

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT PETITION OF KENTUCKY-AMERICAN)
WATER COMPANY, THAMES WATER AQUA) Case No. 2006-00197
HOLDINGS GMBH, RWE AKTIENGESELLSCHAFT,)
THAMES WATER AQUA US HOLDINGS, INC.,)
AND AMERICAN WATER WORKS COMPANY,)
INC. FOR APPROVAL OF A CHANGE IN CONTROL)
OF KENTUCKY-AMERICAN WATER COMPANY)

**BRIEF OF THE
LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT**

COMES the Lexington-Fayette Urban County Government (the "LFUCG"), by counsel, and in accordance with the order of the Public Service Commission, submits its Brief in this matter. Although the LFUCG does not favor RWE Aktiengesellschaft ("RWE") owning American Water Works Company, Inc. ("AWW") for the long-term now that it has expressed its unequivocal desire to divest itself of AWW, the applicable law and the petition as filed require the Commission to deny or dismiss without prejudice the proposed change of control. In the alternative, this matter should remain open and pending before the Commission for final decision until such time as enough additional information becomes available for it to make a meaningful decision. However, assuming *arguendo*, that the Commission finds that it is appropriate under the law to approve the proposed transfer, under no circumstances should it do so without retaining the existing conditions from the RWE merger cases (Commission Case No.'s 2002-0018 and 2002-00317), and placing additional

substantive, meaningful conditions on the Joint Applicants to ensure that the ratepayers of Kentucky-American Water Company (“KAW”) are not required to pay for the change of control and are protected.

I. BACKGROUND

On June 6, 2006, approximately 42 months after closing on a deal to acquire AWW at a premium of more than a billion dollars, RWE caused the Joint Petitioners to file this petition under KRS 278.020 requesting approval for RWE to divest itself of AWW.¹ It is clear from the record that the purpose of this transaction is to maximize RWE’s shareholder profit and realign its operations to its latest strategic vision.² This decision was driven by the desire of the parent company, RWE, to walk away from what it now perceives as a bad deal (indeed, what it now views as a mistaken decision to diversify into water distribution), while minimizing its losses.³

In order to pursue a maximum return to their investors on the proposed divestiture, the Joint Petitioners have chosen the mechanism of an initial public offering (“IPO”) of AWW stock on the New York Stock Exchange pursuant to rules of the United States Securities and Exchange Commission (“SEC”). The IPO method has never before been utilized to transfer control of a regulated

¹ KAW also came under the ultimate control of the parent company, RWE, as result of the AWW acquisition.

² RWE’s Board discussions of this initiative were provided in Response to LFUCG Initial Requests for Information No. 45 [redacted]. See, e.g., pg 12 of 26.

³ RWE took a 759 million euro impairment charge on its American water operation on December 31, 2005. Response to PSC Staff First Information Request No. 12.

utility in Kentucky (or apparently elsewhere)⁴, and has thus presented a unique circumstance to the Commission such that it ordered the parties⁵ to provide arguments as to the scope of the proceeding under the applicable statute, KRS 278.020.

On August 14, 2006 this Commission limited the scope of this proceeding to KRS 278.020(5), primarily based upon the Joint Petitioner's representations that no controlling interest (as defined in KRS 278.020(6)) in AWW would result from the proposed IPO transaction.⁶

On August 16, 2006, the Commission conducted a hearing on the application for the purpose of cross-examining witnesses presented by the Joint Petitioners and the Attorney General. Although the LFUCG chose not to present its own witnesses at this hearing, it participated fully in the cross-examination of

⁴ Although the Joint Petitioners have provided copies of orders from other jurisdictions approving of this proposal, they have failed to cite any instances where an IPO-type process has previously been approved by this Commission or any other state regulatory body. See Response and Supplements to LFUCG Initial Requests for Information No. 2.

⁵ The LFUCG and the Attorney General of Kentucky ("Attorney General") were granted full intervenor status by the Commission.

⁶ Although the Joint Petitioners represented on the record at the hearing that they would not appeal the provisions of the Commission's August 14, 2006 order on the scope of this matter (Transcript of Evidence, page 14, lines 19-22 (Statement of Lindsey Ingram, Esq.)), the LFUCG did not. The LFUCG does not waive **any** argument that it previously raised in its Brief on the application of KRS 278.020 to this matter and the applicability (or lack thereof) of KRS 278.020(5) or (6) to the Joint Petitioners' proposed transfer, or whether an IPO can lawfully take place under existing Kentucky law. In particular, the LFUCG does not waive its right to contest the following: (1) the Commission's finding that IPO's are a lawful means of transferring control under KRS 278.020(5); (2) the Commission's unsolicited finding that the LFUCG has the duty or burden of proving that KRS 278.020(5) as written is not somehow fatally defective under federal securities laws; and (3) the implication that a decision by the Commission to not allow the IPO to take place results in "an unreasonable and unconstitutional restraint upon RWE's property rights". Case No. 2006-00197, Order of August 14, 2006, at f.n. 16, pg. 10.

witnesses.⁷ At the hearing, the Commission determined that all responses to information requests would be included in the record of this proceeding. Following completion of cross-examination, the Joint Petitioners waived their right to present rebuttal testimony, and the Commission determined that simultaneous briefs by all parties should be filed no later than September 22, 2006.

The Joint Petitioners have advocated that there should be an unconditioned and immediate approval by this Commission of the proposed transaction because it is simply a return of AWW and its subsidiaries to its pre-RWE state. However, the evidence in the record highlights the following:

1. The SEC draft registration and prospectus, which will provide a great deal of meaningful information pertaining to AWW, including but not limited to its financial condition and the significant liabilities of the company (Ms. Ellen C. Wolfe, Transcript, p. 71, line 17 through p. 73, line 5; page 80, lines 1-16), **is not currently available, nor will it be any earlier than late 2006** (Pre-filed Testimony of Wolfe, at pp. 7-9; Wolfe, Transcript, p. 59, line 15);

2. There is **no firm closing date for the proposed transaction** (Responses to LFUCG Initial Request for Information No. 11 and Supplemental Requests for Information No. 3; Wolfe, Transcript, p. 71, lines 5-6), **and** if RWE decides that an IPO is no longer in its best interest, **it is not obligated to see it through.** (Mr. Jens Gemmecke, Transcript, p. 43, lines 11-25);

⁷ Based upon its decision not to sign the proposed confidentiality agreement, the LFUCG did not participate in the portion of the hearing at which confidential matters were discussed.

3. There is no requirement that this Commission approve this transaction prior to its review of the SEC prospectus. (Response to LFUCG's Initial Requests for Information No. 2);

4. **It will not be possible to identify the acquirers of AWW until after the IPO is consummated**, as shares are not transferred to the acquirers of AWW until the close of the offering. (Wolfe, Testimony at pg. 9);

5. The specific means of notifying a potential acquirer as to the existence of KRS 278.020(6) and its threshold controlling interest amount has yet to be identified. (Response to LFUCG's Initial Requests for Information No. 4; Wolfe, Transcript, p. 71, line 25 through p. 72, line 14);

6. **The Board of Directors of AWW** that will be in place immediately prior to the IPO offering **has yet to be determined**. (Wolfe, Transcript, p. 76, lines 9-24);

7. **The Joint Applicants intend for AWW to bear all issuer-related costs of the proposed transaction**. (Wolfe, Transcript, p. 80, lines 20-22);

8. This **transfer will result in the call and refinancing of a substantial amount of debt by AWW**⁸, and the rates for such refinancing are not currently available and will depend on market conditions at the time of refinancing. (Wolfe Testimony at pg. 15; Response to LFUCG Initial Requests for Information No. 13);

⁸ As of December 31, 2005 AWW had \$2.6 billion of intercompany debt that was "intended" to be replaced by third party debt as a result of this change of control. Response to PSC Staff First Information Request No. 8 [redacted], "IPO Kickoff Presentation", at pg. 14.

9. AWW and its subsidiaries have no independent input into the choice of an IPO or its consummation. (Wolfe, Transcript, p. 76, lines 1-8);

10. The decision to proceed with the sale of AWW and the IPO mechanism were made to advance RWE's financial and strategic interests (Response to LFUCG Initial Request for Information No. 45 [redacted]; see, e.g., Page 12 of 26), and **no proceeds from the IPO will be used to benefit AWW as the issuer, or to reimburse AWW for its cost as the issuer.** (Wolfe, Transcript, p. 80, lines 17-22); and

11. The **Joint Petitioners have to date expressed an unwillingness to accept any meaningful conditions** on the proposed transaction. (see e.g., Responses to LFUCG's Initial Requests for Information Nos. 5, 10, 13, 14, 15, 22, 47, 50, 54, 55, 57 (in particular No. 15); Mr. Nick O. Rowe, Transcript, p. 30, line 5, through p. 33, line 18).

For the above reasons, and as further argued below, the Commission should be greatly concerned about approving the application, and even more so under the aggressive timeline pushed for by the Joint Petitioners.

II. SCOPE OF PROCEEDING

The Commission has determined that KRS 278.020(5) "represents the codification of the Southgate holding and addresses the transfer of ownership or control of a utility."⁹ It further found that even though KRS 278.020(6) is not triggered by the proposed transaction "as presently described", it can still assess

⁹ Case No. 2006-00197, Order of August 14, 2006 at pg. 8.

whether the proposed transaction is in the public interest and impose conditions on an approval.¹⁰ Finally, the Commission held that it would be appropriate for it to consider additional arguments regarding the unknown acquirers of AWW as part of its public interest determination.¹¹

III. THE PROPOSED TRANSFER VIOLATES KENTUCKY LAW

The Commission has ruled that KRS 278.020(5) applies to this proceeding. This statute mandates that certain requirements must be met by the acquirers (owners) of the regulated utility in order for the transfer to be lawfully approved. It is undisputed that the acquirers of AWW cannot be known until after the IPO is consummated and the shares of AWW are purchased. This is a major problem with the unprecedented IPO method chosen by RWE for divestiture, and is contrary to the law.

This issue is far from theoretical. The Joint Petitioners are not proposing to abandon service, or for RWE to merely divest itself of AWW without any continuation of service. AWW will have new owners. Under Kentucky law, a person acquiring ownership of a utility has to demonstrate the “financial, technical, and managerial abilities to provide reasonable service.” KRS 278.020(5). It is clear from the language of this provision that this requirement applies even if the person acquiring the utility is not acquiring “control, or the right to control” the utility.

¹⁰ Case No. 2006-00197, Order of August 14, 2006 at pg. 9.

¹¹ Case No. 2006-00197, Order of August 14, 2006 at pg. 10, footnote 17.

A. KRS 278.020(5) Does Not Provide for Unknown Acquirers

The Commission's August 14, 2006 Order does not address how the acquirer(s) of AWW can possibly demonstrate these requisite abilities when they are by necessity unidentified. There is no exception in the statute for IPO's, although the legislature could have certainly so provided if it chose to do so.

Statutory construction and discerning the intent of the legislature begins with the plain language of the statute in question. The Kentucky Supreme Court recently reiterated this rule as follows: "[R]esort must be had first to the words, which are decisive if they are clear . . . [s]tatutes must be given their literal interpretation unless they are ambiguous and if the words are not ambiguous, no statutory construction is required . . . [w]e lend words of a statute their normal, ordinary, everyday meaning." Stephenson v. Woodward, 182 S.W.3d 162, 169-70 (Ky. 2005)(citations omitted).

It is clear from the plain language of KRS 278.020(5) that the legislature intended to make certain that acquirers of regulated public utilities have the abilities that are set forth in the clear, unambiguous language in that statute. Nowhere is there any indication that the legislature intended for transfers to be approved where it was impossible for the Commission to make the specific determinations required by the statute. The legislature intended, from the plain language of the statute, that **no transfer** of ownership of a regulated utility would be approved absent such findings.

While it is possible that an owner could simply abandon a utility without meeting the acquirer standards of KRS 278.020(5), where an acquirer exists it is simply a rewriting of the clear language of KRS 278.020(5) to suggest that a seller such as RWE can avoid the necessary review for a transfer of control by its choice of divestiture. The express language of this statute is that the **acquirer** (and not AWW, for instance) **must demonstrate the abilities** that the Kentucky legislature has determined are required for such a transfer of ownership.

There is no evidence that the actual post-IPO owner or owners of AWW will have the abilities required by KRS 278.020(5). Moreover (and as further argued below), this Commission has to weigh the information provided by the Joint Petitioners pertaining to the requisite abilities of AWW against their credibility. These are the very same Joint Applicants who now, less than four years after paying more than a billion dollar premium to obtain AWW¹² and presenting a glowing forecast of their future together, have decided to bail out -- and have insisted that no conditions, whatsoever, are necessary to protect AWW or the ratepayers of its subsidiaries.

¹² RWE states that this "high" premium for acquiring AWW was 46%. Response to LFUCG Initial Requests for Information No. 45 [redacted] at pg. 2 of 26.

B. The Joint Petitioners Have other Lawful Methods of Divesting AWW

The Commission has indicated that it is concerned that KRS 278.020(5) as written might somehow infringe on RWE's property rights.¹³ However, RWE has all of the means of transferring control of AWW that have been used by utilities for decades. It has simply chosen one method that runs afoul of the Kentucky statute. The notion that RWE is harmed if it has to divest its interest by a mechanism that actually complies with Kentucky law exalts RWE's right to maximize proceeds over the protection of the legitimate interests of state regulation, the ratepayers of the divested company, and indeed even the future interests of the company being divested -- which is currently merely following the marching orders provided by RWE. RWE has not presented any evidence or authority sufficient to support a theory that it is entitled to pursue any means it chooses of divesting its interest in a regulated utility. KRS 278.020(5) is presumably constitutional as written, until found to be otherwise by a court of competent jurisdiction.

A court reviewing a statute must "draw all reasonable inferences and implications from the act as a whole, and thereby, if possible, sustain its validity . . . [and] . . . the violation of the constitution must be clear complete and unmistakable in order to find the law unconstitutional"¹⁴ In this instance, KRS 278.020(5) provides that the proponents of a change of control that involves

¹³ Case No. 2006-00197, Order of August 14, 2006 at pg. 10, footnote 17.

¹⁴ Kentucky Industrial Utility Customers v. Kentucky Utilities Company, 983 S.W. 2d 493, 499 (Ky. 1998).

new owners must demonstrate that the new owners have certain abilities as defined in the statute. The statute is clear and easily comprehensible. The Joint Petitioners simply prefer, in advancement of the pecuniary interest of RWE, to use a mechanism for transfer that is totally incompatible with the reasonable, clear and known standard for review that has been in place for decades.

C. An Approval of the Proposed Transfer Results in the Maximization of RWE's Profits Without Protecting the Public

This Commission is under no duty to ensure that RWE's shareholders are afforded a maximum return on this divestiture, and by approving the proposed transfer it would in essence turn any consideration of the public's interest in this matter on its head. It is not in the public interest for RWE to transfer control of AWW to parties unknown in contravention of KRS 278.020(5). It is the duty of the Commission to assure that responsible new owners take control of AWW. If the law needs to be changed to allow an IPO to take place for a Kentucky regulated utility, it is the legislature that makes this decision.

The Commission should therefore deny the application, as it is not consistent with Kentucky law and the proposed IPO process by its very nature is contrary to the public interest.

IV. THE PROPOSED TRANSACTION IS NOT IN THE PUBLIC INTEREST

Even if an IPO can be compliant with KRS 278.020(5), the application still does not meet the Commission's "public interest" standard for changes of control. In its Order approving RWE's acquisition of AWW, the Commission

established the following standard for finding that a transfer of control is in the public interest:

[A]ny 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 or that any potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the acquiring party. 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. Case No. 2002-00018, Order of July 10, 2002, at page 9.

