

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	)	CASE NO. 2002-00317
AMERICAN WATER WORKS COMPANY, INC. FOR	)	
APPROVAL OF A CHANGE OF CONTROL OF	)	
KENTUCKY-AMERICAN WATER COMPANY	)	

ORDER

Kentucky-American Water Company (“KAWC”), Thames Water Aqua Holdings GmbH (“Thames”), RWE Aktiengesellschaft (“RWE”), Thames Water Aqua US Holdings, Inc., (“TWUS”), Apollo Acquisition Company (“Apollo”), and American Water Works Company (“AWWC”) (collectively “Joint Petitioners”) have applied for Commission approval of the transfer of control of KAWC to TWUS, Thames and RWE. At issue is whether TWUS, Thames and RWE have the managerial, technical, and financial ability to provide reasonable utility service and whether the proposed transfer of control is in the public interest. We find in the affirmative on the former issue, but conclude that the proposed transaction is in the public interest only if certain conditions are met.

PROCEDURE

On January 31, 2002, KAWC and Thames applied to the Commission for approval of the proposed transfer of control of KAWC to Thames and RWE. The proposed transfer of control for which they sought approval would occur as a result of the merger of AWWC, KAWC’s parent company, and Apollo, a wholly owned subsidiary

of Thames. We docketed this application as Case No. 2002-00018.<sup>1</sup> On May 30, 2002, after extensive discovery and hearings on the proposed transfer, the Commission approved the transfer subject to certain conditions.

The Attorney General (“AG”), Lexington-Fayette Urban County Government (“LFUCG”), and Bluegrass FLOW, Inc. (“FLOW”) (collectively “Intervenors”) then petitioned for rehearing of this Order, which we denied on July 10, 2002. The Intervenors then sought judicial review of our Orders of May 30, 2002 and July 10, 2002. These actions for review are currently pending before Franklin Circuit Court.<sup>2</sup>

On September 11, 2002, the Joint Petitioners applied for Commission approval of modifications to the proposed transfer of KAWC.<sup>3</sup> We docketed this application as a separate proceeding and established a procedural schedule for its review.<sup>4</sup> We further incorporated by reference the record of the earlier proceeding into this proceeding.

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<sup>1</sup> 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).

<sup>2</sup> Commonwealth of Kentucky, ex rel. A.B. Chandler, Attorney General v. Pub. Serv. Com’n, No. 02-CI-001012 (Franklin Cir. Ct. Ky. filed July 29, 2002); Bluegrass FLOW, Inc. v. Pub. Serv. Com’n, No. 02-CI-001020 (Franklin Cir. Ct. Ky. filed July 30, 2002); Lexington-Fayette Urban County Government v. Pub. Serv. Com’n, No. 02-CI-001024 (Franklin Cir. Ct. Ky. filed July 30, 2002). Franklin Circuit Court has consolidated these actions.

<sup>3</sup> Joint Petitioners tendered their application to the Commission on August 28, 2002. The Commission’s Executive Director found the application deficient in certain respects and refused to accept the application for filing. On September 11, 2002, Joint Petitioners cured these deficiencies.

<sup>4</sup> Our original schedule provided for the issuance of a decision within 60 days. See KRS 278.020(5) (requiring the Commission to complete any review of any application for transfer of control of a utility within 60 days of the application’s filing). Upon FLOW’s motion for additional time to submit the written testimony of its witnesses, however, we extended the review an additional 40 days.

Shortly thereafter we granted the motions of the AG, LFUCG and FLOW for intervention in this proceeding.

On October 16, 2002, after considering the parties' written memoranda on the subject, we found that this proceeding should be treated as a new application for transfer of control. We further found that the principles of *res judicata* barred our consideration of issues already litigated and addressed in Case No. 2002-00018, including Thames' and RWE's ability to provide reasonable utility service and the public interest questions relating to the transfer of control of KAWC to Thames and RWE. We limited the scope of this proceeding to the remaining issues that the new application presented - TWUS's ability to provide reasonable utility service and public interest questions relating to the proposed transfer of control of KAWC to TWUS. While prohibiting the parties from relitigating issues already adjudicated, we permitted inquiry into possible changes in circumstances that occurred after May 30, 2002, as these changes may affect the findings contained in our Order of May 30, 2002.

Following discovery by the parties in this matter, the Commission held a public hearing on November 21, 2002 at our offices in Frankfort, Kentucky. The following persons testified at this hearing: Stephen Smith, Director of Tax and Accounting, Thames Water Plc; James McGivern, Managing Director, Thames Water Plc; Roy W. Mundy II, president of KAWC; Duane Layton, Esq., King and Spalding; Paul B. Trawick, Assistant Professor of Anthropology, University of Kentucky; and Richard Talmadge Eades, President, Geo Active Associates. The Commission also solicited and heard

public comments on the proposed transaction.<sup>5</sup> Following the hearing, all parties submitted written briefs.

### PROPOSED TRANSACTION: AN OVERVIEW

KAWC is a Kentucky corporation that serves approximately 100,000 water customers in the Kentucky counties of Fayette, Bourbon, Clark, Harrison, Owen, Scott, and Woodford. It provides wholesale water service to the cities of Midway, North Middleton, Georgetown, and Versailles, Kentucky; Jessamine-South Elkhorn Water District; and Spears Water Company. KAWC also owns and operates wastewater collection and treatment facilities that serve approximately 80 customers in Clark County, Kentucky. KAWC was originally incorporated in 1882 as Lexington Water Company and has provided continuous service to Lexington, Kentucky and its surrounding area since shortly after its incorporation.

AWWC, a Delaware corporation, owns all of KAWC's common stock. AWWC is a publicly traded water and wastewater services company. It owns and operates regulated utility subsidiaries that provide water or wastewater service to approximately 10 million persons in 23 states. It also owns subsidiaries that provide water and wastewater management services to municipal and other governmental entities. Through these subsidiaries, it manages and operates 1,000 water or wastewater facilities that serve approximately 5 million persons in 18 states and three Canadian provinces.

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<sup>5</sup> The following persons made public comments: Governor Edward T. Breathitt, John Burkhard, Ben Ditty, Patty Draus, Joe Graves, Walker Gretter, Mayor-Elect Teresa Isaacs, Council Member Gloria Martin, Judge/Executive William O'Banion, Warren Rodgers, Chetan Talwalkar, and Rebecca C. Wilson.

RWE, a corporation formed under the laws of the Federal Republic of Germany, is a management holding company. It is Germany's fifth largest industrial group and is a leading international multi-utility provider with core businesses in electricity, water, gas and waste management and utility-related services. RWE has 12 major operating subsidiaries in more than 120 countries on six continents and employs 170,000 persons worldwide, of which 16,000 are based in the United States. It reported \$43.7 billion in sales for the fiscal year ending June 30, 2000.<sup>6</sup>

Thames, a corporation formed under the laws of the Federal Republic of Germany, is a wholly owned subsidiary of RWE and serves as the holding company for RWE's water and wastewater operations. As of December 31, 2000, it had assets with a book value of \$6.4 billion.<sup>7</sup> For the fiscal year ending June 30, 2001, Thames reported external net sales of 1,690 million euros, generating 821 million euros in earnings before interest, taxes, depreciation, and amortization and 563 million euros in operating results.

Thames has delegated the full power and authority to operate Thames' subsidiaries, including its current and future subsidiaries in America, to Thames Water Plc ("Thames Water"). Thames Water, a public limited corporation organized under the laws of the United Kingdom, is the largest water and wastewater utility in the United Kingdom and one of the three largest water/wastewater services companies in the world. It provides water-related services to over 43 million people by managing and

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<sup>6</sup> Case No. 2002-00018, Joint Applicants' Response to the Commission's Order of January 30, 2002, Item 1(a) at 1.

