COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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	]]]]]]]]	Case No. 2002-00317

Brief on behalf of Bluegrass FLOW, Inc.

The Joint Applicants have failed to prove their case that a change of control to Thames Water Aqua US Holdings, Inc.[1] should be approved. TWUS does not satisfy the statutory standards for approval. In addition, the evidence and testimony herein demonstrate that, far from the neutral event Joint Applicants suggest such a transfer to be, the public interest would suffer by the introduction of negative variables occasioned by international ownership. Jurisdictional defects have not been cured. In sum, the proposed event is detrimental to the public interest and the application should be denied.[2]

[1] For convenience and consistency, Bluegrass FLOW, Inc. adopts the abbreviations for the entities as set forth in the Joint Application.

[2] Bluegrass FLOW, Inc. does not waive and specifically reserves all other issues not addressed herein.

Fatal Procedural Error

For purposes of this discussion, TWUS must stand alone. While the Commission has incorporated by reference the evidence and testimony from Case No. 2002-00018, it has prohibited any discussion, inquiry, analysis or argument as to how that evidence affects TWUS. That is a procedural error of a magnitude which fatally taints the entire proceeding and denies the Intervenors and the public generally both substantive and procedural due process. For this reason alone, the Joint Application should be denied without prejudice to a new application with all relevant parties present and subject to full examination.

Even if the Commission allows this case to proceed, the natural effect of its Order limiting the scope of the case to only TWUS necessarily prohibits it from considering any evidence relevant to Thames Holdings or RWE.

Further, by so constricting the scope of this proceeding, any reversal, modification, remand or suspension of the Orders in Case No. 2002-00018 cannot be cured by an order in this case.

The Statutory Standards for Approval are not met

A two pronged analysis is required of the Commission under KRS 278.020, before it can approve the Joint Application for a transfer of control to TWUS. The relative merits of RWE and Thames Holdings, the grandparent and parent corporations, cannot be considered in this analysis, not only because the Commission has prohibited same, but because, as a practical matter, since the stock in TWUS is freely transferable, it must be presumed that any company could become the owner of TWUS at any time.[3]

Subsections (4) and (5) of KRS 278.020 both address transfer of control. It is a cardinal principle of statutory interpretation that, where possible, such subsections should be read together if they are not in conflict. They do not conflict; rather, the one enlarges upon the other in describing the obligations placed upon the Commission when a change of control is required.

Subsection (4) requires the Commission to find that the acquiring entity has the financial, technical and managerial abilities to provide reasonable service. TWUS must meet these objective standards but it cannot.

Subsection (5) further requires the Commission to find the change of control is in accordance with law, for a proper purpose and is consistent with the public interest. These are more subjective, but nonetheless require an analysis and

[3] Even the Joint Applicants characterize the swapping around of subsidiary corporations as mere "housekeeping" matters. (McGivern testimony, CD counter 2:44 (appx.)) TWUS, it should be noted, is not a regulated company and the Commission has no authority over the transfer of its stock, see infra, at p. 12.

finding by the Commission as to each point. Under any reasonable analysis, TWUS does not satisfy this subsection.

A failure on the part of TWUS to meet any one of the six elements defeats the Application as a whole.[4]

Financial ability

TWUS has none. It has no balance sheet, no income statement, no profit and loss statement, no pro forma, no financial statements of any kind. It will be funded at financial closing, the funds will be paid out to the selling shareholders, and TWUS will receive the stock certificates which it will then hold. (McGivern testimony, Smith testimony, Resp. to AG's Initial Request No. 9, Resp. to BGFlow's First Request No. 1.) It is a locked box and nothing more.

All TWUS will have post-transaction are the stock certificates for AWW and a board of directors which is comprised of the same people as the board of AWW. (McGivern testimony, counter 2:46 (appx.)) As the board members are not liable financially (Resp. to Staff Request No. 6), they contribute no financial ability.

The burden of proof has not been met that TWUS has the financial ability to support the operations of Kentucky-American.

Technical ability

[4] The Commission specifically limited the scope of the hearing and briefs to the qualifications of TWUS alone, excluding both Thames and RWE and their related companies. In Case No. 2002-00018, the Commission approved, subject to conditions, a transfer of control to Apollo Acquisition Corporation, which order is now on appeal. That case, arguably, is moot as Joint Applicants now seek approval for a transfer of American Water Works Company stock to TWUS. ("It is this transfer of AWW stock to TWUS for which approval is sought." Joint Application, p. 1.)

Mr. McGivern testified that all of the technical ability needed by TWUS will be supplied by Thames Water Plc (one of the English corporations). (McGivern testimony, counter No. 2:42:35 (appx.)) Of course, under the scope Order, no examination of Thames Water Plc could be had. In fact, counsel is unaware of any evidence incorporated by reference from Case No. 2002-00018 evidencing Thames Water Plc's technical ability. Thames Water Plc is a completely unexamined entity.[5]

In addition, and perhaps most significantly, there is no contract or other written instrument obligating Thames Water Plc to supply technical services, under what terms and for what consideration. Thames Water Plc is not even within the classification of "Joint Applicants" or "Joint Petitioners" and therefore none of the representations made to the Commission by the "Applicants" pertain to Thames Water Plc.[6] (Resp. to BGFlow's Second Requests No. 1.)[7]

Joint Applicants have failed to prove that TWUS has the technical ability required under the statute.

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[5] In the Response to BGFlow's Second Request No. 1, Thames Water Plc adopts, *inter alia*, Joint Applicants Response to BGFlow's First Request No. 10, which stated that TWUS will "utilize" the technical abilities of Kentucky-American, AWW and Thames Water Plc "which are fully described in Case No. 2002-00018." That is an inadequate response in that no cross-references are supplied, states a legal conclusion not a fact, and is inadequate to overcome the limitations on the scope of the examination.

[6] Mr. William J. Alexander signed the Acknowledgment and Acceptance of the Order in No. 2002-0018 on behalf of Thames Water Aqua Holdings GmbH. Thames Water Plc did not sign.

[7] In the referenced response, Thames Water Plc does adopt the Responses to BGFlow's First Requests to the extent applicable to Thames Water Plc – but without the scope of examination necessary to probe this Response, it has no real meaning.

Managerial ability

The point need not be belabored. TWUS has and will not have any employees. Its board members are not even its own. It must rely on the managerial abilities of Kentucky-American, AWW and Thames Water Plc. (Resp. to BGFlow's First Request No. 11.) With regard to Kentucky-American this is a circular answer because it is the ability of TWUS to manage Kentucky-American whlich is in question, not the ability of Kentucky-American to manage TWUS. Again, Thames Water Plc has not been examined and cannot be under the limitations of the Commission's Order. Finally and significantly, no management contract has been produced evidencing an enforceable obligation to provide management services or to disclose the terms thereof.

Joint Applicants have failed to prove that TWUS has the managerial ability required under the statute.

In accordance with law

On the head of this pin many thousands of lawyers might dance. Assuming *arguendo* that there has not been any willful noncompliance with applicable law, mere accord with "the law" is not equal to being consistent with the public interest in this case. (See discussion, infra.)

For a proper purpose

The only answer to the question of "what is the proper purpose?" for which this change of control is sought has been: to permit TWUS to file a consolidated United States tax return on behalf of all United States subsidiaries. While a consolidated corporate tax return is permitted under the Internal Revenue Code, the Code is not relevant to a change of control consideration.

This change of control application is driven purely by a desire to take advantage of a change in German tax laws. The proper question to ask in this proceeding is whether compliance with foreign laws and changes therein justifies a change in control of a Kentucky utility? It cannot be in the public interest of the ratepayers and present and future customers of Kentucky-American for its corporate structure and governance to be influenced by the laws of foreign countries. If the purpose of the change of control were to take advantage of a federal program which would result in cleaner water or reduced rates, there would not be a question. In this case, the only beneficiaries of the change of control to TWUS are the shareholders of RWE.

A proper purpose for a change of control could include increased efficiency, lower costs, rate reductions, or other tangible or intangible benefit to the ratepaying public. The Commission has approved a change of control to Thames Holdings. There must be a *new* justification for a change of control to TWUS, and there has not been.

Consistent with the public interest

The testimony in this case has been that there will be no benefit to the ratepayers and customers of Kentucky-American. Therefor, any negative impact is contrary to the public interest. Set forth, infra, are several aspects of this application which result in negative impacts on the public interest.

Discussed in this section is the nature of the public interest and where it finds expression. It cannot be said that this application to transfer control is in the public interest when the public, by and through their elected representatives, are pointedly excluded from having any discussion about local ownership alternatives. Any application for a change in control of a utility based upon an agreement which forbids good faith and open discussions of local ownership alternatives is and ought to be declared to be contrary to public policy.

In *PSC v. Cities of Southgate, et al*, (Ky.) 268 SW2d 19 (1954), at 21, the Court declined to imply into the powers of the Commission authority "to determine whether public ownership is more beneficial than private ownership, and to determine under whose ownership the lowest rates may be achieved." It concluded "an express legislative declaration is required" before the Commission may address such questions of "basic public policy."

The question was next addressed by the Court in *PSC v. City of Paris, et al*, Ky., 299 SW2d 811 (1957), where, citing *Cities of Southgate*, the Court opined:

> We therefore reject the idea inherent in the final order, quoted above, that a publicly-owned utility has any advantages, not specifically set forth in the statutes, over any other utility. (at p. 815.)

This is but one of several cases involving the contest between Kentucky Utilities and the City of Paris, this time with KU seeking a certificate to bid on a franchise to compete with the city owned electric company. The question of whether there had been "an express legislative declaration" was directly addressed by the Court, which found that there *had been* – by the legislative body of the City of Paris. *Id.*, at 815. Thus, this case stands for the proposition that a local governmental may make a sufficient declaration to which the Commission must defer.

It is noteworthy that the Court also found that the fact that the legislative expression resulted from public referenda "lends dignity" to the expression. This is supportive of the proposition that "public sentiment is a component of the public interest."

In the instant application, the Urban County Council has adopted resolutions expressing its interest in investigating the prospects for public ownership, it has hired expert legal counsel to advise it on eminent domain procedures, and it has hired a valuation consultant to assist it in assessing the water system. As close as may be, the voters have spoken in favor of local ownership by electing a mayor who campaigned on that issue, and defeating soundly the only at-large Council candidate who opposed it. In fact, opposition by the Urban County to this application constitutes a sufficient legislative declaration to which the Commission must give deference.

The Commission, in its Order of May 30, 2002, said, in part: "We find no legal authority to support Bluegrass FLOW's assertion that the presence of a local

government's willingness to acquire a utility's facilities is a sufficient basis for the Commission to delay or deny a private entity's application for approval of a transfer of control." (Order, p. 8.)

In the line of cases just discussed, Kentucky's highest Court moved from seeking a legislative declaration on whether the Commission may address policy questions to determining that the Commission does have that very power.

To buttress the position, however, there has been a clear express legislative declaration by the amendments to KRS 278.020 which created the present subsections (4) and (5), enacted in the 1980's and well after the *Cities of Southgate* case asking for a legislative response.

Policy determinations require a subjective analysis – is one or the other position "better" – as contrasted with, for example, a technical capability determination for which there will be objective standards.

Where KRS 278.020(4) requires the Commission to make objective determinations (does the acquiring company have the financial, technical and managerial abilities?), under KRS 278.020(5) the Commission must make subjective determinations: is the proposed acquisition (a) in accordance with law, (b) for a proper purpose, and (c) consistent with the public interest? While one may argue late into the night over whether "accordance with law" requires an objective or subjective analysis, there is no doubt that determining "proper purpose" and "consistent with the public interest" are subjective and, in fact, policy determinations.

