

Plan re Capital Structure

In its Order approving the proposed acquisitions and transfers, issued February 17, 2020, at pages 13-14, the Commission discusses capital structure and the 10/31/19 Notice and Plan re Capital Structure filed by Bluegrass Water Utility Operating Company, LLC (“Bluegrass Water”) in Case No. 2019-00104. The Commission then finds (p.14):

that Bluegrass Water’s equity-to-capitalization percentage should not exceed 50 percent and that every effort must be made to lower that percentage. Given that the equity-to-capital percentage exceeds 50 percent, Bluegrass Water will submit to the Commission within 30 days of this Order a detailed plan explaining how it will revise its capital structure to achieve its approved equity-to-capital ratio in relation to the instant case.

The related condition to the acquisition/transfer approval, repeating nearly *verbatim* the second sentence quoted above, is set out as Condition # 6 in the Appendix to the 2/17/20 Order.

Plan

Bluegrass Water affirms that its debt and equity model is the same in this case as it was in Case No. 2019-00104. Its goal is to have a 50/50 capitalization structure on average over time. The plan has been and remains to finance acquisitions with equity and to fund investment (repairs, replacements, extensions, and improvements) in utility plant with long-term debt. *See* Joint Application p. 13; 12/6/19 Responses to 1 PSC 13 and 16.

As of September 30, 2019, Bluegrass Water completed all the closings on the acquisitions from eight (8) utilities approved in the 8/14/19 Order entered in Case No. 2019-00104. As of year-end 2019, Bluegrass Water had not yet finalized the complete capital investment plans for the recently-acquired utility plant. Therefore, its capital structure at the end of 2019 was all or nearly all equity.

Bluegrass Water has performed significant repairs on many components of assets acquired which were distressed and underperforming upon acquisition. Bluegrass Water will include a report on such completed repairs in the six-month performance report due in Case No. 2019-00104. As these repairs have significantly improved performance of systems, Bluegrass Water is in process of completing a final assessment of the capital investment necessary to bring utility plant into full compliance with regulatory requirements. Once this final assessment is complete, Bluegrass Water plans to submit an application to the PSC seeking approval for any capital expenditures

and related debt financing that will bring Bluegrass Water’s capital structure toward a 50/50 debt-equity ratio.

Reduction in the equity proportion of capitalization, eventually to at or below the 50% benchmark, will be achieved as debt-funded investment in acquired utility plant occurs. Please refer to Joint Application Exhibit I p.1, showing *pro forma* Bluegrass Water amounts for the Case No. 2019-00104 acquisitions (first column) and for the acquisitions now approved in this proceeding (last column):

	2019-00104 acquisitions	<i>with</i> 2019-00360 acquisitions
Utility Plant in Service	\$ 455,600	\$ 815,601
Construction Work in Progress	\$ 2,949,039	\$ 3,505, 539
Current Assets	\$ 100,000	\$100,000

If the CWIP were entirely debt-funded, then the capitalization ratio with the equity-funded current assets and in-service utility plant would be 60/40 debt-to-equity. If the CWIP were funded approximately 72% by debt and 18% by equity, then the resulting ratio would match the 50-50 goal.

This illustrates the plan to achieve the goal of a 50/50 capitalization structure on average over time, in accord with the Commission findings “that Bluegrass Water’s equity-to-capitalization percentage should not exceed 50 percent and that every effort must be made to lower that percentage.” 2/17/20 Order p. 14. Acquisitions, which are equity-funded, will be balanced out as debt-funded investments in the acquired systems are made. Many of the investments in utility plant will require a KRS 278.020(1)(a) construction certificate, and any long-term debt funding for those projects will require KRS 278.300 approval. To the extent that it obtains debt funding that does not require Commission approval for issuance or assumption (*e.g.*, issues notes meeting the criteria of KRS 278.300(8)), Bluegrass Water intends to notify the Commission of that debt funding to keep it informed of steps taken by Bluegrass Water to reduce the equity portion of its capitalization and achieve the approved ratio and its 50/50 goal.

Bluegrass Water cannot predict when it will achieve the approved equity-to-capital ratio. First, the more-significant investments in utility plant will require prior Commission approval for the construction (KRS 278.020(1)(a)), and the funds will not all be borrowed and expended

immediately upon approval, but as prudently incurred for the work to be done. Second, although its equity-funded acquisitions approved in Case No. 2019-00104 have occurred, and the acquisitions approved in this case will soon occur, Bluegrass Water has filed an application with the Commission related to additional asset acquisitions (Case No. 2020-00028) and is contemplating at least one further application in 2020 regarding other possible acquisitions. Closing on the acquisition of these other assets will increase the absolute amount of equity in Bluegrass Water. Significant investment in the utility plant acquired and debt funding for that investment will be required; however, other than work undertaken to correct violations of environmental and other regulatory standards, the timeline to address repairs and improvements identified by the consulting engineer is approximately one year. *See Joint Application p. 13.* Because the investment in utility plant and corresponding debt funding will always lag the equity-funded closing on the respective assets, it is likely that it will take somewhat longer for investment in the utility plant already acquired (Case No. 2019-00104) and approved to be acquired in this case to produce a company-wide 50-50 capitalization ratio.