As shown below, this standard has not been met by the Joint Petitioners

A. Approving the Proposed Transfer Would Eliminate All of the Benefits found by the Commission in the RWE Acquisition Cases

The Commission applied this public interest standard to RWE's proposal to acquire AWW in order to justify its decision of approval. It specifically found that the following benefits would result from the transfer of control to RWE:

[T]he record contains substantial evidence that the proposed transfer of control is likely to result in benefits to KAWC's ratepayers. Upon completion of the transaction, KAWC will have access to Thames Aqua's 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 Aqua's research and development programs. It will allow KAWC to draw upon RWE's extensive borrowing power and should reduce KAWC's cost of capital. The proposed transfer of control allows KAWC to access Thames Aqua's experience in the area of security.

Clearly, the proposed merger is likely to enhance KAWC's ability to provide reasonable utility service at reasonable rates. Id., at page 10.

All of these benefits are lost if the application is approved.

The Joint Petitioners now argue the exact opposite of what they argued in the RWE merger cases. The only discernible difference between then and now is that RWE is now the seller. A comparison of the records from these cases demonstrates that the Joint Petitioners' assurances to this Commission should be given little or no credibility, regardless of whatever intent one chooses to give them. The desire of RWE to divorce itself from AWW less than four years later speaks for itself, as does the substantial impairment of goodwill for AWW in the amount of \$759 million euros. (Response to PSC Staff First Information Request No. 12).

The Commission cannot accept vague promises from RWE that everything will be fine, given the record of what has transpired to date. With respect to the Commission's public interest standard, the Commission's findings in the RWE acquisition cases **preclude** a finding in this case that the proposed transfer is in the public interest because all of the benefits listed by the Commission in that case would be taken away, and as shown below, the Joint Petitioners have provided **no credible evidence of offsetting benefits** that would change this.

B. The Joint Petitioners Have Failed to Demonstrate that the Proposed Transfer is Likely to Benefit the Public

According to the Joint Petitioners, this transaction will benefit ratepayers in that AWW would once again come under the SEC's jurisdiction, and therefore become more "transparent". When AWW lost this transparency as result of the RWE acquisition in Case No. 2002-00018 it was not considered to be a significant loss. Further, Attorney General witness Dr. Woolridge has testified that this regulatory "benefit" runs at least as much to AWW's shareholders as to the ratepayers. (Dr. J. Randall Woolridge, Testimony, p. 137, line 19 through, p. 138, line 1).

Even if the Commission finds that AWW's return to being a publicly traded company is a benefit to the public, it does not sufficiently counter the loss of the benefits from the RWE acquisition cases. Moreover, as argued below, the Commission does not even have the ability on the current record to determine the process and terms of the proposed IPO, let alone to make a reasoned determination of the required abilities of the persons or entities that will acquire ownership of AWW.

C. There is Not Enough Information Available About the Proposed Transfer at this Point in Time to Allow the Commission to Make a Decision that Adequately Protects the Public

The Joint Petitioners have admitted that the first step in the IPO process is the filing of a registration statement (prospectus) with the SEC, which includes a wealth of information that is all relevant to the Commission's review of this

matter.¹⁵ Perhaps most significantly, the SEC registration requires that AWW lay out under oath the **principal risks involved** in investing in AWW. The Joint Petitioners admit that they have not filed such a statement, and have no firm date for doing so. Further, the Joint Petitioners have not even drafted language to include in the statement that can be reviewed by the Commission or parties to this case. (Wolfe, Transcript, p. 71, line 25 through p. 72, line 10).

