

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. 2006-00197
AND AMERICAN WATER WORKS COMPANY, INC.)
FOR APPROVAL OF A CHANGE IN CONTROL OF)
KENTUCKY-AMERICAN WATER COMPANY)

O R D E R

Joint Petitioners¹ have applied to the Commission for approval of a transaction that will result in the transfer of control of Kentucky-American Water Company (“Kentucky-American”) from its current owner to unidentified persons. This application presents the following issue: Is KRS 278.020 applicable to the proposed transaction? By this Order, we advise all parties that only KRS 278.020(5) is applicable to the proposed transaction.

BACKGROUND

Kentucky-American, a Kentucky corporation, owns and operates facilities that are used in the distribution of water to the public in Bourbon, Clark, Fayette, Gallatin, Grant, Harrison, Jessamine, Owen, Scott and Woodford counties. It also owns and operates

¹ The “Joint Petitioners” are: Kentucky-American Water Company; American Water Works Company; Thames Water Aqua US Holdings, Inc.; Thames GmbH; and RWE Aktiengesellschaft.

facilities for the collection and treatment of sewage for the public in Clark and Owen counties. It is a utility subject to Commission jurisdiction and regulation.²

American Water Works Company (“AWWC”), a Delaware corporation, owns regulated operating subsidiaries in 18 states. It owns all outstanding shares of Kentucky-American stock. It neither conducts nor is authorized to conduct business within the Commonwealth.

Thames Water Aqua US Holdings, Inc. (“TWAUSHI”), a Delaware corporation, is AWWC’s direct parent company. It neither conducts nor is authorized to conduct business within the Commonwealth. It owns subsidiaries that provide water, wastewater services and other water resource management services to approximately 18 million customers in 29 states and Canada.

Thames GmbH (“Thames”) is a foreign corporation that is organized and exists under the laws of the Federal Republic of Germany. It is a wholly-owned subsidiary of RWE Aktiengesellschaft (“RWE”) and is the holding company for most of RWE’s water operations throughout the world. Thames owns all of the outstanding stock of TWAUSHI. It neither conducts nor is authorized to conduct business within the Commonwealth.

Thames has announced its intention to sell up to 100 percent of the shares of AWWC’s common stock in one or more public offerings. According to the Joint Petitioners, the “shares will be sold through one or more underwritten public offerings to a broad group of investors, including institutional and retail investors.”³ If, because of

² KRS 278.010(3)(d) and (3)(e); KRS 278.040(1).

³ Joint Petition at ¶ 16.

unfavorable market conditions, all shares are not sold in the initial offering, then Thames will sell the remaining shares in subsequent offerings as soon as reasonably practicable. Prior to the initial public offering, Thames will effect the merger of TWAUSHI with and into AWWC.

On June 5, 2006, the Joint Petitioners applied to the Commission for approval of the proposed transaction pursuant to KRS 278.020 and for authorization for the proposed transfer of control of Kentucky-American. On June 19, 2006, the Commission, on its own motion, directed all parties to submit memoranda upon the applicability of KRS 278.020(5) and (6) to the proposed transaction. The Joint Petitioners, the Attorney General (“AG”), and Lexington-Fayette Urban County Government (“LFUCG”) have submitted initial and reply memoranda.⁴ On August 7, 2006, the AG moved for an Order in which the Commission establishes the “decisional criteria applicable to this proceeding.” LFUCG and the Joint Petitioners have submitted responses to this motion.

DISCUSSION

This Commission has long held the authority to review the transfer of ownership of utilities. Although the Public Service Commission Act of 1934 failed to specifically address the Commission’s authority in this area, Kentucky courts have recognized “the

⁴ The Commission has granted the AG and LFUCG leave to intervene in this proceeding. Bluegrass FLOW, Inc. (“Bluegrass FLOW”), a Kentucky corporation organized pursuant to KRS Chapter 273, has submitted “public comment” on this issue. Bluegrass FLOW has intervened previously in proceedings involving Kentucky-American. See, e.g., Case No. 2002-00018, (Ky. PSC April 18, 2002). As it has not intervened in this proceeding, the Commission has not considered the arguments contained in Bluegrass FLOW’s public comment.