<sup>7</sup> Case No. 2002-00018, Joint Applicants' Response to the Commission's Order of January 30, 2002, Item 7 at 17.

operating over 540 water/wastewater facilities in 44 countries. Thames holds all of Thames Water's stock.<sup>8</sup>

Apollo is a corporation organized under the laws of Delaware. At the time of KAWC and Thames' application in Case No. 2002-00018, Thames owned all shares of Apollo's stock.

TWUS is a corporation that is organized under the laws of Delaware and whose headquarters is located in Voorhees, New Jersey. Its current financial structure has not been established. It has no employees. Its officers and directors are employees of Thames Water. Thames owns all of TWUS's stock.

On September 16, 2001, RWE, Thames, AWWC and Apollo executed an Agreement and Plan of Merger ("Acquisition Agreement"). This agreement provides for the merger of AWWC and Apollo with AWWC as surviving corporate entity. At the merger closing, Thames will pay \$46 for each share of outstanding AWWC common stock that is not owned either by Thames or AWWC.<sup>9</sup> Based upon the number of outstanding shares of AWWC common stock as of December 31, 2001, Thames' total payment for this stock will be \$4,600,661,572, which RWE intends to finance through the issuance of bonded debt.

AWWC's shareholders approved the Acquisition Agreement on January 17, 2002. The Acquisition Agreement and resulting transfer of control were subsequently submitted to state and federal regulators for their review. As of the date of this Order,

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<sup>8</sup> Because of their close corporate relationship, any reference in this Order to Thames' water operations refers to the activities of Thames and Thames Water.

<sup>9</sup> The Acquisition Agreement requires AWWC to redeem all outstanding shares of preferred and preference stock for \$25 and \$35, respectively, prior to the closing date.

eight state regulatory commissions<sup>10</sup> have approved the proposed transaction. Four other state commissions<sup>11</sup> are still reviewing it.<sup>12</sup> In addition, RWE filed a notification and report form under the Hart-Scott-Rodino Anti-Trust Improvement Act (“HSR Act”) with the Federal Trade Commission and the United States Department of Justice on June 6, 2002. The waiting period set forth in the HSR Act expired on July 5, 2002.

On January 31, 2002, KAWC and Thames applied to this Commission for approval of the transfer of control of KAWC as set forth in the Acquisition Agreement. On May 30, 2002, we approved the transfer, finding that Thames and RWE had the managerial, technical, and financial ability to provide reasonable utility service and that, provided certain conditions are met, the proposed transfer is in the public interest. We affirmed this decision on July 10, 2002 after the Intervenors sought rehearing.

After we granted our approval to the proposed transaction, Thames and RWE modified the transaction. On July 26, 2002, Thames established TWUS to serve as an intermediate holding company to hold the stock of the merged AWWC-Apollo and Thames’ other holdings in the United States<sup>13</sup> and to permit the filing of a consolidated United States tax return for these holdings. Thames had been considering the proposed modification since late 2001. It and KAWC noted in their application in Case

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<sup>10</sup> These states are Hawaii, Illinois, Maryland, New Mexico, Pennsylvania, Tennessee, Virginia, and West Virginia.

<sup>11</sup> These states are Arizona, California, New Jersey, and New York.

<sup>12</sup> Four state regulatory commissions - those of Iowa, Missouri, Ohio, and Texas - have held that their approval of the proposed transaction is not required.

<sup>13</sup> These holdings include: Elizabethtown Water Company, Edison Water Company, E’town Properties, Liberty Water Company, The Mount Holly Water Company, Applied Management, Inc., and Applied Wastewater Management, Inc. See Joint Applicants’ Response to AG’s Initial Request for Information, Item 15.

No. 2002-00018 that the creation of an intermediate holding company between KAWC and Thames Aqua was a potential feature of the proposed transaction<sup>14</sup> and continued to acknowledge such possibility in their responses to discovery requests.<sup>15</sup>

The proposed modifications stem from changes in the tax laws of the Federal Republic of Germany. When the Acquisition Agreement was entered, German law favored a relatively flat corporate structure. In December 2001 revisions in German tax laws occurred that ended the taxation of dividends paid between the foreign subsidiaries of German holding companies and thus encouraged the greater use of intermediate holding companies.

Joint Applicants assert that the ability to file a consolidated tax return provides two financial benefits. First, it would reduce administrative expenses by eliminating the need to file multiple tax returns in the United States. Second, it may permit some tax savings by allowing the payment of taxes calculated on the net profits of all entities within the consolidated group. Thames could recognize for tax purposes losses of some U.S. affiliates that otherwise might not have been recognized.

The creation of TWUS does not appear significantly to alter the final result of the proposed transaction. While TWUS, instead of Thames, will own all of the outstanding shares of the survivor of the AWWC-Apollo merger, Thames will own and control TWUS. Thus RWE and Thames will retain ultimate control over the AWWC-Apollo merger survivor. Thames Water, which operates all of Thames Aqua's water holdings, will operate and manage TWUS.

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<sup>14</sup> Case No. 2002-00018, Joint Application at 10 and Exhibit 5.

<sup>15</sup> See, e.g., Case No. 2002-00018, Joint Applicants' Response to the AG's Initial Data Request, Item 101 at 1028; Joint Applicants' Response to the AG's Second Data Request, Item 21.



The proposed modifications have no immediate or direct effect upon KAWC. None of its stock or debt is involved. No change in KAWC's financial or management structure will occur.<sup>16</sup> As AWWC owns all of KAWC's outstanding common stock, however, RWE, Thames, and TWUS will effectively acquire control of KAWC when the proposed merger is completed.

#### STANDARD OF REVIEW

KRS 278.020 requires Commission review and approval of any change in or transfer of control<sup>17</sup> of a utility. KRS 278.020(4) provides:

No person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission by sale of assets, transfer of stock, or otherwise, or abandon the same, without prior approval by the commission. The commission shall grant its approval if the person acquiring the utility has the financial, technical, and managerial abilities to provide reasonable service.

KRS 278.020(5) provides in part:

No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission. Any acquisition of control without prior authorization shall be void and of no effect. . . .The commission shall approve any proposed acquisition when it

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<sup>16</sup> No change will occur in the method under which KAWC's income taxes are calculated for rate-making purposes. While AWWC currently files a consolidated tax return, KAWC's income taxes for rate-making purposes are calculated on a stand-alone basis. See Testimony of Stephen Smith at 2.

<sup>17</sup> KRS 278.020(5) defines "control" as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a utility, whether through the ownership of voting securities, by effecting a change in the composition of the board of directors, by contract or otherwise." Clearly the proposed merger represents a transfer of control of KAWC.

finds that the same is to be made in accordance with law, for a proper purpose and is consistent with the public interest.

Our review of any proposed transfer of control must address two issues. First, we must determine whether the party acquiring control has the requisite abilities to provide reasonable utility service. Second, we must determine whether the proposed transfer is consistent with the “public interest.”

KRS 278.020 does not define “public interest.” In Case No. 2002-00018, we found that a transfer is in the “public interest” if it does not adversely affect the existing level of utility service or rates or that any potentially adverse effects can be avoided through the Commission’s imposition of reasonable conditions on the acquiring party.<sup>18</sup> We further found that the acquiring party should also demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhanced service reliability, the availability of additional services, lower rates, or a reduction in utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.<sup>19</sup>

FLOW argues that any determination of the public interest must consider the possibility of public ownership of the utility facilities and the efforts of local governments to acquire such facilities. It asserts that the public policy of the Commonwealth favors governmental ownership and that, in those instances where a local government has evidenced an interest in acquiring the facilities of a utility subject to transfer, the public

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<sup>18</sup> Case No. 2002-00018, Order of May 30, 2002 at 7.

<sup>19</sup> Id. See also Case No. 2000-00129, Joint Application of NiSource, Inc., New NiSource, Inc., Columbia Energy Group, and Columbia Gas of Kentucky for Approval of a Merger (Ky. P.S.C. June 30, 2000). The Intervenors have alleged in their actions for review that this interpretation is in error.

interest requires rejection of the application until the local government has completed its deliberations on the acquisition.<sup>20</sup>

We find no legal authority to support the proposition that the public policy of this Commonwealth favors municipal ownership over private ownership. While the Legislature has provided municipal corporations with the power to acquire utility facilities in private hands,<sup>21</sup> it has also encouraged the use of private sector ownership and operation of water facilities.<sup>22</sup> See also Public Service Commission v. Cities of Southgate, Highland Heights, Ky., 268 S.W.2d 19, 21 (1954) (rejecting the assertions that “public ownership is more beneficial than private ownership” and that the Commission must favor the applications of municipal corporations for ownership of utility facilities over those of private corporations).

The language of KRS 278.020, furthermore, fails to support FLOW’s position. The statute makes no reference to any type of ownership. Moreover, the clear and specific time period in which the Commission must review and rule upon an application for transfer of control strongly contradicts FLOW’s position that the Commission may not approve an application for transfer of control of utility facilities while a municipal corporation investigates the possibility of acquiring those facilities. Such investigations may last several months or years. KRS 278.020 provides that our review must conclude within 120 days.

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<sup>20</sup> On April 25, 2002, Lexington-Fayette Urban County Council adopted a resolution in which it stated that “it is actively evaluating the purchase of the Kentucky-American Water Company at this time.” Lexington-Fayette Urban County Council Resolution No. 186-2002.

<sup>21</sup> See KRS 106.220.

<sup>22</sup> See KRS 107.700 - .770.

Our focus in this proceeding must be upon the qualifications of the acquiring party and the potential effects of the transfer actually before us. To the extent that a local government wishes to acquire a public utility's facilities, the Legislature has provided the necessary means for accomplishing such acquisition without any Commission involvement. See KRS 106.220.<sup>23</sup> Commission approval of any proposed transfer of control to a private entity neither impedes nor limits a municipality's right or power to acquire such facilities. Our finding that an applicant has the requisite abilities to provide reasonable utility service should not be construed to mean that other potential acquirers lack such abilities.

### ANALYSIS

#### Provision of Reasonable Utility Service

In our Order of May 30, 2002, the Commission extensively examined RWE's and Thames' qualifications to provide reasonable utility service and found both possessed the requisite abilities to provide such service and that the proposed transfer of control would likely enhance KAWC's ability to provide reasonable utility service at reasonable rates.<sup>24</sup> We have found no evidence in the record of this proceeding to suggest that circumstances have significantly changed to lead to a different conclusion.

FLOW argues that TWUS lacks the requisite abilities to provide reasonable utility services. It notes that TWUS currently possesses very limited financial resources, has

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<sup>23</sup> While a municipality is not required to obtain Commission approval to exercise its powers under KRS Chapter 106, KRS 278.020(4) and (5) still require a municipality to apply to the Commission for approval of the transfer of control of any utility facilities and to demonstrate that it possesses the requisite abilities to provide reasonable utility service.

<sup>24</sup> Case No. 2002-00018, Order of May 30, 2002 at 13 -14.

no employees, and has presented no evidence of acquiring outside managerial, technical, or operational assistance.

We find no merit in this argument. TWUS's qualifications cannot be viewed in isolation; they must, instead, be viewed in conjunction with those of its two corporate parents. The Joint Applicants indicate that RWE will provide all necessary funding for TWUS before the transfer of control occurs.<sup>25</sup> It will also be able to rely upon RWE's access to worldwide capital markets. As Thames Water will manage TWUS's operations and provide technical services to TWUS,<sup>26</sup> TWUS will have the same level of managerial, technical, and financial expertise that Thames currently possesses.

### Public Interest

Benefits to the Public. The Intervenor's argue that the transfer of control of KAWC to TWUS fails to meet the "public interest" standard as set forth in our Orders of May 30, 2002 and July 10, 2002 as it fails to produce any meaningful benefit to KAWC's ratepayers.<sup>27</sup> They note the Joint Applicants' admission that the creation of TWUS will primarily result in limited savings by reducing the number of U.S. federal tax filings and will not benefit either KAWC or KAWC's ratepayers.<sup>28</sup> The absence of any benefit, the Intervenor's argue, requires rejection of the proposed transaction.

This argument is myopic. The proposed transaction involves the transfer of control to TWUS and Thames and RWE. As control has yet to pass from AWWC to any other entity, we cannot view the creation of TWUS in isolation. It is part of a much

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<sup>25</sup> Joint Applicants' Response to AG's Initial Request for Information, Item 10.

<sup>26</sup> Joint Applicants' Response to FLOW's First Request for Information, Item 10.

<sup>27</sup> See Order of May 30, 2002 at 6 - 8; Order of July 10, 2002 at 9 - 10.

<sup>28</sup> Transcript of Hearing of 11/21/2002 ("Transcript") at 64 - 65.

larger and complex transaction. The focus of our examination, therefore, must be upon the entire transaction and any benefits that such transaction will bring to KAWC and its ratepayers.<sup>29</sup> The record clearly shows that significant benefits will result from the entire transaction. In our Order of May 30, 2002, we found:

[I]f the Joint Applicants, AWWC, and RWE accept the conditions and commitments set forth in Appendix A, the proposed merger is in the public interest. It will not result in any increase in utility rates or reduction in the quality of water service. By placing KAWC into a larger company system, the proposed merger will increase KAWC's access to capital, cutting edge technologies, and enhanced R&D [research and development]. It will allow KAWC to draw upon Thames' experience in the area of security practices and to better protect its facilities at lower cost. It will permit greater employee training opportunities and should result in a better-trained work force.

Order at 29. There is no evidence in the record, nor do the Intervenors suggest, that these benefits will be diminished as a result of the revisions to the transaction originally approved.<sup>30</sup>

Conditions to Approval of the Proposed Transaction. In our Orders of May 30, 2002 and July 10, 2002, we found that the Acquisition Agreement and the proposed transfer of control of KAWC to Thames and RWE would be in the public interest only if several conditions were imposed. The Joint Applicants (excluding TWUS) have

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<sup>29</sup> The Intervenors' position that our focus should be limited to the benefits derived from the transfer of control to TWUS assumes that a transfer of control to RWE and Thames has already occurred. No transfer of control of KAWC has yet occurred. If a transfer of control occurs, it will be to TWUS, Thames and RWE.

<sup>30</sup> In its Brief, LFUCG lists several events since May 30, 2002 that require the reconsideration of our earlier findings. These include the sluggish economy in Europe, the possible writedown of certain RWE assets, possible changes in foreign tax laws, and the retirement of AWWC's President. Many of these events are speculative. Even if they occur, they will not alter the basic abilities of both entities to provide utility service at reasonable levels.

accepted all of these conditions. Based upon our review of the revised transaction, we find that the public interest requires the imposition of these conditions to our approval of the revised transaction. The revisions to the original transaction also require that we consider the imposition of additional conditions to protect KAWC's ratepayers and ensure the protection of the public interest. These conditions are discussed below.

Waiver of Any Rights or Claims under International Law or Treaties. The Intervenor has expressed the concern that, upon the completion of the proposed transfer, the Commission's authority will be diluted or weakened by international law - treaties, foreign trade agreements, or other bi-national or multi-national compacts. They assert that the public interest requires that as a condition to approval of the proposed transfer of control, the Joint Applicants must waive all rights and defenses that they currently have or that they may possess in the future under international law or treaty.

While the Intervenor has emphasized the potential dangers of foreign ownership,<sup>31</sup> they fail to point to any specific treaty provision or foreign trade agreement that extends any advantage to the Joint Applicants or in any manner diminishes the

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<sup>31</sup> The AG, for example, states that "if international law whether by treaty, convention, trade agreement or otherwise, supercedes the Commission's [sic] authority, the conditions [imposed upon the merger] are meaningless." After failing to point to a single treaty or agreement that affects this Commission's authority, he states that "given the uncertainty of the application of international law - whether treaties, conventions, trade agreements, or otherwise, it is unclear whether the Commission does indeed have the same jurisdiction and enforcement ability of any commission decision should this transfer be allowed that it has for any other domestically domiciled for profit utilities." AG's Brief at 11.

Similarly, LFUCG raises the specter of preemption of the rights of state and federal governmental units but provides no supporting authority. See LFUCG's Brief at 13, n.10 ("LFUCG submits that it is more important for the Commission not to commit to a transfer of control that may open the door to future changes of unknown scope and nature and which may eventually end up outside the control of the Commission, or state and local governments (or even the United States government) to enforce or regulate unless a condition such as this is required.").

Commission's jurisdiction. We note that none of the Intervenors raised this issue in the prior proceeding and that the AG and LFUCG did not raise the issue in the two prior proceedings in which foreign-owned entities sought approval to acquire control of local utilities.<sup>32</sup>

FLOW provided the only evidence in the record regarding the potentially adverse effects of international agreements upon the Commission's jurisdiction. Its witnesses testified that Commission jurisdiction over the Joint Applicants would be seriously weakened as a result of the North American Free Trade Agreement ("NAFTA") and the General Agreement on Trade and Services ("GATS").

The record shows that neither of FLOW's witnesses is qualified to render an opinion on this issue. Neither witness is a lawyer nor has engaged in any formal study of international law or law in general.<sup>33</sup> Neither witness has any significant experience in international commerce. While both witnesses testified on NAFTA and GATS, neither witness had fully reviewed the treaties. Both acknowledged that they were unfamiliar

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<sup>32</sup> Case No. 2000-00095, Joint Application of Powergen Plc, LG&E Energy Corp., Louisville Gas and Electric Company, and Kentucky Utilities Company For Approval of a Merger (Ky.PSC May 15, 2000); Case No. 2001-00104, Joint Application For Transfer of Louisville Gas and Electric Company and Kentucky Utilities Company in Accordance With E.On AG's Planned Acquisition of Powergen Plc (Ky.PSC Aug. 6, 2001).

<sup>33</sup> Mr. Eades is the owner of an environmental and geographic information/computer system support business. Mr. Trawick is an assistant professor of anthropology.



with many of the treaties' provisions.<sup>34</sup> When cross-examined on various aspects of these treaties, they repeatedly indicated their lack of knowledge of the treaties' terms.<sup>35</sup> Accordingly, we give little weight to their testimony or conclusions.

Our own examination indicates that neither NAFTA nor GATS presently presents a threat to our jurisdiction. NAFTA is an agreement between Mexico, Canada, and the United States. Only investors from these nations are entitled to bring a claim under the treaty. None of the Joint Applicants are from Canada or Mexico. Moreover, any claim that is brought by the investor is brought against the member-signatory. Assuming *arguendo* that any of the Joint Applicants could bring a claim, that claim is solely against the United States. Moreover, federal law would expressly prohibit the Joint Applicants from challenging any action of the Commission in any court of this country based upon the ground that such action is inconsistent with NAFTA.

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<sup>34</sup> We express our strong dissatisfaction with FLOW's presentation of these two witnesses. The Commission granted FLOW additional time in which to obtain witnesses. The witnesses that FLOW presented had a very limited understanding of the issues regarding which they were presented as experts. FLOW furthermore made minimal efforts to reveal their limited qualifications, failing to disclose either witness' curriculum vitae until specifically requested at the hearing. This Commission is further troubled by the manner in which one of FLOW's witnesses testified. His lack of preparation and his unprofessional manner reflect very poorly on FLOW. Should FLOW be involved in any future proceedings before this Commission, we expect it to exhibit a higher level of professionalism than it has demonstrated in this proceeding.

<sup>35</sup> In contrast to FLOW's witnesses, the Joint Applicants presented Duane Layton who is very qualified to testify on international law issues. Mr. Layton, a partner in the law firm of King and Spalding, holds a juris doctor degree from California Western School of Law and a masters of law degree in public international law from Cambridge University. He has practiced in the area of international law since 1983 and served several years as a counsel and adviser on international trade laws with the United States Commerce Department. He has published several articles on international trade issues. He was recently named to a roster of experts qualified to serve on World Trade Organization dispute settlement panels.

We find nothing in the record to suggest that GATS would restrict or curtail our jurisdiction. GATS governs trade in goods and services, but does not address investments. Water is not considered to be either a service or a good; therefore, it does not currently fall within the scope of GATS.

Assuming *arguendo* that GATS addressed water services, it does not create any private right of action on behalf of a foreign corporation. GATS is designed to prevent discrimination by a World Trade Organization (“WTO”) member state against other member states. Only members of the WTO can initiate dispute settlement proceedings against another member. If the Joint Applicants assert a violation of GATS based upon an action that we take, their only remedy is to request the European Union (which represents the interest of the United Kingdom and the Federal Republic of Germany) to initiate a dispute proceeding against the United States. Moreover, if a dispute panel were to find against the United States, it may not take any action against this Commission. Its only remedy is to direct the offending national government to remove the offending measure and to authorize “the claimant government to suspend an equivalent level of trade concessions, such as raising tariffs or suspending market access rights.”<sup>36</sup>

Our Orders of May 30, 2002 and July 10, 2002 already contain conditions adequate to prevent a foreign regulator’s preemption of the Commission’s authority to review the reasonableness of any cost. Intervenors have failed to present a convincing case that additional conditions to the proposed merger are necessary to preserve the Commission’s jurisdiction over KAWC’s rates and services. In the absence of such case, we find the imposition of such conditions is unreasonable.

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<sup>36</sup> Transcript at 232.

TWUS Management and Involvement in KAWC Operations. LFUCG requests that the Commission prohibit any TWUS involvement in the operational control of KAWC or AWWC without prior Commission approval and prohibit any commercial transactions between TWUS and KAWC or AWWC. It further requests that, following completion of the proposed transaction, the membership of TWUS's board of directors and AWWC's board of directors be the same. The Joint Applicants have accepted these conditions. We find that the public interest requires that our approval of the proposed transaction should be conditioned on the imposition of these restrictions.

Joint Applicants Availability to Service of Process. LFUCG and the AG assert that the Joint Applicants should be required to appoint an agent for service of process or to register as corporations transacting business within the Commonwealth. Otherwise, they assert, the Commission's ability to judicially enforce any Order against the Joint Applicants will be significantly impaired. They point to the defenses of improper service and insufficiency of process that AWWC, RWE, and Thames recently raised in their answers to the Intervenors' actions for review of our Orders of May 30, 2002 and July 10, 2002.

The Joint Applicants argue that the proposed condition is unnecessary. They note that the Commission's jurisdiction extends only to the utilities. Of the Joint Applicants, only KAWC meets the statutory definition of utility.<sup>37</sup> KAWC is a Kentucky corporation and is easily served. The other Joint Applicants, they assert, will not be transacting any business in Kentucky. Moreover, they assert, all of the Joint Applicants "have agree[d] to abide by the commitments imposed by the Commission . . . and not

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<sup>37</sup> See KRS 278.010(3).

[to] challenge the Commission's jurisdiction to enforce the Order granting approval of the acquisition."<sup>38</sup>

Our authority extends only to the rates and services of utilities. KRS 278.040(1). So long as KAWC operates facilities in this Commonwealth that distribute water to the public for compensation, it is subject to our jurisdiction and will be the focus of our regulatory efforts. Moreover, KAWC's ownership and operation of such facilities, its physical presence in the Commonwealth, and its status as a Kentucky corporation make it readily amenable to the service of process.

Many conditions necessary for Commission approval of the proposed transfer of control, however, involve not only KAWC, but also some or all of the Joint Applicants. These conditions are meaningless without the ability to ensure the Joint Applicants' compliance. To the extent that persons fail to comply with our Orders or aid and abet the violation of those Orders, KRS 278.990(1) provides us with limited enforcement powers. KRS 278.390, furthermore, authorizes us to obtain judicial enforcement of our Orders. However, such enforcement is not possible if service of process cannot be obtained.

Notwithstanding the Joint Applicants' commitment to abide by any conditions set forth in our Orders, these conditions are meaningless without the necessary tools to obtain their judicial enforcement. Joint Applicants, with the exception of KAWC, have minimal contacts with the Commonwealth and have asserted in other forums in this Commonwealth that they are not subject to service of process under the existing laws of the Commonwealth. They have thus called into serious question our ability to enforce any conditions or commitments that are imposed upon the Joint Applicants.

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<sup>38</sup> Joint Applicants' Brief at 22.

Accordingly, we find that the public interest requires that, as a condition to our approval of the proposed transfer of control, the Joint Applicants should be required to waive all objections and defenses based upon personal jurisdiction to any action that the Commission may bring in Franklin Circuit Court to enforce the provisions and conditions set forth in this Order and appoint an agent in Kentucky for the sole and limited purpose of accepting the service of process of any action that the Commission may bring to enforce the provisions and conditions set forth in this Order.<sup>39</sup>

Restrictions on the Use of Customer Information. The AG and LFUCG propose restrictions on the Joint Applicants' use of customer information. The AG advocates a prohibition upon any disclosure of confidential customer information to any RWE affiliate without prior written notice to the Commission and without prior customer consent. LFUCG urges that we prohibit the use of such information, "including customer mailing addresses and contact information, for any purpose that is not functionally related to the provision of utility service."<sup>40</sup>

We find that the AG's proposal is unnecessary and decline to accept it. KRS 278.2213(5)<sup>41</sup> already imposes this restriction on KAWC. Imposition of the proposal will

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<sup>39</sup> We decline LFUCG's suggestion that all of the Joint Applicants be required to obtain a certificate of authority to transact business in the Commonwealth. Based upon the record, it is clear that, with the exception of KAWC, none of the Joint Applicants will be transacting any business in this state. While we agree that the appointment of an agent for service of process is a necessary condition to Commission approval of the proposed transaction, we reject the implication contained in both proposals that an agent should be appointed to accept service of process for any action arising in this Commonwealth.

<sup>40</sup> LFUCG's Brief at 13.

<sup>41</sup> No utility employee shall share any confidential customer information with the utility's affiliates unless the customer has consented in writing, or the information is publicly available or is simultaneously made publicly available.

neither enhance the public interest nor create additional protections for KAWC's ratepayers.

We find LFUCG's proposal to be unreasonable and unlawful. LFUCG's proposal would prohibit the use of customer information that KAWC or other Joint Petitioners might use "to provide information to Kentucky-American's customers for any purpose for which rate recovery would be refused due to the promotional or lobbying nature of such information."<sup>42</sup> As KRS 278.2213(5) already prohibits the release of such information to utility affiliates, the purpose of the proposed restriction appears to be to limit KAWC's ability to inform its customers of its position on political issues<sup>43</sup> through customer mailings. Such restrictions have been found in violation of the First Amendment of the Federal Constitution. See Consolidated Edison Co. of New York v. Public Service Commission of New York, 447 U.S. 530 (1980). Moreover, the restrictions offer no additional protections to KAWC's ratepayers as Commission regulations prohibit the recovery of expenses related to such mailings through utility rates. 807 KAR 5:016.

Additional Reporting Requirements. LFUCG proposes that additional reporting requirements be placed upon the Joint Applicants.<sup>44</sup> We find that these additional reporting requirements are unnecessary. By our Orders of May 30, 2002 and July 10, 2002, we imposed extensive reporting requirements as a condition to our approval of the proposed transaction. We have incorporated these requirements into this Order.<sup>45</sup>

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<sup>42</sup> LFUCG's Brief at 13-14.

<sup>43</sup> These political issues would include LFUCG's possible acquisition of KAWC's facilities.

<sup>44</sup> See LFUCG's Brief at 11 - 15.

<sup>45</sup> Appendix A, Conditions 27 - 37.

Jacobson Park. LFUCG argues that conditions related to the use of Jacobson Park and its lease agreement with KAWC should be imposed as conditions to our approval of the proposed transaction. We addressed Jacobson Park in detail in our Order of May 30, 2002 and have incorporated herein the conditions contained in that Order. In light of LFUCG's extensive powers of eminent domain that may be used to ensure its control and use of the park, we find that further conditions are unnecessary and inappropriate.

Sharing of any Savings Related to Consolidated Tax Filings. The AG and LFUCG propose that the Joint Petitioners treat any tax savings achieved through the write-off of losses incurred in unregulated U.S. operations against regulated U.S. earnings as a benefit of the transaction and that this benefit be appropriately shared with KAWC's ratepayers. This proposal is unnecessary. In our Order of May 30, 2002, we directed most of the Joint Applicants to develop a mechanism to track the savings and costs resulting from the proposed transaction and a methodology to allocate such costs and savings. We incorporate that condition into this Order and are of the opinion that it adequately addresses this issue.

Funding of Water Assistance and Business Development Programs. LFUCG proposes that the Commission require the Joint Applicants to fund water assistance programs and business development programs similar to those described in a settlement agreement reached in a proceeding involving some of the Joint Applicants and California-American Water Company.<sup>46</sup>

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<sup>46</sup> California-American Water Company, Application 02-01-036 (Cal.PUC filed Jan. 28, 2002).

We find the proposed condition to be unnecessary and inappropriate. We have as a condition to our approval of the proposed transfer of control required the Joint Applicants to actively support economic development throughout the central Kentucky area and to maintain a substantial level of involvement in community activities.<sup>47</sup> Moreover, the programs agreed to by the participants in the California Public Utilities Commission (“PUC”) proceeding are part of a comprehensive settlement agreement. It is inappropriate to impose selected terms from such an agreement out of context and without consideration of the contents of the entire agreement or the circumstances of the parties. Should the California PUC approve the proposed settlement agreement, we will examine the entire agreement to determine whether any provisions trigger the “most favored nations” provision set forth in Condition 51.

Waiver of KRS 278.020(6) Exemption. LFUCG proposes that the Joint Applicants, as a condition to our approval of the transfer of control, waive their exemption from Commission approval of any corporate reorganizations. KRS 278.020(6)(b)<sup>48</sup> expressly provides that corporate reorganizations in which a utility remains under the ultimate control of the same entity are not subject to the requirement of prior Commission approval of a transfer of control. LFUCG fails to explain why such a condition is necessary. The Commission finds that adequate protections are already

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<sup>47</sup> See Appendix A, Conditions 45 and 46.

<sup>48</sup> Subsection (5) of this section shall not apply to any acquisition of control of any . . . [u]tility by an acquirer who directly, or indirectly through one (1) or more intermediaries, controls, or is controlled by, or is under common control with, the utility, including any entity created at the direction of such utility for purposes of corporate reorganization.



in place to protect KAWC ratepayers from any corporate reorganization<sup>49</sup> and declines to impose this proposed condition.

### SUMMARY OF FINDINGS

After considering the evidence of the record and being otherwise sufficiently advised, the Commission finds that:

1. RWE, Thames, TWUS, AWWC and KAWC will, after the consummation of the proposed merger, have the financial, technical, and managerial abilities to provide reasonable utility service.

2. The proposed acquisition of AWWC by RWE, Thames, and TWUS and the proposed transfer of control of KAWC from AWWC to TWUS are in accordance with law and for a proper purpose; they will, however, be consistent with the public interest only under the conditions set forth in Appendix A to this Order.

3. RWE will not, by reason of its ownership of all outstanding shares of common stock of Thames, be a utility as defined in KRS 278.010(3).

4. Thames will not, by reason of its ownership of all outstanding shares of common stock of TWUS, be a utility as defined in KRS 278.010(3).

5. TWUS will not, by reason of its ownership of all outstanding shares of common stock of AWWC, be a utility as defined in KRS 278.010(3).

6. AWWC will not, by reason of its ownership of all outstanding shares of common stock of KAWC, be a utility as defined in KRS 278.010(3).

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<sup>49</sup> See, e.g., Appendix A, Condition 50.

IT IS THEREFORE ORDERED that:

1. All findings contained in our Orders of May 30, 2002 and July 10, 2002 that are not in conflict with the findings of this Order are incorporated by reference as if fully set out herein.

2. The transfer of control of KAWC from AWWC to RWE, Thames and TWUS through TWUS's acquisition of ownership and control of AWWC is approved subject to the conditions set forth in Appendix A of this Order. The proposed transfer of control shall not proceed unless, within 20 days of the date of this Order, written acknowledgements on behalf of RWE, Thames, TWUS, AWWC, and KAWC by each entity's chief executive officer accepting and agreeing to be bound by these conditions are filed with the Commission.

3. Neither RWE nor Thames nor TWUS nor AWWC shall impair KAWC's capacity to meet its obligations to provide adequate, efficient, and reasonable utility service.

4. KAWC is prohibited from guaranteeing the debt of RWE, Thames, TWUS, AWWC, or any of their affiliates or subsidiaries without the prior approval of the Commission.

5. The Joint Applicants shall file with the Commission a copy of the final decision or order or other forms of regulatory notification regarding the proposed merger that each state regulatory authority with jurisdiction over the proposed merger issues within 20 days of the issuance of such order or notification.

6. The Joint Applicants shall notify the Commission in writing of any material change in KAWC's participation in, or funding for, research and development 30 days prior to any proposed change.

7. KAWC shall, for calendar year 2002 and for the next five years thereafter, include with its annual report to the Commission a table that shows each water quality standard imposed by law, the number of water service interruptions, the average employee response time to water service interruptions, the number of customer complaints, and the customer inquiry response time for that year.

8. Beginning with calendar year 2003, the Joint Applicants shall file annually with the Commission a report that details the adoption and implementation of best practices at KAWC.

9. KAWC shall report annually to the Commission its economic development activities and its actual expenditures for economic development activities and civic and charitable activities.

10. KAWC shall annually file with the Commission its current 2-year capital and operation and maintenance budgets and an explanation for any reduction in a budgeted item.

11. Thames, TWUS, and AWWC shall at 6-month intervals submit to the Commission written reports on the actual cumulative costs of the proposed merger until all transaction costs have been incurred. These reports shall be for the periods ending June 30 and December 31, and shall be submitted within 45 days of the end of the reporting period.

12. RWE, Thames, TWUS, AWWC and KAWC shall comply with all reporting and filing requirements described herein. Unless otherwise noted, all quarterly reports shall be filed within 45 days of the close of the reporting quarter, while all annual reports shall be filed by March 31 of the year following the reporting period.

13. Unless otherwise stated, all reports required by this Order shall be filed in the record of Case No. 2002-00277.<sup>50</sup>

14. Within 5 days of the consummation of the merger, KAWC shall file a written notice setting forth the date of merger.

Done at Frankfort, Kentucky, this 20<sup>th</sup> day of December, 2002.

By the Commission

DISSENTING OPINION OF COMMISSIONER ROBERT E. SPURLIN

I cannot agree with the majority's decision to approve the proposed transfer of Kentucky-American to TWUS. TWUS has not demonstrated the financial, managerial, and technical ability to provide reasonable service to Kentucky customers. Moreover, I believe that the proposed transaction is not consistent with the public interest.

In attempting to demonstrate TWUS' financial ability, the joint applicants rely heavily on the ability of TWUS, a subsidiary of RWE, to borrow money at cheaper rates. However, on information and belief, I predict that RWE's rapid acquisition of local utilities throughout the United States will significantly weaken its financial

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<sup>50</sup> Case No. 2002-00277, Compliance of Kentucky-American Water Company, American Water Works Company, RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH with the Provisions of the Orders Approving the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH (Ky.PSC Docket opened July 22, 2002).

standing and will adversely affect TWUS' ability to provide reasonable service to Kentucky consumers.<sup>51</sup>

I believe that the Commission failed to consider evidence demonstrating that the joint applicants may not be as financially sound as they claim to be in their application. For example, on November 19, 2002, the Commission refused to order Kentucky-American to report the total amount spent to oppose LFUCG's potential acquisition of Kentucky-American. While I would agree with this decision under normal circumstances, I believe that, given the tenor of Kentucky-American's advertising campaign, the total amount of their expenditures should have been disclosed.

The Commission also refused to permit the intervention of Public Citizen, an established consumer-rights advocate with access to a vast network of resources. RWE and Thames have repeatedly failed to adequately address the impact that their future liabilities could have on RWE's ability to fund the capital requirements of American Water Works and Kentucky-American. I was hopeful that Public Citizen could shed additional light on these issues and expressed serious concern when my fellow Commissioners refused to allow them to participate in this proceeding.

In my previous dissenting opinion,<sup>52</sup> I stated that RWE had also failed to adequately address the impact that RWE's obligation to decommission nuclear power plants and dispose of nuclear waste will have on its ability to fund the capital requirements of American Water Works and Kentucky-American. In this proceeding,

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<sup>51</sup> Indeed, RWE has already admitted that its net income for 2003 will be "substantially" lower due to the amortization of goodwill related to recent acquisitions, including Thames Water and American Water Works. *RWE Sees FY 2003 Net Down "Substantially" on Goodwill Write-Downs*. AFX News Limited, December 16, 2002.

<sup>52</sup> Case No. 2002-00018.

RWE was given the opportunity to respond to my concerns.<sup>53</sup> However, they again failed to provide any evidence to show that RWE has adequately funded these future liabilities. Given the diminished financial standing of RWE and the dearth of information regarding RWE's impact on future capital requirements, I can only conclude that TWUS has not demonstrated the financial ability to provide reasonable service to Kentucky consumers.

With regard to the acquirer's managerial and technical ability, I find the premature departure of James Barr, former head of Kentucky-American, and the resignation of Director W. T. Young, Jr. disconcerting. The loss of Kentuckians of such caliber and experience signals a major departure from the joint applicants' previous commitment to maintain current management.

Some have argued that the Commission's decision in this proceeding is limited to the proposed transfer of Kentucky-American to TWUS. However, I contend that the majority's decision to approve the proposed transaction will negatively impact Commission policy and adversely affect Kentucky consumers. For example, TWUS' Articles of Incorporation provide that "[N]o director of the Corporation shall be liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director."<sup>54</sup> The Articles further provide "No amendment to or repeal of this Article shall apply to or have any effect on the liability or alleged liability of any director of the

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<sup>53</sup> Response to Item 2 of Commission Staff's First Set of Interrogatories and Requests for Production of Documents dated September 23, 2002.

