

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 IN CONTROL OF)
KENTUCKY-AMERICAN WATER COMPANY)

Case No. 2002-00317

POST HEARING BRIEF OF THE ATTORNEY GENERAL

Comes now the Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention, and submits his Post Hearing Brief. The Joint Petitioners' proposal for the change of control fails to contain any benefit for the ratepayers of Kentucky. Thus, the Petitioners' request for approval of the change of control of Kentucky-American is not consistent with the public interests as required by KRS 278.020(5) and should therefore be denied.

Respectfully submitted,

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OVERVIEW

Case No. 2002-00018 – The First Application

RWE Aktiengesellschaft, through its subsidiary Thames Water Aqua Holdings GmbH, is attempting to acquire all of the common stock of the American Water Works Company, Inc. KRS 278.020 requires RWE to seek approval for the change in control from the Kentucky Public Service Commission. Initially, Thames Water Aqua Holdings GmbH and the Kentucky-American Water Company, as joint applicants, filed an application requesting authorization for the change in control. Under the preliminary plan, the Apollo Acquisition Company, a wholly-owned subsidiary of Thames Water Aqua Holdings GmbH (which is a wholly-owned subsidiary of RWE), would merge “with and into American, the parent of Kentucky-American.”¹

The Commission took action regarding this request, and (by a 30 May 2002 Order) made the determination that RWE and Thames GmbH have the managerial, technical, and financial ability to provide reasonable utility service.² On the issue of whether the transfer of control is in the public interest, the Commission “that a finding in the affirmative on the latter issue is dependent upon the acceptance of certain conditions by the joint applicants, RWE and American Water Works Company (“AWWC”).”³ The joint applicants, RWE, and American accepted the conditions.

The Office of the Attorney General, Bluegrass FLOW, Inc., and the Lexington-Fayette Urban County Government each applied for rehearing of the 30 May Order. By a 10 July 2002 Order, the Commission ruled on the applications for rehearing. The Commission clarified

¹ *In the Matter of: Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH*, Case No. 2002-00018, Joint Petition, page 1.

² Case No. 2002-00018, Order, 30 May 2002, page 1.

³ Case No. 2002-00018, Order, 30 May 2002, page 1.

certain portions of its 30 May Order, and it established a compliance proceeding. The Order on rehearing, however, did not change the net result of the Commission's prior Order of conditional approval.

The Order on rehearing did, nonetheless, expressly note that the Commission did not approve "any transfer involving another RWE or Thames Aqua subsidiary."⁴ This language was necessitated by the decision of RWE to create Thames Water Aqua US Holdings, Inc., another entity for the RWE corporate family.

The Office of the Attorney General, Bluegrass FLOW, and the LFUCG each brought an action for judicial review of the Commission's Orders for Case No. 2002-00018. Those actions are presently pending in the Franklin Circuit Court.

Case No. 2002-00317 – The Second Application

On 26 July 2002, TWUS was established. The reason for the establishment is that RWE has the desire to file a consolidated United States Tax Return. Under the proposal, TWUS will be a wholly-owned subsidiary of Thames GmbH. TWUS will hold all of the stock of the survivor of the AWW/Apollo Acquisition Inc., merger activity as well as the stock of Thames Water Holdings, Inc.

The transfer of stock from AWW/Apollo to TWUS represents a transfer of control that requires Commission approval.⁵ Because the transfer of control to TWUS is scheduled to take place prior to RWE and Thames GmbH acquiring control of AWW, the current request for approval has the practical effect of rendering the prior application a segment of the overall scheme. The decision of RWE (which knew about the change in German law prior to the filing

⁴ Case No. 2002-00018, Order, 10 July 2002, page 5.

of the application in Case No. 2002-00018) to seek piece-meal approval of its transaction raises a problem relating to the scope that is applicable for this matter. In determining the scope of the proceedings for the current case, the Commission has made the following ruling.

The scope of this proceeding is limited to: reviewing TWUS's qualifications, determining whether the transfer of control of KAWC to TWUS is consistent with the public interest, and determining whether any change in circumstances since the issuance of our Order of May 30, 2002 in Case No. 2002-00018 requires reconsideration of the findings contained that Order.⁶

The Attorney General's objection to the Commission's ruling relating to the scope of this proceeding is a matter of record, and the objection remains. With the objection noted, the Attorney General submits his post hearing brief for this case. The request for approval of the change of control is not consistent with the public interests as required by KRS 278.020(5) and should therefore be denied.

⁵ See KRS 278.020; Case No. 2002-00018, Order, 10 July 2002, pages 5 and 6.

⁶ Case No. 2002-00317, Order, 30 October 2002, pages 4 and 5.

ARGUMENT

I

THE JOINT PETITIONERS HAVE NOT MET THEIR BURDEN PURSUANT TO KRS 278.020(5).

In Case Number 2002-00018, the predecessor case to the case sub judice, the Commission sets forth its standard of proof necessary to demonstrate whether a transfer of control is in the public interest.⁷

Any party seeking approval of the transfer of control must show that the proposed transfer will not adversely effect 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 requiring party. *The acquiring party should also demonstrate that the proposed transfer is likely to benefit the public through improved service quality, enhance service reliability, the availability of additional services, lower rates, or a reduction in the utility expenses to provide present services. Such benefits, however, need not be immediate or readily quantifiable.*⁸ [Emphasis added].

By applying the Commission's standard for the public interest, the Petitioners must demonstrate that there is likely to be a benefit. The Petitioners have failed to demonstrate that the transfer of control of KAWC to TWUS is in the public interest.⁹ Not only have the Petitioners not demonstrated that there will be a benefit, they have asserted that there will be no effect on Kentucky-American Water Company or its ratepayers (11/21/01; 10:03:24).

⁷ See *In the Matter of the Application for Approval of the Transfer of Control of Kentucky American Water Company to RWE Aktiengesellschaft and Thames Water Holdings GmbH*, Case Number 2002-00018.

⁸ See Order May 30, 2002, at p. 7 and 8. See also Order on Rehearing, July 10, 2002, at p. 9.

⁹ The Attorney General has objected to the Commission's standard of review. Indeed, in 2002-00018, the Attorney General maintained that the Applicants must demonstrate an actual, affirmative benefit in order to meet the public interest standard. That position is not waived in this case. Rather, given the fact that the Public Service Commission has adopted a standard - a standard which the Attorney General has appealed to Franklin Circuit Court, the Attorney General has elected not to reargue a point which the Commission has declined to accept. However, in the event that the Commission or other parties maintain that the Attorney General would waive his previous position by not asserting same herein, the Attorney General asserts again that the standard for review to meet the public interest element is that there be a demonstration of actual, affirmative benefits.

In Mr. Stephen Smith's pre-filed testimony, he states that the sole purpose for the creation of TWUS, the underlying reason for the need to have Commission approval of this transaction, is to "allow for the inclusion of Kentucky-American in the filing of the consolidated tax return, TWUS will have no impact on Kentucky-American."¹⁰

As a result, in the absence of any benefits to be provided to Kentucky-American's ratepayers, the Petitioners have failed to meet the Commission's public interest standard. Accordingly, the transfer of control of KAWC to TWUS must be denied.

¹⁰ See prefiled testimony of Stephen Smith , Response to Question 6; see also 11/21/02;10:03:24-10:04:04 (no impact); 10:27:19-10:27:30 (no harm, no benefit).

II

**IN THE ALTERNATIVE, IF THE COMMISSION APPROVES
THE TRANSFER OF CONTROL OF KAWC TO TWUS,
ADDITIONAL CONDITIONS MUST BE IMPOSED
TO MITIGATE AGAINST THE INHERENT RISKS
IN THIS TRANSACTION.**

**A. THE COMMISSION MUST DEMAND THAT THE APPLICANTS SHARE ANY
TAX SAVINGS OR OTHER BENEFITS ASSOCIATED WITH THE CREATION
OF TWUS.**

Based on the Motion and Petition to Modify Order, at paragraph 13, the Applicants state that the change in tax law

“made it financially desirable to create an intermediary holding company to take advantage of the law. The advantage created is the ability of RWE and Thames Holdings to file a consolidated tax return, incorporating all of the existing Thames Holdings businesses in the United States and the AWW businesses. This would be less expensive from an administrative perspective than filing multiple returns and will allow payment of taxes calculated on the net profits of all entities in the consolidated group. This could result in potential future benefits in that it may be possible to recognize for tax purposes losses that otherwise might not have been recognized. It is this future opportunity for tax savings together with the current administrative costs savings that led to the financial desirability of this action.”

Thus, as the Joint Petitioners admit, the creation of TWUS will create benefits. There is a direct benefit relating to administrative savings, and there is a potential direct benefit if one of the two present income streams falls into a tax loss position (11/21/02; 10:30:45-10:30:46). If such is the case, they should share those savings based on the public interest standard. Moreover, such a saving should result in order to comport with the general ratemaking scheme. Specifically, if the cost for providing service decreases, so should rates. Likewise, the sharing of

the savings would comply with the Commission's May 30, 2002 order in case number 2002-00018 which requires the tracking and sharing of any savings resulting from the transaction.