jurisdiction is implied necessarily from the statutory powers of the commission to regulate the service of utilities.”⁵

Kentucky courts further found that, when reviewing such transfers of ownership, the Commission should focus upon the acquiring party’s ability to provide adequate service. “[W]here an existing utility proposes to sell its system, the [C]ommission, in order to carry out its responsibility, must have the opportunity to determine whether the purchaser is ready, willing and able to continue providing adequate service.”⁶ One court also noted that the Commission must consider whether the proposed transaction is in the public interest.⁷

The General Assembly codified and expanded these decisions in KRS 278.020(5).⁸ This statute provides:⁹

No person shall acquire or transfer ownership of, or control, or the right to control, any utility under the jurisdiction of the commission by sale of assets, transfer of stock, or otherwise, or abandon the same, without prior approval by the commission. The commission shall grant its approval if the

⁵ Public Service Commission v. Cities of Southgate, Highland Heights, 268 S.W.2d 19, 21 (Ky. 1954). See also Public Service Commission v. City of Paris, 299 S.W.2d 811 (Ky. 1957); South Central Rural Tel. Co-op. Corp. v. Public Service Commission of Ky., 453 S.W.2d 257 (1970).

⁶ Id.

⁷ See, e.g., Blue Grass State Tel. Co. v. Public Service Commission, 382 S.W.2d 81 (Ky. 1964). But see City of Catlettsburg v. Public Service Commission, 486 S.W.2d 62, 64 (“When an existing utility proposes to sell its system, the power and authority of the Public Service Commission are limited to a determination of whether or not the purchaser is ready, willing, and able to continue providing adequate service.”).

⁸ 1986 Kentucky Revised Statutes and Rules Service 845.

⁹ When the General Assembly enacted this law in 1986, the statute applied only to persons “under the jurisdiction of the commission.” 1986 Kentucky Revised Statutes and Rules Service 845. In 1994 the General Assembly amended the statute to delete this phrase. See 1994 Kentucky Revised Statutes and Rules Service 250.

person acquiring the utility has the financial, technical, and managerial abilities to provide reasonable service.

Two years after enacting this law, the General Assembly enacted KRS 278.020(6)¹⁰ to specifically address the acquisition of control of a utility. It provides in pertinent part:

No individual, group, syndicate, general or limited partnership, association, corporation, joint stock company, trust, or other entity (an "acquirer"), whether or not organized under the laws of this state, shall acquire control, either directly or indirectly, of any utility furnishing utility service in this state, without having first obtained the approval of the commission. Any acquisition of control without prior authorization shall be void and of no effect. As used in this subsection, the term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a utility, whether through the ownership of voting securities, by effecting a change in the composition of the board of directors, by contract or otherwise. Control shall be presumed to exist if any individual or entity, directly or indirectly, owns ten percent (10%) or more of the voting securities of the utility. This presumption may be rebutted by a showing that ownership does not in fact confer control. Application for any approval or authorization shall be made to the commission in writing, verified by oath or affirmation, and be in a form and contain the information as the commission requires. The commission shall approve any proposed acquisition when it finds that the same is to be made in accordance with law, for a proper purpose and is consistent with the public interest. The commission may make investigation and hold hearings in the matter as it deems necessary, and thereafter may grant any application under this subsection in whole or in part and with modification and upon terms and conditions as it deems necessary or appropriate. The commission shall grant, modify, refuse, or prescribe appropriate terms and conditions with respect to every such application within sixty (60) days after the filing of the application therefor, unless it is necessary, for good cause shown, to continue the application for up to sixty (60) additional days. The order continuing the application shall state fully the facts that make continuance necessary. In the absence of that action within

¹⁰ 1988 Kentucky Revised Statutes and Rules Service 906.

that period of time, any proposed acquisition shall be deemed to be approved.

