aqua proposes to recover the plant acquisition adjustment, in resolving these issues the Commission will base its decision on such factors including, but not limited to, the following: 1) negotiated price paid; 2) improvements in quality of service; 3) the initial investment per customer, based on the

² Inducement Contracts, Exhibit D of the Application.

negotiated price; 4) the cost involved in restoring the system to required standards; 5) the potential to add additional customers through acquisition; 6) operational economics; 7) the total facilities involved in the purchase, including both utility and non-utility property; 8) the short- and long-run economic benefits of the acquisition at a price in excess of net book; and 9) overall benefits to existing and new customers.

FINDINGS

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. Aqua is ready, willing and able to purchase and operate the Middlesboro and Clinton facilities currently owned by Kentucky Water. Furthermore, the stockholders of Kentucky Water are ready, willing and able to sell, inasmuch as they wish to divest themselves of the ownership and operation of these facilities.

2. The quality of service to the present customers of these facilities will not suffer in that Kentucky Water's employees will continue to operate the facilities under the direction of Aqua, since it is proposed that Kentucky Water will become a wholly-owned subsidiary of Aqua (Case No. 9432).

3. The agreed-upon purchase price for the Middlesboro and Clinton facilities is \$2,878,000, which was determined through negotiations between the stockholders of Kentucky Water and the directors and officers of Aqua.

4. Aqua has filed with the Commission its Articles of Incorporation.

5. Aqua requested, and the Commission approves, the initial issue of common stock up to the amount of \$200,000 comprised of 2,000 shares of no-par value common stock to be sold at \$100 per share.

6. Aqua should maintain its books of account in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission. Accounting for an acquisition includes:

a. Recording the utility plant acquired at its original cost to the person first devoting it to public service, estimated if not known, in the appropriate utility plant in service accounts;

b. Crediting the requirements for accumulated provision for depreciation and amortization applicable to the original cost of the properties acquired to the appropriate account for Accumulated Provision for Depreciation and Amortization;

c. Transferring the cost of any non-utility property to Account No. 121--Non-Utility Property;

d. Crediting contributions in aid of construction, estimated if not known, to Account No. 271--Contributions in Aid of Construction; and

e. Including in Account No. 108--Utility Plant Acquisition Adjustment, any difference between the purchase price and the original cost of the utility plant and non-utility property less the amounts credited to Accumulated Depreciation and Amortization Reserves and Contributions in Aid of Construction.

7. The granting of approval of the transfer of the two plants in this proceeding does not constitute approval of the journal entries to be recognized upon the transfer. The proposed journal entries filed November 1, 1985, are not in conformity with the Uniform System of Accounts and/or with the Commission's ratemaking procedures. Approval of these journal entries could be the subject of future Orders if the Commission so determines.

8. The journal entries to be recognized by Kentucky Water and Aqua, due to the proposals, should be filed with the Commission within 20 days of the transfer.

9. Where legal and proper for general accounting purposes, this acquisition transaction, if not at "book value," can either increase or decrease the debt and/or equity on the utility's books. Therefore, Aqua is hereby apprised that, in its next rate case, it will have the burden of proof of demonstrating why interest charges on debt that exceed those charges which would have been incurred to finance the original cost of plant in service, excluding any acquisition adjustment less accumulated depreciation and contributions in aid of construction, should be allowed for rate-making purposes. It will also have the burden of proof of demonstrating why a return on equity or amortization of an acquisition adjustment that resulted from this transaction should be allowed for rate-making purposes.

10. Aqua should adopt the existing rates, rules and regulations filed with and approved by the Commission for Kentucky Water.

11. Aqua will finance the purchase through proceeds from Industrial Revenue Bonds actually to be issued by the cities of Middlesboro and Clinton in the amounts of \$3,000,000 and \$400,000 respectively. The bonds will be amortized over 15 years at a fixed rate of 9.25 percent for 10 years. Aqua will assume the debt service on the bonds. The proceeds of the bonds will be used for purchase of facilities in the amount of \$2,878,000, bond issuance costs of \$125,000, and rehabilitation fund requirements of \$397,000.

12. Kentucky Service should file a final Annual Report reflecting the results of its operations for the period from January 1, 1985, through the date of closing.

IT IS THEREFORE ORDERED that:

1. The transfer of Kentucky Water's Middlesboro and Clinton facilities to Aqua be and it hereby is approved subject to the conditions set forth previously in the findings of this Order.

2. The financing of \$3,400,000 as described in Finding No. 11 be and it hereby is approved, subject to Aqua's filing a plan to spend the rehabilitation funds.

3. In future rate cases, the allowable costs, both capital and expense, associated with this transfer will be determined in accordance with Finding No. 9.

4. Aqua shall account for this transfer in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission as described in Finding No. 6.

5. Kentucky Water and Aqua shall file the required journal entries in accordance with Finding No. 8.

6. Aqua shall adopt the existing rates, rules and regulations filed with and approved by the Commission for Kentucky Water.

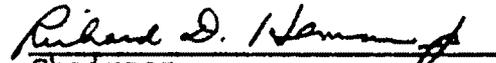
7. The initial issuance of common stock by Aqua as described in Finding No. 5 be and it hereby is approved.

8. Kentucky Water shall file an Annual Report for the partial year 1985 in accordance with Finding No. 12.

9. Nothing contained herein shall be deemed a warranty or finding of value of securities authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

Done at Frankfort, Kentucky, this 15th day of November, 1985.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary