

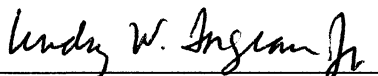
COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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

**POST-HEARING BRIEF OF PETITIONERS**  
**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.**

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AQUA US HOLDINGS INC. and

RWE AKTIENGESELLSCHAFT

## INTRODUCTION

On May 30, 2002 the Commission in Case No. 2002-00018 approved the transfer of control of Kentucky-American Water Company ("Kentucky-American") to Thames Water Aqua Holdings GmbH ("Thames Holdings") and RWE Aktiengesellschaft ("RWE") through the proposed merger of Kentucky-American's parent company, American Water Works Company, Inc. ("American") and Apollo Acquisition Company<sup>1</sup> ("Apollo"). In order to effectively implement the approved acquisition with the optimum administrative efficiency, an intermediary holding company, Thames Water Aqua US Holdings, Inc. ("TWUS") has now been created to hold the American stock. Joint Petitioners, Kentucky-American, Thames Holdings, RWE, TWUS, Apollo and American, commenced this proceeding seeking approval of the limited modification to the acquisition already approved by the Commission.

The Commission held a hearing on November 21, 2002 allowing evidence both on whether TWUS satisfied the requirements of KRS 278.020 and whether there had been any change in circumstances which would warrant a reconsideration of the May 30, 2002 Order. Joint Petitioners established in the hearing that TWUS has the ability to provide the requisite reasonable utility service to Kentucky-American's customers and that the transfer of control to TWUS is consistent with the public interest. Intervenors, the Lexington-Fayette Urban County Government, the Attorney General, and Bluegrass FLOW, Inc. did not present any evidence of a change in circumstances. The only evidence offered in opposition to the modification of the acquisition involved "concerns" about the alleged impact of certain international agreements on the Commission's jurisdiction. Joint Petitioners established that the concerns are unfounded. The limited modification to the previously approved acquisition, adding TWUS to the corporate structure, should therefore be approved by the Commission in accordance with KRS 278.020.

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<sup>1</sup> Apollo is a wholly owned subsidiary of Thames Holdings. Thames Holding is a wholly owned subsidiary of RWE.

I. **THE MODIFICATION TO THE APPROVED ACQUISITION IS LIMITED TO THE ADDITION OF AN INTERMEDIARY HOLDING COMPANY**

The formation of TWUS should have no impact on the Commission's prior approval of the proposed acquisition. Nothing has changed either in the structure of the acquisition or its impact on Kentucky-American other than the addition of an intermediary holding company to the corporate hierarchy. That limited modification to the approved acquisition is of no consequence in terms of determining whether or not the acquisition meets the requirements of KRS 278.020. The Commission should, therefore, approve the modification to the acquisition found to be in the public interest in the Order of May 30, 2002 in Case 2002-00018.

A. **Findings and Conclusion in Earlier Proceeding**

The Commission will recall that on September 16, 2001, RWE, Thames Holdings, American and Apollo executed an Agreement and Plan of Merger which provided that American, the parent company of Kentucky-American, would merge into Apollo and become the surviving corporate entity. American would thereafter become a wholly owned subsidiary of Thames Holdings whose water business is operated by Thames Water, Plc ("Thames"), the largest water and wastewater company in the United Kingdom and one of the largest water and wastewater companies in the world. Kentucky-American and Thames Holdings filed a Joint Petition pursuant to KRS 278.020 seeking an Order from the Commission approving the change of control of Kentucky-American which will result from the acquisition. The Commission approved the acquisition by Order dated May 30, 2002 in Case No. 2002-00018, hereinafter the "May 30, 2002 Order."

The Commission found that "[t]he proposed merger will not impair or have any immediate effect upon KAWC's ability to provide reasonable utility service to its customers."

(May 30, 2002 Order, p. 13). Significantly, it noted that the acquisition agreement requires no change in KAWC's management, labor force, operating practices, or financial structure. (May 30, 2002 Order, p. 13). The Commission found that substantial benefits could be gained through the acquisition, including (1) enhancement of Kentucky-American's ability to provide reasonable utility service at reasonable rates and (2) access to RWE's "extensive borrowing power." (May 30, 2002 Order, p. 13). The Commission recognized the commitment of both RWE and Thames to research and development and acknowledged the corresponding technologies which would be made available to Kentucky-American as a result of the acquisition. (May 30, 2002 Order, p. 14). It noted that of particular importance is the benefit to be gained in these troubled times from Kentucky-American's access to Thames' expertise with regard to security. (May 30, 2002 Order, p. 14).

These findings led to the ultimate conclusion that the merger, as qualified by the Commission through conditions and commitments, was in the public interest:

Our review of the record leads us to conclude that if Joint Applicants, AWWC and RWE accept the conditions and commitments set forth in Appendix A,<sup>2</sup> 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. 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.

(May 30, 2002 Order, p. 29).

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<sup>2</sup>The Appendix included fifty-six comprehensive commitments which were accepted by Kentucky-American, American, Thames, and RWE.