<sup>54</sup> Application, Certificate of Incorporation of Thames Water Aqua US Holdings, Inc., Article VII.

Corporation for or with respect to any acts or omissions of such director occurring prior to such amendment or repeal.”<sup>55</sup>

While I recognize that Kentucky-American is a Kentucky corporation governed by Kentucky corporate law, I am deeply concerned that the majority would place the future of Kentucky-American, a company that provides a vital resource to Kentucky residents, under the control of a company whose directors are held to such low fiduciary standards. Shouldn't we all be held responsible for our actions? Should we absolve corporate directors of any and all liability? What have we learned from recent business scandals involving the nation's most prominent and influential companies? Who suffers most when companies are not held accountable for their actions? I find TWUS' Articles, which do virtually nothing to protect company shareholders or the public at large, repugnant to the ideals of honest dealing and fair play. Clearly, the proposed transfer is not consistent with the public interest.

In fact, the Joint Applicants have presented nothing to show that the public will receive any benefit whatsoever from the proposed transaction. While the filing of a consolidated tax return will allow Thames Holdings and RWE to achieve certain administrative savings, the applicants have not demonstrated that these benefits will in any way inure to Kentucky consumers. I am not alone in my findings. Indeed, the Attorney General concluded that that there will be no benefit to Kentucky ratepayers, and Bluegrass FLOW asserts that the only beneficiaries of the proposed transfer are the shareholders of RWE.

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<sup>55</sup> Application, Certificate of Incorporation of Thames Water Aqua US Holdings, Inc., Article VII.

Clearly, TWUS has not shown that it can provide reasonable service to Kentucky consumers. I do not believe that the proposed transaction is consistent with the public interest. Instead, I am forced to conclude that the public will be adversely affected by this acquisition. For the foregoing reasons and for all the reasons stated in my previous opinion, I respectfully dissent.

  
Robert E. Spurlin, Commissioner

ATTEST:

  
Executive Director



## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2002-00317 DATED December 20, 2002

The proposed merger agreement between RWE, Thames, AWWC, and Apollo and the transfer of control of KAWC from AWWC to TWUS, Thames and RWE are approved upon the following conditions:

#### OPERATIONS AND FINANCIAL

1. KAWC will not apply to the Commission for a rate adjustment or make any other filing that has the effect of increasing its rates for water service before March 16, 2004, or one year following the date of the consummation of the proposed merger, whichever is later.

2. At no time prior to May 30, 2007 will KAWC apply to the Commission for recovery of costs associated with the protection of water utility assets except through adjustments in its general rates for water service.

3. KAWC's books and records will be maintained and housed in Kentucky.

4. RWE, Thames, TWUS, AWWC, and KAWC will not assert in any Commission proceeding that Commission review of the reasonableness of any cost has been or is preempted by a United Kingdom, Federal Republic of Germany, European Community, or other foreign regulator.

5. RWE, Thames, TWUS, AWWC, and KAWC will not assert in any judicial or administrative proceeding that the Commission lacks for rate-making purposes jurisdiction over KAWC's capital structure, financing, and cost of capital.

6. RWE, Thames, TWUS, AWWC, and KAWC will obtain Commission approval prior to the transfer of any KAWC asset with an original book value in excess

of \$1 million or real property or real estate with a net original book value in excess of \$200,000.

7. KAWC will obtain Commission approval prior to any transfer of control or ownership of the land upon which Jacobson Park is located.

8. Neither KAWC nor its ratepayers, directly or indirectly, will incur any additional costs, liabilities, or obligations in conjunction with TWUS, Thames or RWE's acquisition of AWWC.

9. KAWC will not incur any additional indebtedness, issue any additional securities, or pledge any assets to finance any part of the purchase price paid by Thames for AWWC stock.

10. The payment for AWWC stock will not be recorded on KAWC's books.

11. The premium that Thames pays for AWWC stock, as well as all transaction-related costs, will not be "pushed down" to KAWC and will not be recovered from KAWC's ratepayers.

12. RWE, Thames and TWUS's acquisition of AWWC will not affect the accounting and rate-making treatments of KAWC's excess deferred income taxes.

13. No early termination costs, change in control payments, or retention bonuses paid to a KAWC or AWWC employee as a result of the proposed transaction will be allocated to KAWC or recovered from KAWC's ratepayers.

14. KAWC will not bear any costs incurred to comply with any law, regulation, standard, or practice of the United Kingdom, Federal Republic of Germany, or European Community necessary to complete the proposed transaction.

15. For at least one year from the date of the consummation of the merger or until March 16, 2004, whichever occurs later, each of KAWC's current corporate officers

will continue in his current position and perform his current duties unless he requests reassignment or retirement, is unable to continue to perform the duties of that position due to some physical, mental, or civil disability, or has engaged in some misconduct that requires his removal or reassignment.

16. For at least one year from the date of the consummation of the merger or until March 16, 2004, whichever occurs later, RWE, Thames, TWUS, AWWC or KAWC will notify the Commission in writing within 10 days of any changes in KAWC's corporate officers and management personnel.

17. RWE and Thames will take an active and ongoing role in managing and operating KAWC in the interests of customers, employees, and the Commonwealth of Kentucky, and will take the lead in enhancing KAWC's relationship with the Commission, with state and local governments, and with other community interests, and to advance these goals shall, among other things, arrange for meetings between RWE's and/or Thames' chief executive and the Commission and/or its Staff at least twice a year.

18. No later than March 16, 2003, RWE, Thames, TWUS, AWWC, and KAWC will develop and implement a mechanism to track the savings and costs resulting from the proposed merger and a methodology to allocate such savings and costs and will submit to the Commission in writing that mechanism and a detailed description of that allocation methodology.

19. Following the consummation of the proposed merger, RWE, Thames, TWUS, AWWC, and KAWC will submit written reports to the Commission annually on the adoption and implementation of best practices at KAWC.

20. RWE, Thames, TWUS, AWWC, and KAWC will retain separate books for each corporate entity operating within Kentucky and will follow state cost allocation guidelines, as well as all applicable codes of conduct.

21. KAWC's equity-to-capital ratio will be maintained between 35 to 45 percent. If the equity-to-capital ratio exceeds this range, RWE, Thames, TWUS, AWWC, and KAWC will notify the Commission in writing within 30 days of this development and will submit to the Commission a detailed plan of action to return KAWC's equity-to-capital ratio to this range.

22. AWWC will implement the revisions to its Retention Bonus Plan as set forth in Joint Applicants' Supplemental Response to Item 3(d) of the Commission Staff's Second Set of Interrogatories and Requests for Production of Documents in Case No. 2002-00018.

23. RWE, Thames, TWUS, AWWC, and KAWC will notify the Commission in writing within 30 days of any downgrading of the bonds of RWE, Thames, TWUS, AWWC, or any AWWC subsidiary and will include with such notice the complete report of the issuing bonding agency.

24. KAWC will match in its future rate proceedings the cost of any "best practices" that are implemented with a reasonable estimate of the savings or increased revenues that will result from the implementation of such practices and will not implement the practices if the increased revenues or decreased expenses do not exceed the cost of such practices.

25. KAWC will not be the employer or purchaser of last resort for employees, assets, and products associated with any failed or troubled RWE, Thames, TWUS, or AWWC affiliate venture.

26. KAWC's utility operations will continue to be a priority and will not be used to solely benefit non-utility affiliates.

### REPORTING

27. Unless the Commission requests otherwise, all documents filed with the Commission on behalf of RWE or any RWE subsidiary or affiliate will be in English and all financial statements will be stated in their original currency and in U.S. dollars (converted as of the date of the financial statement).