B. CHANGES IN CIRCUMSTANCE WARRANT THE RECOGNITION OF ADDITIONAL CONDITIONS FOR THE TRANSACTION.

In its 30 May 2002 Order, the Commission found that a "most favored nations clause would ensure that KAWC ratepayers receive all of the merger benefits that RWE, Thames, and AWWC make available to other jurisdictions."¹¹ Thus, "if any state regulatory commission, except for a commission that presently exercises jurisdiction over both AWWC and Thames operating subsidiaries, imposes conditions on RWE, Thames or AWWC as a condition for its approval of the proposed merger and those conditions would benefit ratepayers in other jurisdictions, proportionate net benefits and conditions will be extended to KAWC ratepayers."¹² RWE, AWW, and the joint applicants from Case No. 2002-00018 accepted this requirement and condition.

The "Terms and Conditions" of the Maryland-American approval include the following commitments:

With respect to its Maryland customers, neither American, Thames, RWE nor Maryland-American shall disclose confidential customer information, including names, addresses, and phone numbers to an affiliate of RWE, except for contracted billing purposes, without prior written notice to the Commission and without prior consent of the customer.¹³

and

¹¹ Case No. 2002-00018, Order, 30 May 2002, page 23.

¹² Case No. 2002-00018, Order, 30 May 2002, Appendix A, page 9, Condition 51.

¹³ Responses to the Attorney General's Supplement Request for Information Dated October 7, 2002, Item Number 6, Maryland-American agreement numbered paragraph 11.

Upon closing of the merger transaction, RWE and Thames shall each appoint an agent who will accept service of process in Maryland.¹⁴

The Commission should recognize and impose these conditions for the immediate benefit of the Kentucky rate-payers.¹⁵ The General Assembly's decision to enact the "No Call" law¹⁶ (which went into effect on 15 July 2002) evidences the public policy in Kentucky that the protection of privacy against unwanted marketing efforts is supported by the legislature. The rapid growth of the "No Call" list (which currently contains over 752,000 Kentucky residential telephone numbers representing almost two million Kentuckians) provides ample support for the immediate recognition and implementation of a condition that will further enhance consumer protection and privacy. The immediate recognition of the Maryland condition for confidential information will also further support the General Assembly's mandate for confidentiality set forth by KRS 278.2213.

With regard to the Maryland condition for maintaining an agent for service of process, it is clear that the applicants' previous agreement to a "most favored nations" clause requires the extension of this benefit to Kentucky. The Petitioners have made the commitment to allow KAWC ratepayers to receive merger benefits that RWE, Thames, and AWWC made available to other jurisdictions. It is equally clear that the conditions imposed by the Commission in Case No. 2002-00018 and accepted by RWE, AWW, and the joint applicants (for that case) create

¹⁴ Responses to the Attorney General's Supplement Request for Information Dated October 7, 2002, Item Number 6, Maryland-American agreement numbered paragraph 12.

¹⁵ This does not suggest that these are the only benefits in existence that fall under the "most favored nation" provision. These particular benefits are of paramount interest in providing protection to Kentucky rate payers and should be given recognition and imposed as quickly as possible.

¹⁶ See KRS 367.46951 to KRS 367.46999.

obligations and duties for parties other than Kentucky-American. Unless the Commission has the undeniable ability to enforce its Orders, the conditions concerning RWE, Thames GmbH, and American Water Works (and perhaps TWUS) have uncertain meaning “but for” the charity and gracious compliance by parties other than Kentucky-American.

The need for this condition cannot be discounted as being merely speculation. Specifically, RWE and Thames GmbH have claimed in their Answer to the Attorney General’s appeal of PSC Case Number 2002-00018 that, “insufficiency of service of process upon RWE and Thames, including improper service, and for insufficiency of process. Nevertheless, Defendants RWE and Thames subject to the jurisdiction of this Court for the purpose of this appeal only.¹⁷” Accordingly, unless the Petitioners are required to appoint an agent for service of process, any potential redress against parties other than KAWC might only be had if they feel benevolent enough to extend it.

C. THE JOINT PETITIONERS MUST WAIVE ANY DEFENSE OR CHALLENGE AVAILABLE UNDER INTERNATIONAL LAW THAT MIGHT PREVENT OR HINDER THE COMMISSION’S ENFORCEMENT OF ANY CONDITIONS IMPOSED WITH AN APPROVAL OF THE TRANSFER OF CONTROL.

In the current case, the Petitioners are requesting the transfer of control of Kentucky-American Water Company to TWUS with the declaration that they understand that the conditions imposed in case number 2002-00018 will nonetheless apply to TWUS. In granting the approval along with the conditions, the Commission framed the issued as follows:

At issue is whether and 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

¹⁷ See *Commonwealth of Kentucky, ex rel. A. B. Chandler, III, Attorney General vs. Public Service Commission, et al*, Franklin Circuit Court Action Number 02-CI-1012, ninth defense.

former issue, but conclude that a finding in the affirmative on the later issue is dependent upon the acceptance of certain conditions by the joint applicants, RWE and American Water Works Company.