**B. Changes Since Earlier Proceeding**

On July 26, 2002, after the entry of the Commission's Order approving the proposed acquisition, TWUS was created by Thames Holdings. (Prepared Testimony of Stephen Smith, "Smith," p. 2). TWUS is a Delaware corporation which is to have but one purpose: to hold the stock of the Thames Holdings' water interests in the United States so that a consolidated tax return can be filed for those businesses. (Smith, p. 2). At the time the acquisition was structured and the parties entered into the Agreement and Plan of Merger, German law favored a relatively flat corporate structure. (Smith, p. 2). The law was subsequently changed, opening the door to the filing of a consolidated tax return. (Smith, p. 2). TWUS was created in order to enable Thames Holdings and RWE to obtain the administrative savings which will result from the filing of a consolidated tax return. (Smith, p. 2).

The Commission will recall that Joint Petitioners indicated in the prior proceeding that an intermediary holding company might be created for this purpose. (Transcript of November 21, 2002 Hearing, "Hearing," p. 44, lines 11-16; see also Case No. 2002-00018, footnote 2 to Exhibit 5 to Joint Petition of Kentucky-American Water Company and Thames Water Aqua Holdings GmbH for Approval of a Change in Control of Kentucky-American Water Co. and Transcript of May 1, 2002 Hearing, pp. 24-25). The formation of TWUS was therefore not an unexpected modification of the approved acquisition. (See Brief on Behalf of Bluegrass FLOW, Inc., p. 5, footnote 7, filed in Case No. 2002-00018). Once the issue was fully analyzed, the decision was made to create an intermediary holding company. It appeared important to one of the other jurisdictions reviewing the acquisition that the intermediary company be in existence, so RWE and Thames Holdings obliged and formed TWUS in advance of the intended timetable. (Hearing, p. 46, lines 11-17). Accordingly, the only aspect of the acquisition previously

approved by the Commission which will change is that TWUS rather than Thames Holdings will own the American stock.

The Commission was notified of this modification to the approved acquisition because the stock of American will be owned by TWUS, rather than Thames Holdings. This limited modification will not impact any of the substantive aspects of the previously approved acquisition. (Hearing, p. 130, lines 10-21).

The change is one in corporate structure alone. (Hearing, p. 64, lines 5-25; p. 65, lines 1-9; p. 123, lines 15-23). The modification to the corporate hierarchy will be unnoticeable by either Kentucky-American or its ratepayers. (Hearing, p. 63, lines 2-10; p. 127, lines 1-6). TWUS will have no direct role in Kentucky-American's operations. (Smith, p. 2). Indeed, Joint Petitioners have committed that TWUS will not be involved in the operational control of either American or Kentucky-American without specific approval from the Commission. (Response to Lexington-Fayette Urban County Government Supplemental Request "LFUCG Supplemental Request," #8; Hearing, p. 78, lines 12-25; p. 79, line 1). TWUS will not engage in any commercial transactions (exchange of goods and services) with American or Kentucky-American. (LFUCG Supplemental Request, #16; Hearing, p. 80, lines 23-25; p. 81, lines 1-12). Kentucky-American will continue to be a wholly-owned subsidiary of American and will remain a Kentucky utility subject to the jurisdiction and regulation of the Commission. (Smith, p. 2; Hearing, p. 63, lines 2-10).

There will be no change in the consideration of Kentucky-American's taxes for rate making purposes. With or without the formation of TWUS, Kentucky-American will continue to be regulated on a stand-alone basis. (Hearing, p. 47, lines 24-25; p. 48, lines 1-8). TWUS will simply own the U.S. businesses of Thames and file a consolidated tax return on their behalf.

(Hearing, p. 44, lines 17-22). Such filing will have no impact on Kentucky-American. Moreover, Joint Petitioners have assured that the formation of TWUS will result in no harm to Kentucky-American's ratepayers (Hearing, p. 47, lines 10-23), but instead will merely provide an administrative savings to RWE. (Hearing, p. 47, lines 24-25; p. 48, lines 1-17).

It is immediately apparent that the modification has no impact on the factors relied upon by the Commission to approve the proposed acquisition. The modification to the acquisition should, therefore, likewise be approved.

## **II. THE INTERVENORS HAD EVERY OPPORTUNITY TO CHALLENGE THE LIMITED MODIFICATION TO THE APPROVED ACQUISITION**

The Commission has devoted much effort to carefully defining the scope of this proceeding to ensure that the modification is given the required statutory review without infringing on the jurisdiction of the Franklin Circuit Court which is currently reviewing the appeals from the May 30, 2002 Order. Although the Intervenor fought hard for the opportunity to revisit the issues raised in the May 30, 2002 Order, they failed to offer any evidence of a change in circumstances which would support a reconsideration of the Order. Significantly, the Intervenor was not denied the opportunity to present evidence which would warrant reconsidering any aspect of the approved acquisition; they simply discovered that no such evidence exists. Although the scope of the hearing was limited, discovery was not. Even with this latitude, the Intervenor was unable to adduce any evidence that a change of condition or any other factor existed that would suggest the need to modify the prior order.