The Commission has the legal authority to make policy determinations as part of its process of determining proper purpose and public interest. Further, the Court has decided that deference must be given to local legislative declarations. The Lexington-Fayette Urban County Government has legislatively declared that it is in the public interest that the local ownership of Kentucky-American be investigated because of the Government's concerns "that the proposed change of control of Kentucky-American Water Company may result in significant negative changes in rates, level of service, local presence, and accountability." *Urban County Council Resolution 186-2002, adopted May 1, 2002.* Finally, KRS 106.220, which authorizes any municipality to acquire any existing water system by eminent domain, specifically provides that:

> (T)he right to acquire same is hereby declared to be a *superior and paramount right*, superior and paramount to any other public use. . . . (emphasis supplied.)

Therefor, once the Urban County has begun the process of exploring the exercise of its eminent domain power to acquire KAW, it has asserted a public interest right superior to any other public use. This, by definition, determines the public interest in this case.

The Commission must give deference to these legislative declarations and paramount right, and deny the Joint Application. This is the legal authority the Commission sought in its May 30th Order. To approve a change of control, which will lead to a financial and operational integration of Kentucky-American into the RWE system is an impediment to local acquisition. To act contrary to the

legislative declarations of public interest is contrary to the law and the statutes. There will be no harm to Kentucky-American in a dismissal of the Joint Application without prejudice; there could be a substantial detriment to the public interest to approve a change of control in the face of current circumstances.

Additional Bases for a finding of
Not Consistant with the Public Interest

Following are sections setting forth other reasons the requested change of control is not consistent with the public interest.

1. Future changes of control will escape Commission jurisdiction: Under a plain reading of KRS 278.020(6), post-transaction, RWE will have the ability to shift ownership of Kentucky-American where it wants within its corporate family without seeking Commission approval under subsection (5). It cannot be in the public interest for the Commission to surrender authority if it need not.

2. A future change could subject Kentucky-American to NAFTA: Without regard to whether water supply and service issues are subject to international treaties (see discussion, infra, at p. 13), the Joint Applicants have admitted that among them they own twenty-eight (28) Canadian and Mexican subsidiaries. (Resp. to BGFlow's Second Request No. 2.) A future "housekeeping" transfer of stock in TWUS to one of these subsidiaries is all which would be needed to provide the foreign investor status under the treaty.

Pursuant to the "*Statement by the Governments of Canada, Mexico and the United States*" tendered by Joint Applicants on November 26th, at tab 4:

> Unless water, in any form, *has entered into commerce* and become a good or product, it is not covered by the provisions of any trade agreement, including NAFTA. . . . Water in its natural state in lakes, (and) rivers . . . is not a good or product, is not traded, and therefor is not . . . subject to the terms of any trade agreement. (emphasis supplied.)

The moment Kentucky-American draws water from the Kentucky River or Jacobson Park lake, that water is no longer in its natural state. It is one step removed from commerce. Once Kentucky-American wholesales water to other communities, it has put that volume of water into commerce. Once Kentucky-American retails water to a customer, it has put that volume of water into commerce.

Highbridge Springs Water Co., of Wilmore, Ky., draws water from its natural state, bottles it and puts it into commerce. The Pepsi-Cola company processes city water drawn from the Detroit River, bottles it and sells it as the popular *Aguafina* brand bottled water. (Detroit Free Press, August 8, 2002.) Indeed, the competition among brands of bottled water is as intense as among brands of soda -- and with which they compete for retail shelf space.

It is a small step onto this slippery slope. Once foreign ownership is introduced into the equation this is easily possible, and not the drop-dead impossibility Mr. Layton offered with such certainty. Even admitting of the *possibility* is detrimental to and not consistent with the public interest.

3. The GATS Treaty is only a step away: Mr. Layton conceded two critical points under cross examination:

(a) He agreed with the two witnesses offered by BGFlow that water services were not currently subject to GATS.

(b) He admitted that change was possible and that the United States could easily subject water services to GATS, saying, "Absolutely, yes." (Layton testimony, counter No. 4:22.40 (appx.))