At the hearing in this matter, the LFUCG attempted to solicit from AWW's chief financial officer, Ellen C. Wolfe, an indication of what would be reported as the principal risks involved in investing in AWW. The information was not forthcoming. (Wolfe, Transcript, p. 80, line 8-16). This revelation **in and of itself** demonstrates that this transaction cannot be found to be in the public interest. It is simply unreasonable for the Commission to approve the proposed transaction without any information as to what the Joint Petitioners see as the principal risks involved in investing in AWW. At the very least, it is unreasonable to even consider approval of this transaction until such time as AWW provides its SEC registration statement and the Commission and the parties to this proceeding have a reasonable opportunity to review and consider the contents of the initial step in the IPO process.

The Joint Petitioners have not presented any evidence to show that waiting for the SEC registration statement will cause a hardship to them. They have no intention of actually closing the IPO until sometime in 2007, if then.

¹⁵ It is worth noting in this regard that AWW was unable to provide an annual report for 2005 as requested until Sept. 12, 2006, as the report was apparently not completed until then. Supplemental Response to Hearing Data Request No. 4.

While KAW may see some tactical or political advantage in having a decision from this Commission within 120 days, no legitimate reason has been advanced as to why the Commission should rush to a final decision in this case without even the benefit of the reviewing the basic foundation document for the transfer of control. This is particularly true since the Joint Petitioners are seeking final and irrevocable approval from this Commission that will continue **even if the terms of the proposed transaction change materially over the course of the IPO process.**

The Joint Petitioners, when asked to identify the benefits to AWW and KAW of this proposed transaction, have stated that SEC oversight and compliance will be a principal benefit, including the transparency that SEC filings will provide. However, the Joint Petitioners also claim that it is unnecessary for transparency in the IPO process prior to Commission approval. Transparency will be enhanced, and the public and ratepayers protected, if the Commission insists on a full review of the SEC registration statement prior to determining whether this transaction should be approved, and under what conditions.

Based on the foregoing, the application should be denied or dismissed, or in the alternative, the case should remain open and a final decision remain pending until such time as the additional necessary information is forthcoming for this Commission to make a meaningful, reasoned decision.

V. THE RATEPAYERS SHOULD NOT BEAR THE COST OF THIS TRANSACTION, OR OF DEBT REFINANCING RELATED TO THIS TRANSACTION

Even if the Commission chooses to proceed with a final decision at this point, in addition to the inherent risk in proceeding without known acquirers and concrete information, and the fact that there is no ascertainable benefit to the public or ratepayers as part of the proposed transaction¹⁶, the record also shows that the proposed transaction is actually detrimental to the surviving AWW, the public and KAWC's ratepayers.

RWE expects AWW (and by implication its subordinates, including KAW) to pay for the issuer costs of the IPO process. (Wolfe, Transcript, p. 80, lines 20-22). Obviously, this expense would not occur "but for" the transaction, and should be properly borne by RWE.

In addition, one of the consequences of RWE's decision to unload AWW through an IPO is that AWW will have to refinance an enormous amount of debt.¹⁷ While some of this debt will mature in the relatively near future, much will be refinanced purely because of RWE's decision to divest. AWW has no information as to the cost of this very large refinancing, saying only that it will depend on market conditions. However, in no event should any increased costs

¹⁶ The Joint Petitioners have made no effort to quantify any benefits to AWW or KAW as a result of this transaction. Response to LFUCG Initial Requests for Information No. 38.

¹⁷ AWW had \$2.6 billion in intercompany debt outstanding, as of December 31, 2005, all of which is intended to be refinanced with third party funds. Loan agreements between RWE and AWW explicitly foresee an early redemption in the event of a change of control. Response to PSC Staff First Request Information Request No. 8 [redacted], "IPO Kickoff Presentation", pg. 14.

related to this debt refinancing be passed down to KAWC's ratepayers, as RWE has initiated the proposed process for its own benefit.