Since the limited modification to the approved acquisition involves nothing more than a change in the corporate hierarchy, Joint Petitioners advocated a narrow scope for this proceeding. In contrast, the Intervenor argued that the Commission's review of the modification

must include a re-examination of the issues laid to rest in the May 30, 2002 Order. The Attorney General stated:

The Attorney General intends to request discovery, present evidence, and test the evidence of the **Joint Petitioners** concerning the financial, technical, and managerial abilities to provide reasonable service. He also has the same intent for the matters pertaining to whether the proposal is in accordance with the law, for a proper public purpose, and is consistent with the public interest. (emphasis in original).

(Attorney General's Memorandum in Response to 13 September 2002 Order of the Public Service Commission, p. 9).

The Lexington-Fayette Urban County Government ("LFUCG") likewise noted that "Although some information from the record in Case No. 2002-00018 may well be relevant and timely, it is likely that other information will need to be updated, and the updated information may provide a perspective that was not available at the prior proceeding." (Lexington-Fayette Urban County Government's Motion to Dismiss and Memorandum on the Issues Raised by the Commission in its September 13, 2002 Order, p. 5). The Intervenors strongly urged the Commission to open up this proceeding to include a review of all of the factors addressed in the May 30, 2002 Order.

The Commission rejected the contention that the issues raised in the earlier proceeding could be rehashed herein and by Order dated October 16, 2002 defined the scope of this proceeding to be "limited to consideration of Thames Water Aqua US Holdings, Inc.'s ("TWUS") ability to provided reasonable utility service and to the question of whether the proposed transfer of control to TWUS is in the public interest." (October 16, 2002 Order, p. 1). Moving the Commission to reconsider, the Intervenors protested, arguing that the October 16, 2002 ruling precluded them from introducing evidence of a change in circumstances which, under the principles of res judicata, would warrant reconsidering the findings and conclusions in



the May 30, 2002 Order. (Lexington-Fayette Urban County Government's Motion to Reconsider and Clarify the Commission's Order of October 16, 2002; the Attorney General's Objection to, with Motion for Consideration of, the 16 October 2002 Order of the Public Service Commission). The Commission thereafter clarified its ruling explaining that it would provide the Intervenors with the full opportunity to establish "any change in circumstances since the issuance of [the] May 30, 2002 Order" approving the acquisition. (October 30, 2002 Order, p. 5).

Consistent with that ruling, the Commission placed no limitations upon the Intervenors during the November 21, 2002 hearing with regard to presenting evidence of a change in circumstances. The Intervenors, however, did not come forward with any such evidence. Although they had fought hard for the opportunity to do so, the Intervenors presented no direct evidence constituting a challenge to the continued validity of any of the findings of fact contained in the May 30, 2002 Order. It is important to note that Joint Petitioners did not place any hurdles in the Intervenors' path in this regard. There were indications that the Intervenors sought to explore a change in the financial stability of RWE and the environmental record of Thames. Joint Petitioners offered up witnesses to address both topics (Hearing, p. 68, lines 1-25); however, the Intervenors decided not to question these witnesses. Despite their prior fervor, the Intervenors did not even attempt to bring any new revelations to the Commission.

In the absence of evidence of a change in circumstances, the Commission's earlier findings and conclusions are binding herein. (October 16, 2002 Order, p. 7 as modified by October 30, 2002 Order, p. 5). Accordingly, the only issues to be addressed in this proceeding are the ability of TWUS to provide reasonable utility service and whether the proposed transfer of control to TWUS is in the public interest. Joint Petitioners presented an abundance of

evidence establishing that TWUS meets the statutory requirements. The Intervenors, in turn, introduced no evidence to the contrary, thus making the decision of the Commission much easier.

**III. TWUS HAS THE ABILITY TO PROVIDE THE REQUISITE REASONABLE UTILITY SERVICE**

The same factors which led the Commission to the conclusion that Thames Holdings has the financial, technical and managerial ability to provide reasonable utility service apply equally as well to its newly created wholly-owned subsidiary, TWUS. The requirements of KRS 278.020(4) are therefore readily met.

**A. Joint Petitioners' Evidence**

As with Thames Holdings, TWUS is backed by the financial strength of RWE. (Smith, p. 2; Hearing, p. 124, lines 15-24). The Commission has already found the financial ability of RWE to be more than sufficient to satisfy the requirements of KRS 278.020(4). (May 30, 2002 Order, p. 13).

RWE, a corporation formed under the laws of the Federal Republic of Germany, is a management holding company. It is Germany's fourth 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, 2002. Moody's Investors Service reported in 2001 that RWE has "a strong financial profile." Standard & Poor's and Moody's Investors Service currently give RWE credit ratings of AA- and A1, respectively.

(May 30, 2002 Order, p. 4).

Since TWUS will be able to draw upon the financial standing of RWE, TWUS clearly has the financial ability to provide reasonable utility services.

TWUS will likewise be able to rely upon the expertise of Thames which operates all the water businesses of Thames Holdings. (Smith, p. 2; Hearing, p. 121, lines 2-9; p. 125, lines 2-7). Again, the Commission has already assessed and approved the technical and managerial ability of Thames. (May 30, 2002 Order, p. 13).

