

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC PROPOSED ACQUISITION BY)	
BLUEGRASS WATER UTILITY OPERATING)	
COMPANY, LLC AND THE TRANSFER OF)	
OWNERSHIP AND CONTROL OF ASSETS BY P.R.)	
WASTEWATER MANAGEMENT, INC., MARSHALL)	CASE NO.
COUNTY ENVIRONMENTAL SERVICES, LLC, LH)	2019-00104
TREATMENT COMPANY, LLC, KINGSWOOD)	
DEVELOPMENT, INC., AIRVIEW UTILITIES, LLC,)	
BROCKLYN UTILITIES, LLC, FOX RUN UTILITIES)	
LLC, AND LAKE COLUMBIA UTILITIES, INC.)	

ATTORNEY GENERAL'S POST-HEARING BRIEF

The above-named applicants in this matter filed a Verified Joint Application for Approval of Acquisition and Transfer of Ownership and Control of Utility Assets (“Application”) proposing an acquisition by Bluegrass Water Utility Operating Company, LLC (“Bluegrass UOC”) of the assets of the other applicants. Specifically, the applicants submitted the Application “pursuant to KRS 278.020(6), (7), and (10), requesting that the Commission approve the acquisition and transfer of control of utility assets used in providing wastewater services to more than 1300 customers in areas of Bullitt, Franklin, Hardin, Madison, Marshall, McCracken, Scott, and Shelby Counties, Kentucky.”¹ The standards set forth by the relevant portions of KRS 278.020 require 1) Commission approval before the transfer, 2) the acquiring utility proves it has the “financial, technical, and managerial abilities to provide reasonable service,” 3) that the

¹ Application at 1.

acquisition “is to be made in accordance with the law, for a proper purpose and is consistent with the public interest,” and 4) that the “person acquiring the utility has provided evidence of financial integrity to ensure the continuity of sewage service in the event that the acquirer cannot continue to provide service.” As discuss below, Bluegrass UOC has not met their burden of proof as to portions of the relevant law. The record is devoid of evidence as to whether Bluegrass UOC has the financial or managerial ability to provide reasonable service, there is no evidence of financial integrity to ensure continuity of service, and without a significant number of conditions imposed on Bluegrass UOC, the proposed acquisitions are not in the public interests.

It is well settled that “[a]pplicants before an administrative agency have the burden of proof.”² In making its determination, the “Commission may analyze and weigh all the evidence, including that adduced during discovery and at the hearing.”³ Although the Attorney General conducted discovery and participated at hearing he did not support testimony in this matter. Nevertheless, because an intervenor does not support testimony in the case “does not require the Commission to approve the transfer.”⁴

Financial Ability

Given the consolidated nature of the balance sheets, it is unclear [REDACTED]

[REDACTED]⁵ In the

² *Energy Regulatory Commission v. Kentucky Power Co.*, 605 S.W.2d 46, 50 (Ky. App. 1980) citing *Lee v. International Harvester Co.*, 373 S.W.2d 418, 420 (1963).

³ *In Re. Kentucky Power Company*, Case No. 2002-00475 (Ky. Commission Jul. 17, 2003) at 3.

⁴ *Id.*

⁵ Confidential Response to AG Post-Hearing Request No. 5.

Application, it was stated that Bluegrass UOC will be funded “with equity capital from First Round and debt financing from US Water Capital.”⁶ At the hearing it became apparent that [REDACTED]
[REDACTED]⁷ Additionally, there is no documentation or evidence of any commitment from any entity for equity capital.⁸ In fact, Bluegrass UOC states there is no evidence that the “equity capital . . . necessary to acquire the assets that are subject of the Joint Application” has been received or committed.⁹ Importantly, this lack of evidence is in reference to the less than half-a-million dollars needed to acquire the systems, not the nearly three million dollars Bluegrass UOC allegedly intends to invest in the systems post-acquisition.¹⁰ Bluegrass UOC’s statement in its Application that it “has secured the commitment of equity capital and long-term loans to finance the acquisition, the planned repairs and improvements, and operation of the systems,” is not supported by a single shred of record evidence.¹¹ As such, Bluegrass UOC has failed to meet its burden of proving it has the financial ability to provide reasonable service.

Managerial Ability

As for Bluegrass UOC’s managerial ability, the Application initially points to CSWR’s current portfolio of water and wastewater systems, and CSWR’s “experienced management team.”¹² Additionally, it notes that Bluegrass UOC

⁶ Application at 14.

⁷ Confidential Video Testimony Evidence (“VTE”) at 00:06:08; 0:17:18.

⁸ Response to AG Post-Hearing Request 6.

⁹ *Id.*

¹⁰ Application, JA Exhibit N (redacted)

¹¹ Application at 21.