It is simply unconscionable that KAW ratepayers should bear any additional costs as a result of the end of RWE's misadventure in the American water market. If AWW has to refinance called debt or other instruments at a higher cost due to this transaction, none of these increased costs should be passed through to KAW. These increased costs should be borne by the entity that has caused them – RWE – and AWW should be held harmless from this and other potential financial damage by receiving a reasonable share of the proceeds of the IPO revenues as recommended by the Attorney General.¹⁸

No costs or expenses that are related to this transaction should be allowed to be passed down to the ratepayers of KAWC, and appropriate conditions should be placed on the Joint Petitioners to avoid such a result should the Commission approve the application.

VI. THE CURRENT CONDITIONS SHOULD REMAIN IN PLACE

Despite the argument by the Joint Petitioners that conditions are simply not necessary in this case, this is not true, especially in light of the fact that this transaction may not even ultimately take place. At the very least, the existing conditions imposed on the Joint Petitioners by the Commission in the RWE merger cases must remain in place to preserve the status quo. There is absolutely no basis for eliminating any conditions unless and until ownership of

¹⁸ Rubin Testimony at pp. 22-23.

AWW is actually transferred. Any decision to release conditions even after the sale should be based on an analysis of the specific condition, and whether there is sufficient grounds to release the condition, and not by some blanket release. It is premature to specify those conditions that can be safely released, although some will need to be rewritten so as to specify the correct parties that will be bound post-IPO.

VII. RESOLVING THE RWE TANGLE

RWE and its subordinates have presented this Commission with an almost impossible burden given the existing law and RWE's choice of an exit strategy. It is simplistic in the extreme and disingenuous to suggest that AWW is merely "coming home", and that this transaction is essentially a return to pre-RWE ownership. The future AWW is in a more precarious financial and management situation because of its detour to the RWE organization, and RWE is not proposing any steps to assure that AWW will be in at least as good, if not better, condition than when RWE acquired it.

To further complicate the Commission's review of this matter, the Attorney General is correct in his observation that forcing RWE to continue to own AWW creates other problems. RWE has already turned to its true future interest in electricity and gas, and cannot be relied on to care even as much as it has in the past about AWW's needs – thus increasing the risk of continued RWE ownership.

It should be clear, however, that the Commission cannot in congruence with the public interest grant the relief requested by the Joint Petitioners. This transaction is not even defined yet. Vital information is missing, and will not be available **at least** until AWW files its SEC Registration Statement. This record is simply devoid of the most basic information, and the most basic document for reviewing a transfer of control – the transfer document itself. There is no reasonable or rational basis for the Commission to issue an approval for the Joint Petitioners’ proposal at this time. Furthermore, there is no need for the Commission to rush to irrevocably give its approval to this transaction. The Joint Petitioners have admitted that there is no legal reason for this Commission to approve this transaction prior to AWW submitting its SEC registration statement – they simply prefer it that way.¹⁹ That is not reason enough to grant approval at this time.

AWW and KAW will be facing substantial challenges in the post-RWE future. It is important that the decision in this case be protective of the future AWW, KAW, and in particular the ratepayers of KAW, rather than accepting the Joint Petitioners’ invitation to protect the interests of RWE above all other considerations. There is little or no indication that RWE has taken any interest in prioritizing the needs of post-divestiture AWW, KAW or KAW’s ratepayers in devising its IPO plan.

¹⁹ Response to LFUCG Initial Requests for Information No. 2.

As previously noted above, AWW faces debt cost increases that it will likely attempt to pass on to KAW's ratepayers as a subsidiary. AWW is being forced to finance its own divorce from RWE, and that cost will have to be made up somewhere. RWE does not propose to in any way ameliorate the financial impact of the divestiture on AWW; its sole concern appears to be maximizing the proceeds from the IPO, all of which will be retained by RWE.

The Commission has no way of knowing who will own AWW post-IPO. Even the actual proposed mechanism for the IPO is unknown. The warnings that will be given to potential purchasers of AWW stock about management and risk factors at AWW are unknown.