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 service companies in the world. It provides water-related services to over 43 million people by managing and operating over 540 water/wastewater facilities in 44 countries.

(May 30, 2002 Order, p. 5).

TWUS's access to the technical and management skills of Thames places it into the position to provide the requisite technical and management support necessary to provide reasonable utility service.

Joint Petitioners have established that the addition of TWUS to the corporate structure will not affect the post-acquisition operation or management of Kentucky-American. Just as with Thames Holdings, TWUS will be able to rely on Kentucky-American's proven technical abilities, along with the technical expertise added by American and its affiliates, as further enhanced by the expertise of Thames. (Response to Bluegrass FLOW Request, "FLOW," #10). Likewise, the managerial abilities of Kentucky-American, American, and Thames will be equally as available to TWUS as they would have been to Thames Holdings. (FLOW, #11). Again, TWUS will have the same financial backing of RWE which was expected to bring greater access to capital at lower costs to Thames Holdings. (Hearing, p. 124, lines 18-24).

Joint Petitioners thus established that the limited modification does not change any of the Commission's prior findings under KRS 278.020(4). TWUS has the financial, technical, and managerial ability to provide reasonable utility service as required by the statute.

**B. Matters Brought out on Cross-Examination**

Both LFUCG and the Attorney General appear to question only one aspect of the statutory requirements of KRS 278.020(4), that being the financial ability of RWE to provide continued support for the corporate hierarchy at the same level as has existed in the past. The same challenge was made in the prior proceeding. (Brief on Behalf of Bluegrass FLOW, Inc., p. 12; Lexington-Fayette Urban County Government Brief, p. 11; Post-Hearing Brief of Attorney General, p. 14, filed in Case No. 2002-00018). Nonetheless, the LFUCG seeks again to discuss the financial impact which the acquisition will have on RWE, relying on comments from financial analysts who question the allegedly high premium paid for the American stock. (Hearing, p. 89, lines 22-25; p. 90, lines 1-18). The Commission has already assessed the amount of premium to be paid for the American stock and its impact on the Commission's approval of the acquisition.<sup>3</sup> (May 30, 2002 Order, pp. 5-6). The comments of the analysts thus fail to rise to the level of a change in circumstances and do nothing in the way of establishing that RWE lacks the financial ability to provide reasonable utility service.

Nor do the analysts' ambiguous projections regarding European utilities in general carry any weight in this matter. (Hearing, p. 101, lines 23-25; p. 102, lines 1-16). In the prior proceeding the Commission noted that RWE has "extensive borrowing power". (May 30, 2002 Order, p. 13). It recognized that RWE has higher bond ratings than American. (May 30, 2002 Order, p. 13). It found that due to RWE's financial strength, the proposed acquisition will provide Kentucky-American with access to world capital markets and enable it to obtain capital at a lower cost. (May 30, 2002 Order, p. 13). The LFUCG has presented no evidence that these findings are no longer valid. RWE's financial rating has not changed since the May 30, 2002

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<sup>3</sup>In response to such criticism, RWE responds that it remains satisfied with its strategy of buying high quality corporations with a relevant market position. (LFUCG Supplemental Request, #10; Hearing, p. 90, lines 4-18).

Order. (Hearing, p. 126, lines 17-25). Its financial standing remains solid. Notwithstanding the speculation of some analysts, the Commission's prior assessment of RWE's financial abilities is, therefore, still conclusive.

The Attorney General seeks to challenge RWE's financial condition indirectly by raising an issue as to a change in German tax law which is expected to increase RWE's tax liability. (Hearing, p. 55, lines 24-25; p. 56, lines 1-15). The Attorney General went no further than to establish that RWE's tax liability is expected to increase. (Hearing, p. 56, lines 9-15). The Attorney General did not seek to quantify the increase or explore what impact it would have on RWE's overall financial strength. Again, this evidence fails to rise to the level of a change in circumstances. If a potential increase in tax liability qualified as a threat to the company's financial integrity, no company would ever be able to establish its financial strength.

Evidence that American's performance has been slightly lower than the third quarter last year because of a drought is of equal insignificance to the Commission's review. (Hearing, p. 94, lines 11-25; p. 95, lines 1-11; p. 97, lines 3-7). The Commission's approval of the acquisition was not premised upon a certain level of performance by American, but rather on a finding that Joint Petitioners have the financial, technical, and managerial abilities to provide the requisite reasonable utility service. American's slightly reduced performance during a drought has no bearing on this determination.

Similarly, the departure of James Barr ("Barr") and his replacement by W.J. Alexander ("Alexander") does not rise to the level of a change in circumstances. (Hearing, p. 102, lines 17-25; p. 103, lines 1-8). First, such departure was not unexpected. (Post Hearing Brief of the Attorney General, p. 19, in Case No. 2002-00018). Second, there is no proof that Joint Petitioners' financial, technical, or managerial abilities are in any way linked to retaining Barr.

