

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

COMPLIANCE OF KENTUCKY-AMERICAN)
WATER COMPANY, AMERICAN WATER WORKS)
COMPANY, RWE AKTIENGESELLSCHAFT AND)
THAMES WATER AQUA HOLDINGS GMBH WITH)
THE PROVISIONS OF THE ORDERS) CASE NO. 2002-00277
APPROVING THE TRANSFER OF CONTROL OF)
KENTUCKY-AMERICAN WATER COMPANY TO)
RWE AKTIENGESELLSCHAFT AND THAMES)
WATER AQUA HOLDINGS GMBH)

ORDER

Kentucky-American Water Company (“Kentucky-American”), Thames Water Aqua Holdings (“Thames”), Thames Water Aqua US Holdings, Inc. (“TWUS”), RWE Aktiengesellschaft (“RWE”) and American Water Works Company (“AWWC”) (collectively “Joint Applicants”) have applied for Commission approval of Kentucky-American’s 2005 Third Quarter Dividend on common stock (“Third Quarter Dividend”). Finding that the Commission may not retroactively approve Kentucky-American’s payment of the Third Quarter Dividend, we deny the application.

In Case No. 2002-00317,¹ the Commission approved the transfer of control of Kentucky-American from AWWC to Thames, TWUS, and RWE subject to 61 conditions. One of these conditions was that Joint Applicants obtain Commission approval prior to

¹ 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).

the payment of any dividend or transfers of any funds within a calendar year that collectively represent more than 5 percent of Kentucky-American's retained earnings as of December 31 of the prior calendar year to RWE, Thames, TWUS or any other entity related to RWE.²

We imposed this condition to ensure Kentucky-American's financial ability to provide reliable service and to guard against any effort to drain Kentucky-American's treasury to finance RWE's acquisition of AWWC or pay the premium associated with the acquisition.³ It enables us to monitor transfers from Kentucky-American and prevent unusual or extraordinary transfers of funds. Absent the imposition of this condition, our statutory ability to monitor and prevent such conduct is very limited.

On October 26, 2005, Kentucky-American Water Company ("Kentucky-American") declared its Third Quarter Dividend of \$830,717 that was scheduled to be paid on December 5, 2005. Joint Applicants submitted their request for Commission approval of Kentucky-American's Third Quarter Dividend on December 7, 2005.

Because of an error in the information presented to its Board of Directors ("Board"), Kentucky-American declared a first quarter common stock dividend of \$862,065. Kentucky-American's management informed its Board that \$1,184,542 of earnings was available for the common stock dividend when only \$174,541 was actually available. Kentucky-American states the error was not discovered in time for corrective action until the Board met to consider the third quarter results.

² Id., App. A at 6.

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) at 20 – 21.

In the third quarter of 2005 Kentucky-American reported earnings available for common stock dividends of \$2,761,477, which should have resulted in a dividend of \$2,071,107. However, due to the error that occurred in the first quarter of 2005, Kentucky-American only declared and paid a Third Quarter Dividend of \$830,717, so as not to violate its 75 percent dividend policy.⁴

Applicants state that Kentucky-American's declared Third Quarter Dividend of \$830,717 is in conformity with the historical dividend policy of paying 75 percent of earnings available for common dividends.⁵ Collectively the declared dividend of December 6, 2005 and dividends paid earlier in 2005 represent more than 5 percent⁶ of Kentucky-American's accumulated retained earnings as of December 31, 2004.⁷

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<u>Quarter</u>	<u>Quarter Ending</u>	<u>Payable Date</u>	<u>Earnings Available</u>	<u>Quarterly Dividend</u>	<u>Dividends as % of Earnings</u>
4 th Quarter 2004	12/10/04	03/21/05	\$ 49,559	\$ 31,348	63.254%
1 st Quarter 2005	03/25/05	06/20/05	124,982	862,065	689.751%
2 nd Quarter 2005	06/24/05	09/19/05	(632,171)	0	0.000%
3 rd Quarter 2005	09/23/05	12/05/05	+ 2,761,477	+ 830,717	30.082%
Totals for 2005			<u>\$ 2,303,847</u>	<u>\$ 1,724,130</u>	74.837%

⁵ See Exhibit to Joint Applicants' Request for Approval of Dividend Payment.

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<u>Quarter</u>	<u>Quarter Ending Date</u>	<u>Payment Date</u>	<u>Dividend Amount</u>
4 th Quarter 2004	12/10/04	03/21/05	\$ 31,348
1 st Quarter 2005	03/25/05	06/20/05	862,065
2 nd Quarter 2005	06/24/05	09/19/05	0
3 rd Quarter 2005	09/23/05	12/05/05	+ 830,717
Total			\$ 1,724,130
Retained Earnings as of 12-31-04			÷ <u>25,924,241</u>
Ratio of Dividends to Retained Earnings			<u>6.65%</u>

⁷ Annual Report of Kentucky-American Water Company to the Public Service Commission of the Commonwealth of Kentucky for the Year Ended December 31, 2004 at 13.

Kentucky-American concedes that its payment of the Third Quarter Dividend on December 5, 2005 was a technical violation of Condition 32 but asserts that it “has not violated its policy, previously approved by the Commission of paying 75 percent of net income available to common stock as a common stock dividend.”⁸ Kentucky-American further states that “[a]ppropriate mechanisms have been put in place to prevent a recurrence of the mistake.”⁹

As Kentucky-American has failed to obtain Commission approval as required before making payment, the Commission will not now retroactively affirm or ratify that unlawful conduct. Kentucky-American paid its Third Quarter Dividend on December 5, 2005 – 2 days before Joint Applicants’ application for our approval of the dividend payment. Retroactive approval of Kentucky-American’s Third Quarter Dividend would only encourage utilities to enter into unauthorized transactions without obtaining the necessary regulatory approval and then present the transaction to the Commission as a fait accompli. Utilities that have failed to observe the law should not be excused from its requirements.¹⁰ We place Joint Applicants on notice that in the future their failure to fully comply with all Merger Commitments will subject each Joint Applicant to administrative sanctions. See KRS 278.990(1). We choose not to employ

⁸ Kentucky-American’s response to Commission Staff’s Request for Information, Item 4.

⁹ Id.

¹⁰ See, e.g., Kenton County Water District No. 1, Case No. 91-046 (Ky.PSC Nov. 8, 1991) at 4 (“As no purpose will be served by the post-execution approval of these documents, the Commission will not stamp its imprimatur upon these documents.”).

administrative sanctions here because of Kentucky American's assurance that appropriate mechanisms are indeed now in place to prevent a recurrence.

IT IS THEREFORE ORDERED that Joint Applicants' application for Commission approval of Kentucky-American's December 6, 2004 Third Quarter Dividend of \$391,848 is denied.

Done at Frankfort, Kentucky, this 19th day of May, 2006.

By the Commission

ATTEST:



Executive Director