¹² Application at 21.

depends on “the engagement of qualified third-party firms to provide operation and maintenance of the systems and customer service and billing, as well as in the oversight of these firms and function by CSWR,” to show it has “[m]anagerial ability.”¹³ CSWR may have an experienced management team, but that team is and will be in Missouri.¹⁴ There is currently no “determination” as to whether Bluegrass UOC plans to have any physical presence in Kentucky.¹⁵ Additionally, CSWR is not a party to this case. Although Bluegrass UOC is depending on “qualified third-party firms” to evidence its managerial ability, it does not have agreements in place for the Commission to determine and evaluate if the third-parties actually chosen can provide reasonable service.¹⁶ The entity overseeing these third-parties would not be Bluegrass UOC either, nor would it be Bluegrass Utility Holding Company or even Kentucky CSWR, but instead is CSWR.¹⁷ That is because none of the Kentucky entities have employees.¹⁸ Bluegrass UOC’s dependence on an ultimate parent company who is located out of state, who will be directing third-party contractors who have not yet been chosen and cannot be evaluated, is damning. If the acquisitions are approved Bluegrass will provide no service, and the entity directing service (CSWR) is not under Commission jurisdiction, and those entities or individuals directed by CSWR that will be providing operations and customer service are not yet identified or committed to do so. The Commission has no evidence that Bluegrass UOC has the managerial

¹³ Application at 22.

¹⁴ Application at 4.

¹⁵ VTE at 5:05:27.

¹⁶ VTE at 5:01:15; 5:10:00, *et seq.*

¹⁷ VTE at 5:11:35.

¹⁸ VTE at 5:12:36.

ability to provide reasonable service, and thus Bluegrass UOC has failed to meet its burden of proof on this issue.

In Accordance With the Law and For a Proper Purpose

As an initial matter, the Attorney General is concerned that if the proposed transaction is approved that Bluegrass UOC will immediately be out of compliance with a number of regulations due to its plan to not have an office located in the Commonwealth.¹⁹ For instance, the Attorney General believes that Bluegrass UOC may immediately violate at least the following regulations: 807 KAR 5:006, Section 14(1); 807 KAR 5:006, Section 3(a); 807 KAR 5:006, Section 10(1); 807 KAR 5:006, Section 14(30(b)); 807 KAR 5:006, Section 14(1)(c)(1); 807 KAR 5:006, Section 23; 807 KAR 5:006, Section 24; 807 KAR 5:011, Section (2)(4); 807 KAR 5:011, Section 8(4)(e); and 807 KAR 5:011, Section 12. As such, in addition to the conditions presented in Appendix A and explained below, the Commission should ensure customers are protected and served in accordance with the letter and intent of these regulations, possibly requiring regular office hours and an office location located in the Commonwealth.

Public Interest

As proposed, the acquisition subject to the Application is not in the public interest. The Commission has previously held that “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 or that any potentially adverse effects can be avoided through the Commission's imposition of reasonable conditions on the

¹⁹ VTE at 5:05:27.

acquiring party.”²⁰ If even in light of the deficiencies discussed *supra*, the Commission considers approving the proposed transaction it should do so only upon the “imposition of reasonable conditions.”²¹ The reasonable conditions the Attorney General believes the Commission must impose on Bluegrass UOC or others are provided in Appendix A to this brief. In order to provide context and explanation of some of those conditions, he explains a selected number here.

A. Bluegrass UOC must maintain a minimum debt to capitalization ratio of 40% and a maximum debt to capitalization ratio of 60%.

The Application stated that a “50/50 capital structure has been developed for Bluegrass UOC.”²² Nevertheless, Bluegrass UOC chose not to commit to a capital structure that limited debt or equity exceeding 60%. This lack of commitment is concerning given the varying debt/equity ratios of the CSWR subsidiaries in Missouri and Arkansas.²³ In Case No. 2006-00197 the Commission required Kentucky-American to maintain an equity to capital ratio between 35-45 percent, thus ensuring that total capitalization was not majority-equity.²⁴ Of course as a general matter, equity capital is more expensive than debt capital. The Attorney General proposes a requirement of debt or equity ratios as a percentage of total capitalization between 40-60 percent. This range will ensure that the utility

²⁰ Application for Approval of the Transfer of Control of Kentucky-American Water Company to RWE Aktiengesellschaft and Thames Water Aqua Holdings GMBH, Case No. 2002-00018, Order (Ky. Commission May 30, 2002) at 7.

²¹ *Id.*

²² Application at 14.

²³ Confidential Response to AG DR 1-5.

