

## **Notice and Plan re Capital Structure**

In its Order approving the proposed acquisitions and transfers, issued August 14, 2019, at page 18, the Commission finds:

that Bluegrass Water's equity-to-capitalization percentage should not exceed 50%, and that every effort must be made to lower that percentage. If the equity-to-capital percentage exceeds 50%, Bluegrass Water shall notify the Commission in writing within 30 days of this occurring and submit to the Commission a detailed plan explaining how it will revise its capital structure to achieve its approved equity-to-capital ratio.

The related condition to the acquisition/transfer approval, repeating the second sentence quoted above, is set out as Condition # 6 in the Appendix to the 8/14/19 Order.

### **Notice**

Bluegrass Water Utility Operating Company, LLC ("Bluegrass Water") hereby gives notice to the Commission that its equity-to-capital percentage exceeds 50%. Other than current liabilities in the nature of accounts payable, Bluegrass Water's present capitalization is entirely equity and will exceed the benchmark for the near term.

### **Plan**

As described in the 8/14/19 Order at page 16, "Bluegrass Water will finance the acquisition and operations utilizing a 50/50 capitalization structure." It is the goal 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. As of September 30, 2019, Bluegrass Water completed the last closings on the acquisitions approved in the 8/14/19 Order and had not yet undertaken significant investment in the recently-acquired utility plant. Therefore, its capital structure at the end of the 2019 third quarter is all or nearly all equity.

Prior to the first closing on an approved acquisition, Bluegrass Water's capitalization structure was 100% equity. *See* Joint Application Exh. N p.1 (column 1). As disclosed in the course of the 2019-00104 proceedings (*see, e.g.*, Response to AG post-hearing Data Request 06; Affidavit of Phil Macias filed 8/9/19), the funding necessary to make the acquisitions was equity capital received by Bluegrass Water's parent member (CSWR, LLC) in early August 2019. That equity then was dropped down to Bluegrass Water to pay the closing costs for each acquisition as it was

made. The “total payments at closing” by Bluegrass Water for each transaction are shown as a journal entry credit in the post-closing accounting entries filed October 30, 2019 in compliance with 8/14/19 Order Condition # 1. With rounding, the sum of the actual “total payments at closing” shown in the journal entries is \$440,000, which is somewhat less than the total *pro forma* “utility plant in service” amount (\$455,600) shown on Joint Application Exhibit N p.1 (last column).

Reduction in the equity proportion of capitalization, eventually to below the 50% benchmark, will be achieved as debt-funded investment in acquired utility plant occurs. Please refer to Joint Application Exhibit N p.1 (last column) showing *pro forma* Bluegrass Water UOC Sewer Acquisition amounts for:

Utility Plant in Service	\$ 455,600
Construction Work in Progress	\$ 2,949,039
Current Assets	\$ 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 84/16 debt-to-equity. If the CWIP were funded approximately 60% by debt and 40% by equity, then the resulting ratio would match the 50-50 goal.

This illustrates the plan to achieve the approved equity-to-capital ratio and the goal of a 50/50 capitalization structure on average over time. 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, *see* the capital investment worksheets provided in response to AG post-hearing Data Request 07, 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 so that the Commission will be kept 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 now occurred, Bluegrass Water has applied to the Commission for approval of additional asset acquisitions (Case No. 2019-00360) and is contemplating further application(s) regarding other possible acquisitions. Closing on the acquisition of these other assets will increase the absolute amount of equity in Bluegrass Water. These other systems will also need significant investment in the utility plant acquired and debt funding for that investment by Bluegrass Water; however, because the investment in utility plant and corresponding debt funding will always occur after the equity-funded closing on the respective assets, it may take somewhat longer for investment in the already-acquired utility plant to produce a company-wide 50-50 capitalization ratio.