Certainly, Alexander, the CEO of Thames' Water Division, is capable of providing the same high level of management experience and expertise to American.

The Intervenors accordingly failed to rebut Joint Petitioners' evidence as to the satisfaction of the requirements of KRS 278.020(4). The addition of TWUS to the corporate structure will not result in a rate increase or a reduction in the quality of the excellent water services Kentucky-American's customers have come to expect. (Smith, p. 2). Kentucky-American will still have access to RWE's capital and will be able to draw upon the already approved management and technical expertise offered by RWE and Thames Holdings. (Hearing, p. 125, lines 2-7). The evidence thus establishes the ability of TWUS to provide the requisite reasonable utility service required by KRS 278.020(4).

#### **IV. THE TRANSFER OF CONTROL TO TWUS IS IN THE PUBLIC INTEREST**

The formation of TWUS will also have no impact on the Commission's prior finding that the acquisition is consistent with the public interest. (Response to Lexington-Fayette Urban County Government Request, "LFUCG," #7). To the contrary, the public interest is well-served by approving the limited modification to the approved acquisition. The requirements of KRS 278.020(5) are therefore met.

##### **A. Joint Petitioners' Evidence**

The evidence which must be presented to satisfy the requirements of KRS 278.020(5) has been clearly defined by the Commission. First, "any party seeking approval of a transfer of control must show that the proposed transfer will not adversely affect the existing level of utility service or rates . . ." (May 30, 2002 Order, p. 7). Second, "[t]he 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." (May 30, 2002 Order, pp. 7-8). Joint Petitioners have fully satisfied both elements.

There will be no detriment to Kentucky-American as a result of the addition of TWUS to the corporate structure. Kentucky-American's tax expense will continue to be calculated on a stand-alone basis. (Hearing, p. 47, lines 24-25; p. 48, lines 1-8). Kentucky-American will have no interaction with TWUS because TWUS will not become involved in the operational control of either Kentucky-American or American. (LFUCG, #16; Hearing, p. 78, lines 12-25; p. 79, line 1). None of the costs associated with forming or operating TWUS will be borne by Kentucky-American or American. (Response to Attorney General Request, "AG," #16). Adding TWUS to the corporate hierarchy would not change the regulation of Kentucky-American (Hearing, p. 63, lines 2-10), nor will the formation of TWUS harm either Kentucky-American or its ratepayers. (Hearing, p. 48, lines 13-17; p. 64, lines 5-10; p. 127, lines 1-6). There will be substantially no change in the acquisition as originally approved by the Commission. (Hearing, p. 130, lines 10-21). The addition of the intermediary holding company to the hierarchy will thus have no impact on Kentucky-American.

On the other hand, the benefits to be gained by the public from the acquisition are overwhelming. The benefits associated with Thames Holdings' ownership of the American stock already enumerated by the Commission are equally applicable to TWUS:

The proposed merger will enhance KAWC's ability to provide reasonable utility service at reasonable rates. Upon completion of the transaction, KAWC will have access to Thames' resources and expertise. It will allow KAWC to share best operating practices, increase KAWC's access to technical resources, enhance KAWC's access to capital markets, and derive the benefits of Thames' research and development programs.

The proposed merger will allow KAWC to draw upon RWE's extensive borrowing power. It will permit KAWC to access world capital markets. As RWE has higher bond ratings than AWWC, capital will likely be available to KAWC at a cost lower than AWWC's. Given the increasing capital expenditures needed to replace aging water infrastructure, access to capital at the lowest possible cost will be critical to KAWC maintaining its present system at the lowest possible rates.

Both RWE and Thames have a strong commitment to research and development ("R&D"). In 2001 RWE spent over \$400 million on R&D. Thames has an annual budget of \$13 million. Thames has developed cutting-edge technologies in the area of water distribution and transmission. These technologies include alternative water treatment solutions, burst pipe prediction methodology, and trenchless technologies.

Of some significance, given current concerns of terrorist attacks against water infrastructure sites, the proposed merger will permit KAWC to access Thames' experience in the area of security. Thames Water has operated water facilities in regions of the world that have heightened security concerns. As a result, it has developed an expertise in these matters. Having operated in a relatively risk free environment in the United States, AWWC and KAWC, in contrast, have little experience in this area.

(May 30, 2002 Order, pp. 13-14).

There is no evidence of a change in circumstances which warrants a reconsideration of these findings which clearly establish 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." (May 30, 2002 Order, pp. 7-8).

#### **B. Intervenor's Evidence**

To refute these uncontradicted findings, the Intervenor introduce two new matters which they contend must be considered before determining whether the modification to the approved acquisition is in the public interest. It is significant to note that neither of these matters is related



to the formation of TWUS, but rather both could have just as easily been asserted in the prior proceeding. Further, consideration of these matters has no bearing on whether either the approved acquisition or the limited modification to the acquisition is in the public interest.