Therefore, the Commission should deny or dismiss the petition. However, assuming *arguendo* that it does not, the LFUCG respectfully recommends that the Commission adopt the following process in this proceeding:

1. That the existing case record remain open pending further proceedings;
2. That the Joint Petitioners are ordered to provide to the Commission and to all parties to this proceeding the SEC registration statement as soon as it becomes available;
3. That upon receipt of the registration statement, the Commission set a reasonable procedural schedule for review of the registration statement and all issues raised by it. The schedule should include a provision for reasonable discovery and additional testimony and a public hearing if necessary;

4. That upon conclusion of that process, the Commission will issue such Order or Orders as it considers necessary;

5. That to sufficiently protect the public and KAW's ratepayers the Commission further order the following:

- a. That **all of the conditions from the RWE merger cases remain in place** as to all of the Joint Petitioners until the proposed transfer is consummated, and as to AWW and KAW beyond the consummation of the propose transfer;
- b. That neither KAW nor its ratepayers, directly or indirectly, will incur **any additional costs, liabilities, or obligations in conjunction with the proposed transfer**, including especially including the issuer costs of this transaction and any increased costs caused by refinancing debt as a result of the transaction;
- c. the adoption of the Attorney General's proposal that a reasonable portion of the proceeds of any IPO be provided to AWW to offset the costs and liabilities it has been, and will be, incurring as a result of these events;
- d. A "most favored nations" provision similar to the following: "If any state regulatory commission imposes conditions upon any of the Joint Applicants, or if the Joint Applicants agree by settlement or otherwise to conditions in order to obtain approval of the proposed transfer and those conditions would benefit the AWW subsidiary or

the ratepayers in any other jurisdiction, proportionate net benefits will be extended to KAW and its ratepayers”;

- e. That for a period of time extending at least one year from the date of consummation of the proposed transfer, each of KAW'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;
- f. That for a period of time extending at least one year from the date of consummation of the proposed transfer AWW or KAW will notify the Commission in writing within 10 days of any changes in KAWC's corporate officers and management personnel;
- g. That for a period of time extending at least one year from the date of consummation of the proposed transfer KAW will not eliminate any non-management or union employee positions; and
- e. any other reasonable condition advanced by the Attorney General that does not otherwise conflict with the above.

AWW cannot be expected to effectively advocate for its own interest in this regard, as it is merely a subset of RWE at this point, and all of the diverse Joint Petitioners are managed by the same conglomerate. It will be up to the Commission to assure that future AWW and future KAW are strong, financially

viable entities, and the Attorney General's proposal has significant merit in achieving that goal. The Commission and the parties will be in a far better position with a full record to assess what conditions and requirements will be necessary and proper to protect all of the important interests involved in this case.

VIII. CONCLUSION

RWE's chosen method of divesting its interest in AWW causes significant problems under Kentucky's statutory scheme. The record established so far does not come close to providing a basis to approve the proposed transaction. If the application is not denied, further proceedings are necessary as discussed above. When and if approval is granted for RWE's divestiture of AWW, it must include very strong protections for the future AWW and KAW, including, but not limited to, all of the existing conditions from the RWE merger case. In addition, KAW ratepayers must not be burdened by **any** additional costs associated with RWE's corporate maneuvering, including any increased costs associated with debt refinancing occasioned by this transaction.

Respectfully submitted,

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CERTIFICATION, NOTICE OF FILING, CERTIFICATE OF SERVICE

Pursuant to Commission Order, counsel certifies that the electronic version of this document is a true and accurate copy of the document filed in paper medium, a copy in paper medium has been served on all the parties of record as further certified below, the electronic version has been transmitted to the Commission, and the Commission and other parties have been notified by electronic mail that the electronic version has been transmitted to the Commission, and an electronic version has been uploaded to the file transfer protocol site designated by the Executive Director. I further certify that an original and one (1) copy of this document were served by first class U.S. Mail delivery, postage prepaid, to Beth O'Donnell, Executive Director, Public Service Commission, P.O. Box 615, 211 Sower Boulevard, Frankfort, Kentucky 40602-0615; furthermore, it was served by mailing a copy by first class U.S. Mail delivery, postage prepaid, on the following, all on this the 22nd day of September, 2006:

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