The World Trade Organization publication submitted by Joint Applicants on November 26th, tab 5, reinforces this opinion. While correctly stating that the WTO "is not after your water,"[8] the WTO states:

> In respect of water distribution and all other public services, the following policy options, *all perfectly legitimate*, are open to all WTO members:
>
> • To make GATS commitments covering the right of foreign companies to supply the service, in addition to national suppliers. (Id, emphasis supplied.)

Contrary to the impression Mr. Layton tried to achieve, it is entirely contemplated that water services could be subjected to WTO and treaty authority. This is not about water quality, which seems to be nationally governed; it is about rates and

[8] Mr. Layton at some length described the WTO as a collection of members and not an entity which takes any action by itself, so, of course, it would not be after anyone's water.

available supply and condemnation (included within the treaty term "expropriation" per Mr. Layton). Approval of the Joint Application subjects Kentucky-American to potential treaty terms at the whim of a United States negotiating team seeking some concession from the European Union. And instead of this Commission and the Commonwealth of Kentucky retaining ultimate authority over our utility, it has become incumbent on the President of the United States to attempt to obtain changes in *state law* to conform to treaties. (Joint Petitioners' Response, November 26th, tab 3, § 3312(b)(1)(A).

Like it or not, the world has come to the banks of the Kentucky River and this Commission should acknowledge that it is not consistent with the public interest to permit an ownership change which has the potential to subject Kentucky-American to these treaties – particularly where that condition could obtain without any further action or approval (or attempted disapproval) by the Commission.

4. <u>The General Assembly has stated the paramount public interest:</u> In enacting KRS 106.220(1) and declaring the right of a municipality to acquire its local water system to be "a superior and paramount right, superior and paramount to any other public use," the General Assembly has declared the public interest. Where the legislature, the Urban Council and the public have declared an interest in local ownership of Kentucky-American, this Commission has the ability and the duty to find that the public interest requires a denial of the current application. It must be remembered that underlying this utility is a

franchise right of the public, granted by the Urban County Government for a period not to exceed twenty years, after which it returns to the public. Any action which would make it even one step more difficult to acquire the water system is not in the public interest.

5. Despite Mr. McGivern's confused answer, the Joint Applicants deny the jurisdiction of the Commonwealth: Although Commission staff counsel obtained an answer from Mr. McGivern to the effect the Joint Applicants[9] would apparently submit to the jurisdiction of the Kentucky Courts for the purpose of enforcing Commission orders, counsel for Kentucky-American was quick to state to the Commission that no process agents would be appointed. In response to written question, the Joint Applicants pointedly refused to submit to the general jurisdiction of the Commonwealth. (Resp. to BGFlow Firsts Request No. 6.) Before the Franklin Circuit Court, this Commission, and the commissions of other states, Joint Applicants have been careful to submit "to the jurisdiction *of the commission*" without a broader commitment. It is anticipated the answer of Mr. McGivern will be clarified, if not sharpened, to this very fine point.

Without submission to the general jurisdiction of Kentucky for all purposes, qualification to do business in the Commonwealth pursuant to statute, and appointment of process agents, approval of a change in control would place Kentucky-American and its customers at risk that a gap in enforcement powers

[9] Which would not include Thames Water Plc.

would occur. Without submission and compliance to law which the General Assembly have enacted for public protection, it is clear that a change of control is directly contrary to and inconsistent with the public interest.

Conclusion

There is no set of conditions which can cure the defects in this application.

For the reasons set forth, the Commission should deny the Joint Application.

Respectfully submitted,

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NOTICE AND CERTIFICATE OF SERVICE

Counsel gives notice that the original and three copies of this document have been filed with the Public Service Commission by sending same by first class mail, postage prepaid, to Mr. Thomas M. Dorman, Executive Director, Public Service Commission, 211 Sower Blvd., Frankfort, KY 40611, by uploading this document (together with the required Index and Read1st documents) to the file transfer protocol site designated by the Executive Director, and by service of a hardcopy of same upon the individuals listed below on this the 5th day of December, 2002. Counsel also certifies that the electronic version has been transferred to the Commission, and the Commission and other parties have been notified by electronic mail that the electronic version has been transmitted to the Commission.

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