1. Alleged Threat to the Commission's  
Jurisdiction From International  
Agreements

FLOW sought through the testimony of Richard T. Eades (“Eades”) and Professor Paul B. Trawick (“Trawick”) to create some doubt as to whether the approved acquisition will impair the Commission’s jurisdiction over Kentucky-American. FLOW’s witnesses allege that the North American Free Trade Agreement (“NAFTA”) and the General Agreement on Trade and Services (“GATS”) could be relied upon by the foreign corporations in Kentucky-American’s corporate hierarchy, hereinafter “RWE/Thames,” to avoid the jurisdiction of the Commission. (Prepared Testimony of Professor Trawick, “Trawick,” p. 7; Prepared Testimony of Richard Eades, “Eades,” p. 7). The testimony, however, proved to be premised upon misinformation and false assumptions. Neither NAFTA nor GATS is applicable to this fact pattern. Even if the agreements were applicable, they would pose no threat to the Commission’s jurisdiction.

Eades, who owns an “environmental and geographic information/computer system support business” and Trawick, an anthropology professor, both expressed a general dislike for international agreements. Trawick in fact suggests that democracy is “under threat” because of NAFTA in particular (Trawick, p. 3) and that “the existence of GATS agreement is deeply troubling.” (Trawick, p. 6). Eades and Trawick attempt to paint a frightening picture of foreign corporations employing international agreements to obtain exorbitant damage awards against local bodies and to usurp local authority. Fortunately, the picture has no basis in reality.

The “concern” expressed by these witnesses proved to be nothing more than hyperbole.

There is no provision in either NAFTA or GATS which support the contention that:

- (1) Foreign investors can demand payment from local and state governments. (Trawick, p. 3).
- (2) The U.S. Government can force the people of Lexington to rescind a condemnation or else contribute heavily to a damage award. (Trawick, p. 4).
- (3) If RWE raises its water rates substantially, the people of Lexington will be able to do nothing about it. (Trawick, p. 7).
- (4) A cause of action by a foreign investor against a state could end up in world courts or the courts of the WTO. (Eades, p. 7).
- (5) State laws are “super-ceded” in the world courts. (Eades, p. 7).

These statements are completely unfounded and provide no basis for claiming that the public interest is not served by the addition of TWUS, a Delaware corporation, to the corporate hierarchy.

To counter the inflammatory and misleading claims of Eades and Trawick, Joint Petitioners introduced the testimony of an international lawyer, Duane Layton (“Layton”) who was able to quickly distinguish fact from fiction. (Hearing, pp. 218-247). First, Joint Petitioners do not have NAFTA in their armory. NAFTA is an agreement between Mexico, Canada, and the United States. (Hearing, p. 157, lines 5-8; p. 223, lines 3-10). The parties who are entitled to bring a Chapter 11 NAFTA claim against the United States are limited to investors from Mexico or Canada. (Hearing, p. 157, lines 5-10; p. 223, lines 13-25; p. 224, lines 1-4). None of the Joint Petitioners fall within this category. British investors, German investors, and U.S. subsidiaries of such investors have no rights against the U.S. under NAFTA. (Hearing, p. 157, lines 11-15; p.

227, lines 23-25; p. 228, lines 1-3). There is simply no entity in the ownership chain of Kentucky-American which is entitled to file a NAFTA claim. (Hearing, p. 157, lines 9-25; p. 158, lines 1-19). There is, likewise, no indication that NAFTA will be available to Joint Petitioners in the future. RWE/Thames has no Mexican or Canadian subsidiaries in the chain of ownership and further has no plans to create such subsidiaries. (Hearing, p. 58, lines 18-25; p. 59, lines 1-5). The argument that NAFTA poses a threat to the Commission's jurisdiction must, accordingly, be summarily rejected.

FLOW's reliance upon GATS is equally flawed. GATS governs trade in services and goods not investments. (Hearing, p. 228, lines 5-10). Water is not considered to be either a service or good. (Hearing, p. 165, lines 8-13; p. 230, lines 21-23). Acknowledging this fact, FLOW's counsel suggested that the Agreement could be amended some day to include water. Of course, it is conceivable that any agreement could be amended. However, the possibility of an amendment adds no weight to FLOW's position because such amendment would still pose no threat to the Commission's jurisdiction. Assuming, *arguendo*, that GATS is modified in the future to include water services,<sup>4</sup> and that RWE/Thames become unhappy with a decision made by the Commission, GATS still would provide RWE/Thames with no avenue for individual relief. Private investors such as RWE/Thames have no rights under GATS; only parties to GATS have such rights. (Hearing, p. 232, lines 7-13).