This statute focuses on the acquirer of a utility, not the transferor. Commentators have suggested that this statute was intended to reduce the likelihood of a hostile takeover of a utility.¹¹

The Joint Petitioners argue that both statutory subsections govern the proposed transaction. They note that, as the subsections share a common purpose and a common subject matter, they must be construed together. They note that subsection 5, while generally addressing the issue of utility transfers, is “very terse” and “incomplete.” It lacks procedural guidance and enforcement remedies. It contains no provision for a Commission investigation of or hearing on the proposed transfer and few standards for reviewing applications for proposed transfers. Subsection 6, the Joint Petitioners further note, provides these details and thus supplements and complements Subsection 5.

Joint Petitioners argue that the failure to apply both subsections will result in an incomplete and inadequate investigation of the proposed transfer. They note that Subsection 5 requires the Commission to consider only the acquiring party’s “financial, technical and managerial abilities to provide reasonable service,” but such standard is lacking in Subsection 6. Conversely, Subsection 6 allows the Commission to consider broad public interest questions that the transfer may pose while Subsection 5 is silent on the Commission’s ability to entertain such questions.

Failure to apply both subsections, Joint Petitioners further argue, will limit the Commission’s enforcement powers and its ability to protect the public interest. They

¹¹ John Park, Comment, Public Utility Takeovers in Kentucky: A Rare Breed Gets Rarer, 78 Ky. L.J. 181 (1989).

note that only Subsection 6 provides that a transfer of control without prior Commission approval is void and allows for the imposition of conditions on the proposed transaction.

Opposing this position, the AG and LFUCG argue that Subsection 6 is inapplicable. They note that, as the transaction is currently proposed, no identifiable “acquirer” is present and that the Joint Petitioners have no intention of permitting any person to acquire a controlling interest in AWWC.¹² In the absence of any person who would acquire controlling interest through the proposed transaction, they argue that Subsection 6 is not triggered and does not govern the Commission’s review.

The AG argues that Subsection 5 is applicable to the proposed transaction. Subsection 5, he notes, applies when either a transferor or acquirer is present. Upon completion of the proposed transaction, no individual may possess ownership of 10 percent or more of AWWC stock, but RWE will no longer possess any AWWC stock and thus no longer possess control of Kentucky-American. A transfer of control, therefore, will have occurred.

The AG rejects the Joint Petitioners’ contention that application of Subsection 6 is necessary to ensure a thorough and complete investigation of the proposed transfer. He notes that KRS 278.250 and .260 and the Southgate holding authorize the Commission to investigate and hold hearings on the proposed transaction. Similarly, he argues that KRS 278.410 prohibits the Commission from approving any transfer that would be contrary to law or the public interest and thus establishes an additional standard for review of the proposed transaction not expressly found in Subsection 5.

¹² See Joint Petition at ¶ 50.

LFUCG asserts that Subsection 5 is currently also inapplicable to the proposed transaction. It asserts that “KRS 278.020(5) does not provide for Commission pre-approval of an IPO [initial public offering].”¹³ The identities of the acquirers, and hence their financial, managerial and technical abilities to provide reasonable utility service, cannot be ascertained until completion of the sale of AWWC stock. It requests that “the Commission make a finding, based upon the Joint Petition as filed, that no approval for a transfer of control can be given until the acquiring person or persons are identified with specificity, and that the procedural schedule be modified accordingly should this case remain pending.”

Based upon our review of KRS 278.020 and its statutory history, the Commission finds that Subsections 5 and 6 should not be construed as dependent. Subsection 5 represents the codification of the Southgate holding and addresses the transfer of ownership or control of a utility. Subsection 6 focuses more narrowly on the “acquisition of control” of a utility. While a transaction results in a transfer of control may trigger both subsections, it does not necessarily do so.

The proposed transaction will result in a transfer of control, but as presently described will not result in an “acquisition of control” for purposes of KRS 278.020(6). Upon its completion, RWE, the entity that currently controls AWWC and Kentucky-American, will no longer control either entity. As the proposed transaction results in the transfer of RWE’s ability to control AWWC and Kentucky-American, Subsection 5 is applicable. As there is no evidence that at the proposed transaction’s completion any

¹³ LFUCG’s Memorandum in Response to the Commission’s June 19, 2006 Order at 3.

entity will possess a sufficient quantity of AWWC stock to control AWWC and thus Kentucky-American, Section 6 is not applicable at this time.