28. If RWE, Thames or TWUS issues new debt or equity in excess of \$100 million, it will notify the Commission in writing as soon as practicable prior to such issuance.

29. If AWWC issues new debt or equity in excess of \$100 million, it will notify the Commission in writing 30 days prior to such issuance.

30. No later than 30 days after the public announcement of any acquisition of a regulated or non-regulated business representing 5 percent or more of Thames' total capitalization, RWE and Thames will notify the Commission in writing of such acquisition.

31. No later than March 31 of each year following the consummation of the proposed merger, RWE, Thames, and TWUS will report in writing to the Commission on KAWC's proportionate share of RWE's total assets, total operating revenues, operating and maintenance expenses, and number of employees for the most recently completed fiscal year. If AWWC remains a subsidiary of Thames and TWUS and KAWC remains a subsidiary of AWWC, this report will also reflect KAWC's proportionate share of Thames's and TWUS's total assets, total operating revenues, operating and

maintenance expenses, and the number of employees for the most recently completed fiscal year.

32. RWE, Thames, TWUS, AWWC, and KAWC will obtain Commission approval prior to KAWC's payments of any dividend or transfers of any funds within a calendar year that collectively represent more than 5 percent of KAWC's retained earnings as of December 31 of the prior calendar year to RWE, Thames, TWUS or any other entity related to RWE.

33. RWE, Thames, and TWUS will notify the Commission in writing at least 30 days prior to AWWC's payment of any dividend or transfer of any funds representing more than 5 percent of AWWC's retained earnings to RWE, Thames, TWUS or any other entity related to RWE.

34. RWE, Thames, TWUS, AWWC or KAWC will file the following reports with the Commission: RWE's quarterly interim reports to its shareholders; RWE's annual reports to its shareholders; and RWE's, Thames', AWWC's, and KAWC's annual audit reports.

35. Beginning for calendar year 2002 and for the next 5 years thereafter, KAWC will include in its annual report to the Commission a table that shows each water quality standard, the number of water service interruptions, the average employee response time to water service interruptions, the number of customer complaints, and the customer inquiry response time for that calendar year.

36. Thames, TWUS, and AWWC will semi-annually submit written reports to the Commission on the actual cumulative costs of the proposed merger. The reports should be for reporting periods ending June 30 and December 31 and submitted within 45 days of the end of the reporting period.

37. RWE, Thames, TWUS, AWWC, and KAWC will file with the Commission, no later than March 31 of each year, a detailed organization chart showing all subsidiaries and affiliates of RWE as of the end of the previous calendar year.

#### SERVICE QUALITY AND RELIABILITY

38. KAWC customers will experience no material adverse change in utility service due to the merger.

39. RWE, Thames, TWUS, AWWC and KAWC will adequately fund and maintain KAWC's treatment, transmission, and distribution systems; comply with all applicable Kentucky statutes and administrative regulations; and supply the service needs of KAWC customers.

40. When implementing best practices, RWE, Thames, TWUS, AWWC and KAWC will take into full consideration the related effects on the levels of customer service and customer satisfaction, including any negative effects resulting from any future work force reductions.

41. At least 30 days prior to any planned reduction of 5 percent or more in KAWC's work force, RWE, Thames, TWUS, AWWC or KAWC will notify the Commission in writing of the planned reduction and will include with such notice a written study of the reduction's expected effects on service and KAWC's plan for maintaining service quality at the reduced work force level.

42. RWE, Thames, and TWUS will maintain AWWC's and KAWC's levels of commitment to high quality utility service and will fully support maintaining KAWC's record for service quality.

43. KAWC will continue to protect and safeguard the condition of all of its watershed land holdings surrounding its reservoirs and well fields in Kentucky.

## OTHER COMMITMENTS AND ASSURANCES

44. If RWE establishes a headquarters for its operations in the United States during the 10 years following the consummation of the proposed merger, it will locate such headquarters in the Commonwealth of Kentucky, will include in that headquarters the corporate management personnel of those operations, and will require the chief executive officer and subordinate officers of these operations to reside in Kentucky.

45. RWE, Thames, TWUS, AWWC, and KAWC will actively support economic development and social and charitable activities throughout the areas in which KAWC serves for as long as KAWC continues to serve those areas.

46. KAWC will maintain a substantial level of involvement in community activities, through annual charitable and other contributions, on a level comparable to or greater than the participation levels experienced prior to the date of the merger.

47. RWE and Thames will maintain and support the relationship between KAWC and the communities that it serves.

48. RWE, Thames, TWUS, AWWC, and KAWC will file annually with the Commission a formal analysis of any potential synergies and benefits from any water or wastewater utility merger or acquisition in the United States that occurred in the previous calendar year and that is exempted from Commission review, together with a proposed methodology for allotting an appropriate share of the potential synergies and benefits to KAWC's ratepayers.

49. At least 40 percent of the members of KAWC's Board of Directors will be persons who are not employees or officers of RWE, Thames, TWUS, AWWC, or any other RWE affiliated entity, and who reside within the area that KAWC serves.



50. AWWC will hold all of KAWC's common stock and shall not transfer any of that stock without prior Commission approval even if the transfer is pursuant to a corporate reorganization as defined in KRS 278.020(6)(b).

51. If any state regulatory commission, except the New Jersey Board of Public Utilities, imposes conditions on RWE, Thames, TWUS, or AWWC as a condition for its approval of the proposed merger and those conditions would benefit ratepayers in any other jurisdiction, proportionate net benefits and conditions will be extended to KAWC ratepayers.

52. KAWC will retain its current name and will continue as a corporation organized under Kentucky law.

53. KAWC's headquarters will remain in Lexington, Kentucky.

54. RWE, Thames, TWUS, AWWC, and KAWC will honor all existing KAWC contracts, easements, or other agreements with the LFUCG, and will negotiate with the LFUCG in good faith regarding the renewal of those agreements.

55. KAWC will not, for at least one year from the date of the consummation of the merger or until March 16, 2004, whichever occurs later, eliminate any non-management or union employee positions, except for those positions related to the transfer of accounting and call center functions to AWWC Service Company that were planned prior to the announcement of the Acquisition Agreement.

56. RWE, Thames, TWUS, AWWC, and KAWC will maintain a sound and constructive relationship with those labor organizations that may represent certain AWWC or KAWC employees, will remain neutral respecting an individual's right to choose to be a trade union member, will continue to recognize the unions that currently

have collective bargaining agreements with KAWC, and will honor any agreements with those unions.

57. RWE, Thames, TWUS, and AWWC agree that the Franklin Circuit Court of this Commonwealth has personal jurisdiction to hear and consider any legal action or proceeding that the Commission may bring against them to enforce the provisions and conditions set forth in this Order and the Commission's Orders of May 30, 2002 and July 10, 2002 in Case No. 2002-00018. They further agree to waive all objections and defenses based upon personal jurisdiction to any action that the Commission may bring in Franklin Circuit Court to enforce the provisions and conditions set forth in these Orders.

58. RWE, Thames, TWUS and AWWC shall appoint an agent in Kentucky for the limited purpose of accepting the service of process of any action that the Commission may bring to enforce the provisions and conditions set forth in this Order and the Commission's Orders of May 30, 2002 and July 10, 2002 in Case No. 2002-00018.

59. TWUS shall not be involved in the operational control of KAWC or AWWC without prior Commission approval.

60. TWUS shall not engage in any commercial transactions involving the sale or exchange of goods or services with KAWC or AWWC. "Commercial transactions" does not include financial transactions such as the payment of dividends or the filing of a consolidated federal tax return.

61. Following completion of the proposed transaction, the membership of the Boards of Directors of TWUS and AWWC shall be the same.