RWE/Thames could possibly prevail upon the European Union (the signatory party which represents the United Kingdom and the Federal Republic of Germany) to represent its interests before a World Trade Organization dispute settlement panel and present a GATS claim to such panel. (Hearing, p. 232, lines 7-13). Yet, even if the European Union were to prevail in

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<sup>4</sup>Even with an amendment, the United States would have to agree to include water in the list of service sectors where the United States is willing to grant market access and national treaty obligations before a GATS water claim could be brought. (Hearing, p. 230, lines 8-17).

such a dispute, nothing could be done to vindicate RWE/Thames's financial interests. There are no damage awards under GATS. (Hearing, p. 232, lines 7-23; p. 233, lines 5-16). Injunctive relief is not available under GATS. (Hearing, p. 233, lines 14-16). RWE/Thames could not utilize any court system in the United States to enforce the decision of the dispute settlement panel. (Hearing, p. 233, lines 16-19). The most that RWE/Thames could hope for would be that the European Union would be authorized by the dispute settlement panel to suspend an equivalent level of trade concessions afforded to the United States. (Hearing, p. 232, lines 7-23). Such a decision will not directly or indirectly impact this Commission's jurisdiction. The claims of Eades and Trawick to the contrary are pure fiction.

The facts established by Joint Petitioners are that neither GATS nor NAFTA provide for any dire consequences to be suffered by either the Commission or the ratepayers it serves to protect. It is not possible for RWE/Thames to resort to the World Trade Organization to circumvent or overturn a state judgment or regulatory ruling. (Hearing, p. 233, lines 20-23). Nor do the international agreements pose any danger to state laws. See 19 U.S.C. § 3312. It is thus apparent that neither Eades nor Trawick understand the literal terms of either GATS or NAFTA. The international agreements have no impact on the Commission's jurisdiction.

It is also apparent that neither Eades nor Trawick has an understanding of either the regulatory process in general or the proposed purchase of the American stock by RWE. Trawick appears to believe that such purchase has already been consummated in some jurisdictions and has resulted in an "immediate" 23% rate increase for Illinois-American Water Company in particular. (Trawick, p. 4). Obviously, the sale of the American stock has not yet taken place and therefore cannot have been the cause of an alleged "immediate" rate increase in Illinois. Further, as the Commission knows, any rate increase following the yet-to-be consummated

acquisition must necessarily be authorized by the applicable administrative agency having jurisdiction over the American subsidiary in question. Utilities simply do not have the ability to unilaterally increase rates in order to recover “the highest possible profits to investors” as contended by FLOW’s expert. (Eades, p. 5). Certainly, regulated utilities do not have that power in the Commonwealth. KRS 278.040 and KRS 278.190.

Notwithstanding the enthusiasm of Eades and Trawick in detailing the alleged dangers associated with allowing international corporations to do business in the Commonwealth, there is no threat to the jurisdiction of the Commission from either GATS or NAFTA arising out of the presence of foreign corporations in the Commonwealth. Certainly, neither international agreement has anything to do with the addition of a Delaware corporation to Kentucky-American’s corporate hierarchy. The “concerns” of Eades and Trawick can accordingly be tossed aside as unfounded and irrelevant.

2. Alleged Inability to Sue Foreign Corporations

The Intervenors also make a back-door attempt at challenging the accessibility of those Joint Petitioners who are foreign corporations to the Kentucky courts. The implication is that the Commission's Orders are meaningless against a foreign corporation inasmuch as the Commission would have no mechanism available to enforce such Orders. The argument is legally and factually unsound. With or without the formation of TWUS, the Commission retains full authority to enforce its Orders.

The General Assembly has gone to great lengths to arm the Commission with sufficient authority to carry out the task of regulating utilities within the Commonwealth. It broadly defined the jurisdiction of the Commission “to regulate utilities and enforce the provisions [of KRS Chapter 278].” KRS 278.040(1). “The jurisdiction of the Commission shall extend to all

utilities in this state. The Commission shall have exclusive jurisdiction over the regulation of rates and service of utilities . . .”. (emphasis added). KRS 278.040(2). The Commission has investigative powers allowing it to examine the condition of any utility subject to its jurisdiction and to address specific complaints made against such utilities. KRS 278.250 and KRS 278.260. The Commission may order management and operational audits. KRS 278.255. It may enter orders prescribing just and reasonable rates for the utility and addressing the service provided by the utility. KRS 278.270 and KRS 278.280. The General Assembly has specifically provided for the enforcement of such orders which are backed up by both the mandamus and injunctive powers of the state courts. KRS 278.390. Enforcement proceedings “have priority over all pending cases.” KRS 278.390. Finally, the Commission has authority to assess penalties against not only utilities, but officers, agents and employees of utilities. KRS 278.990.

Neither the approved acquisition nor the limited modification to the acquisition will have any impact on these statutory provisions which clearly protect the Commission's jurisdiction over Kentucky-American and directly arm the Commission with the ability to enforce its Orders. Following the acquisition, Kentucky-American will remain a utility under the direct regulation of the Commission. (Hearing, p. 63, lines 2-10). The Commission’s jurisdiction over Kentucky-American will remain clearly defined by KRS 278.040. The Commission will retain its power to enforce its Orders against Kentucky-American. KRS 278.390. Should it ever prove to be necessary, it will have the power to assess a monetary penalty against Kentucky-American. KRS 278.990. There is no validity to the claim that the presence of a foreign corporation in the corporate hierarchy in any way diminishes these powers.