The Commission finds no merit in the Joint Petitioners' argument that our ability to review the proposed transaction and protect the public interest will be lessened if Subsection 6 is not applicable. As noted in Southgate, the Commission has always possessed the implied power to review and hear evidence on utility transfers.¹⁴ KRS 278.020(5) codified this implied power. The enactment of KRS 278.020(6) did not reduce or modify this power.

KRS Chapter 278, moreover, provides statutory authority and guidance for Commission review of and hearing on transfers of control. KRS 278.250 authorizes us to investigate and examine the condition of any utility. KRS 278.310 provides for rules for Commission investigations and hearings. KRS 278.280 permits the Commission to assess conditions to proposed transfers of control to ensure reasonable utility service.¹⁵

The Commission further finds no merit to LFUCG's argument that Commission review of the proposed transaction is premature. Given the nature of the proposed transaction, the identity of those persons acquiring AWWC stock will not be known until completion of the transaction. As the transfer of AWWC stock can lawfully occur only if the Commission grants its prior approval to transfer, identification of the acquiring parties before the Commission considers the proposed transaction is not possible.

¹⁴ This implied power includes the authority to examine the effects of the proposed transfer on the adequacy of utility service, to determine if the proposed transfer is in the public interest, and to impose conditions upon the proposed transfer to ensure that it will not adversely affect utility service.

¹⁵ Even in the absence of this statute, the Commission's implied powers would permit the assessment of conditions to utility transfers of control where such conditions are necessary to protect the public interest.

Acceptance of LFUCG's argument requires us to hold that KRS 278.020(5) and KRS 278.020(6) prohibit initial public offerings. LFUCG has offered no argument or evidence to support the proposition that the General Assembly intended this result when enacting either section of KRS 278.020.¹⁶

Given the nature of the proposed transaction, the specific identity of the acquiring shareholders may not be necessary to ascertaining whether the proposed transaction is in the public interest or to assessing its immediate effects on Kentucky-American's service. The lack of this information, therefore, should not delay the Commission's review of the proposed transaction.¹⁷ Should any person attempt to acquire at least 10 percent of AWWC's stock, however, the requirements of KRS 278.020(6) will be triggered and additional review of the proposed transaction in light of this acquisition will be necessary.¹⁸

Our findings should not disrupt this proceeding nor require any revisions to the existing procedural schedule. The Commission still expects to complete its review of the proposed transaction within 120 days of the filing of the Joint Petition. To the extent

¹⁶ Moreover, LFUCG has failed to address whether such a prohibition would conflict with federal securities laws or constitute an unreasonable and unconstitutional restraint upon RWE's property rights.

¹⁷ Our refusal to postpone our review of the proposed transaction should not be considered as a final rejection of LFUCG's arguments regarding the need to identify the acquirers of AWWC stock. These arguments may properly be considered in determining whether the proposed transaction is in the public interest.

¹⁸ According to KRS 278.020(6), "control shall be presumed to exist if any individual or entity, directly or indirectly, owns ten percent (10%) or more of the voting securities of the utility. This is a rebuttable presumption, however, and the execution of this transaction – if it is approved – could trigger Subsection 6 review even if no single person or entity acquired 10% of the voting securities.

greater review of certain issues or evidence is warranted and such review cannot be completed within this 120-period, however, the Commission will not be constrained to extend this proceeding beyond that period.

SUMMARY

Based upon our review of the Joint Application and the parties' memoranda, the Commission finds that KRS 278.020(5) is applicable to the proposed transaction and that KRS 278.020(6) is not applicable.

IT IS THEREFORE ORDERED that:

1. The AG's Motion for An Order Establishing Criteria is granted.
2. All parties are advised that KRS 278.020(5) is applicable to the proposed transaction and that KRS 278.020(6) is not applicable.

Done at Frankfort, Kentucky, this 14th day of August, 2006.

By the Commission

ATTEST:



Executive Director