The question must again be asked whether the conditions will be accepted by TWUS. More importantly however, is the new question of whether the Commission has the unequivocal ability to enforce these conditions given the potential impact of international law. Indeed, if international law whether by treaty, convention, trade agreement, or otherwise, supercedes the Commissions authority, the conditions are meaningless. If the conditions are meaningless, the Commission can not find in the affirmative that the transfer of control is in the public interest.

Through discovery, the intervenors made numerous inquiries as to the effect of international law on any enforcement action that the Commission may take relative to the conditions placed on the Petitioners with any approval of this transaction. They have given assurances, both through discovery as well as through Mr. Duane Layton at the hearing, that current international law will not preempt or supercede any commission action. Unfortunately, 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 other domestically domiciled for profit utilities.

Indeed, the application of international law to the current business world has not been well articulated and defined. Even Mr. Layton noted that earlier this year he was one of six non-governmental Americans appointed as being qualified to serve on the dispute settlement panel established by the WTO (11/21/02; 03:35:55). Given this uncertainty or lack of meaningful guidance, the Commission should demand that the Petitioners waive any defense or challenge available under current or future international law against the Commission's jurisdiction and

enforcement of any conditions imposed with an approval of the transfer of control of KAWC to TWUS. This waiver, of course, would not constitute prejudice or harm. First, if no such defenses or challenges exist, the Petitioners waive nothing. If defenses or challenges do exist, the Petitioners are merely presenting the Commission with that which they have maintained that the Commission already has - unequivocal ability and jurisdiction to enforce any conditions with any approval of the transfer of control.

D. THE JOINT PETITIONERS MUST AGREE THAT THEY WILL NOT EXERCISE ANY RIGHT AGAINST OR BEFORE THE KPSC THAT IS NOT OTHERWISE GENERALLY AVAILABLE TO A US DOMICILED, FOR-PROFIT, COMPANY.

In order to guarantee an even playing field of utility companies regulated by the Commission, the Petitioners must agree not to exercise any right available under international law that would put it at an advantage over a US domiciled, for-profit company regulated by the Commission. By so doing, the applicants would be willing to observe, and be regulated by, the Commission in its decisions on a level playing field with other domestic companies. This agreement would eliminate any prejudice or discrimination exercisable by the Petitioners by preventing them from contravening the Commission's regulatory process by attempting to assert an international right not otherwise available to a US company. In sum, it would place the Petitioners at par with US companies – no better, no less.

CONCLUSION

The Joint Petitioners' proposal for the change of control fails to contain any benefit for the ratepayers of Kentucky. Thus, the Applicants' request for approval of the change of control of

Kentucky-American is not consistent with the public interests as required by KRS 278.020(5) and should therefore be denied.

Respectfully submitted,

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Notice of Filing

Counsel gives notice of the filing, by hand delivery to Thomas M. Dorman, Executive Director of the Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601, of the original and three photocopies. Further, counsel gives notice of the uploading to the Commission's file transfer protocol site of one copy in electronic medium. The filing is in compliance with Instructions 5(a) and 9 of the Commission's 16 September 2002 Order of procedure. This action was taken on 5 December 2002.

/s/ David Edward Spenard
Assistant Attorney General

Instruction 13 Certification

Per Instruction 13 of the Commission's 16 September 2002 Order of procedure, counsel certifies that the electronic version of the filing is a true and accurate copy of the document filed in paper medium. The electronic version has been transmitted to the Commission. The other parties have been notified by electronic mail that the electronic version has been transmitted to the Commission.

/s/ David Edward Spenard
Assistant Attorney General

Certificate of Service

Counsel certifies service of this document. Service took place on 5 December 2002 by mailing of a true and correct photocopy of the same, first class postage prepaid, to the other parties of record. The other parties of record are the following: Roy W. Mundy II, Kentucky-American Water Company, 2300 Richmond Road, Lexington, Kentucky 40502; Lindsey W. Ingram Jr., Robert Watt, Stoll, Keenon & Park, LLP, 300 West Vine Street, Suite 2100, Lexington, Kentucky 40507 1801; Jack Hughes, 124 West Todd Street, Frankfort, Kentucky 40601; David Barberie, Lexington-Fayette Urban County Government, Department of Law, 200 East Main Street, Lexington, Kentucky 40507; Anthony G. Martin, Lexington-Fayette Urban County Government, Department of Law, P. O. Box 1812, Lexington, Kentucky 40588; and Foster Ockerman, Jr., Martin, Ockerman & Brabant, 200 North Upper Street, Lexington, Kentucky 40507.

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