Nonetheless, the Intervenors query how will the Commission reach these foreign corporations. Although it is respectfully suggested that the answer to this query is likewise

found in the provisions of the Kentucky Revised Statutes, Joint Petitioners have provided a practical solution as well and have stated clearly and repeatedly that they agree to abide by the commitments imposed by the Commission in its May 30, 2002 Order. (Hearing, p. 131, lines 13-25; p. 132, lines 1-4). Joint Petitioners will not challenge the Commission's jurisdiction to enforce the Order granting approval of the acquisition. (Hearing, p. 74, lines 7-22; AG, #20). Joint Petitioners could not have stated it more clearly:

[T]he issue here is have RWE and Thames submitted to the jurisdiction of the PSC, have they accepted all of the terms of the Order previously handed down by the PSC, and will we continue to be regulated as we are today, and, of course, the answer to all of that is yes.

(Hearing, p. 74, lines 8-13. See also Hearing, p. 131, lines 3-25; p. 132, lines 1-11).

Further, the Commission has already obtained commitments from Joint Petitioners which it felt were necessary to protect its ability to enforce its orders:

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

RWE, Thames, 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.

(May 30, 2002 Order; Appendix A, pp. 1-2).

There is, accordingly, no reason for the Commission to doubt its ability to police Joint Petitioners' compliance with its Orders.

The Intervenors' public interest challenges are thus faulty. The factors which led the Commission to find in May of this year that the proposed acquisition was within the public interest have not been altered by the addition of TWUS, an intermediary holding company, to the

corporate hierarchy. The modification to the approved acquisition will not require any change in the management of Kentucky-American, American, Thames Holdings, or Thames all of whose expertise, financial strength, and commitment to Kentucky-American customers has already been assessed by the Commission. There is much to be gained by both Kentucky-American and its ratepayers and no proven detriment from either the proposed acquisition or the limited modification thereto. The acquisition as modified to include the proposed transfer of control to TWUS, therefore, remains in the public interest.

#### V. COMMITMENTS AND CONDITIONS

The Intervenors made several efforts to obtain additional commitments from Joint Petitioners and to add conditions to those previously agreed to. For example, the LFUCG attempted to get Mr. McGivern to agree that Thames and RWE would accept as a condition in this proceeding the adoption of a customer assistance program such as was included in the proposed California order. (Hearing, p. 104, lines 6-11). Similarly the Attorney General sought a commitment from American, Thames, RWE and Kentucky-American to limit disclosure of customer information. (Hearing, p. 75, lines 3-12). These attempts to add to the conditions agreed to by Joint Petitioners are misplaced.

The issue before the Commission in this proceeding is the impact of TWUS on the merger transaction and its conformity with KRS 278.020. Joint Petitioners have agreed to conditions pertinent to TWUS. For example, TWUS will not become involved in the operational control of Kentucky-American or American without prior Commission approval. (Hearing, p. 78, lines 20-25, p. 79, line 1). Because TWUS is the focus of this investigation, conditions or commitments related to issues raised in the prior proceeding or which effect issues raised in that



proceeding are not relevant. The Commission has limited the scope of this proceeding as set forth in its Order of October 30, 2002 herein:

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 in that Order.

(October 30, 2002 Order, pp. 4-5).

Without any evidence that the prior Order must be modified due to a change of circumstances, the Intervenors' efforts to indirectly modify that Order through the use of additional conditions on or commitments from Joint Petitioners other than TWUS must fail. Any additional conditions imposed on Joint Petitioners unrelated directly to the activities of TWUS will violate the finding of the Commission in its Order of October 16, 2002 herein:

... [W]e conclude that the principles of *res judicata* bar us from considering issues already litigated and addressed in Case No. 2002-00018 unless conditions or circumstances have changed such that the Commission should reconsider these issues.

(October 16, 2002 Order, p. 10).

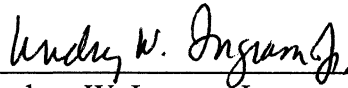
Having found that the prior Order cannot be changed, the Intervenors should not be allowed to circumvent that Order with the imposition of new conditions.

### **CONCLUSION**

For these reasons, Joint Petitioners urge the Commission to approve the limited modification to the proposed acquisition approved by the Commission on May 30, 2002. TWUS has the managerial, technical and financial ability to provide reasonable utility service as required by KRS 278.020(4). In addition, the proposed transfer of control to TWUS is in the public interest and thus satisfies the requirements of KRS 278.020(5).

Respectfully submitted on this the 5<sup>th</sup> day of December, 2002.

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### **CERTIFICATION**

In conformity with paragraph 13 of the Commission's Order dated September 26, 2002, this is to certify that the electronic version of this Post-Hearing Brief is a true and accurate copy of the Post-Hearing Brief filed in paper medium; that the Joint Petitioners have notified the Commission and all parties by electronic mail on December 5<sup>th</sup> 2002 that the electronic version of this Post-Hearing Brief has been transmitted to the Commission, and that a copy has been served by mail upon:

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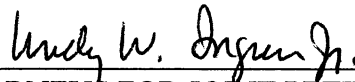
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and that the original and three copies have been filed with the Public Service Commission in paper medium on the 5<sup>th</sup> day of December, 2002.



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