²⁴ The Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holding 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, Case No. 2006-00197, Order (“Final Order, Case No. 2006-00197”) (Ky. Commission Apr. 16, 2007) Appendix A, page 3.

is not too risky in that its debt ratio is too high and to ensure the weighted cost of capital is not too high with an unreasonable percentage of equity out of total capitalization. In addition, Bluegrass UOC should submit, post-closing, a detailed plan to ensure the range is maintained.

- B. Bluegrass UOC will not be the employer or purchaser of last resort for employees, assets, services and/or products associated with any affiliate of Bluegrass UOC.

The Commission has previously imposed this requirement on other acquiring or transferring utilities with out of state affiliates not subject to Commission jurisdiction.²⁵ Imposition of this commitment is reasonable and necessary to ensure that Kentucky ratepayers do not have unnecessary costs and expenses foist upon them.

- C. Bluegrass UOC and its affiliates will not achieve savings at the expense of degrading the adequacy and reliability of the customers' retail service.

The Commission has previously noted in a separate transaction that its “principle concern is the possible degradation of service quality” following the change in control.²⁶ In order to ensure that customers receive better, or at least the same level of service, Bluegrass must not degrade the adequacy or reliability of service in order to achieve savings due to the proposed acquisition. As such, in order to ensure service is not degraded, the Commission should require for a reasonable time after approval of the acquisition that Bluegrass UOC will file reports regarding discharge quality, number of service interruptions, employee or contractor response times, number of customer complaints and customer inquiry

²⁵ *Id.* at 20.

²⁶ *Id.* at 19.

time. Additionally, the Commission should determine the most relevant metrics for discharge and inspection purposes, including monitoring and reporting on Division of Water citations or violations.

Financial Integrity to Ensure the Continuity of Sewage Service

The law requires that prior to approving this Application the Commission must find that Bluegrass UOC “has provided evidence of financial integrity to ensure the continuity of sewage service in the event that the acquirer cannot continue to provide service.”²⁷ Bluegrass UOC has not provided that evidence. Instead, Bluegrass UOC points only to the fact that CSWR is responsible for operating utilities in other states as compliance with this section.²⁸ Of course, this ignores that Bluegrass UOC already depends on CSWR for management to begin with, and has no ability to provide service itself.²⁹ As previously noted, CSWR is not a utility, is not subject to Commission jurisdiction and is not located in the Commonwealth of Kentucky.³⁰ The Application merely pointed to Bluegrass UOC’s alleged compliance with the financial portion of a separate section of the statute as compliance with this requirement.³¹ Such a cross-reference is inadequate from a plain reading of the statute, which makes clear that the financial integrity section applies “in addition to findings required by those subsections [dealing with technical, financial and managerial abilities].”³² In light of Bluegrass UOC’s

²⁷ KRS 278.020(10).

²⁸ VTE at 5:15:48.

²⁹ VTE at 5:17:47.

³⁰ Given the lack of Kentucky employees and dependence on yet-identified contractors, questions still go unanswered in this matter, including as to who the Division of Water contacts in light of emergencies or inspections.

³¹ Application at 23.

³² KRS 278.020(10).

failure to provide evidence of the requisite integrity, the Application should be denied. If the Commission nevertheless approves the Application, the Commission must ensure that Bluegrass UOC sets aside, by insurance product, bond, sinking fund, or other funding mechanism, at least six (6) months of money to pay the eventual third-party operations entity chosen by Bluegrass UOC. The Commission should require that after entering into an operations agreement Bluegrass UOC must immediately set up whatever mechanism necessary that will cover six (6) months of operations from the chosen firm. This will ensure interim service continues should Bluegrass UOC be unable to provide reasonable service.

Final Considerations

The Attorney General is sincerely worried about the level of service that an out-of-state entity with no presence in Kentucky can provide. The Commission showed a similar concern in a separate matter, noting “we are of the opinion that the public interest requires that [the utility’s] local management have the necessary authority and autonomy to make decision on a local level.”³³ Of course, the record here makes clear there will be no local management, and all service, both operationally and customer oriented, will be conducted by third-party contractors. There will be no one from the utility on the ground. In addition to the regulations noted above that indicate a requirement that a utility maintain an office in Kentucky, there are serious considerations the Commission must contemplate in this matter.

³³ Final Order, Case No. 2006-00197 at 21.

Finally, the Attorney General puts Bluegrass UOC on notice that in any subsequent rate case he will review Bluegrass UOC's investments and costs thoroughly for prudence and reasonableness. These consist of investments in the system, including "geotagging" to ensure third-party contractors are doing their jobs.³⁴ It seems inherently unreasonable that customers will have no in-state access to books, records or personnel, while the utility also spends additional funds to ensure third-party contractors are compliant with their agreements because Bluegrass UOC has no employees of its own. The Attorney General also cautions that he generally disagrees with recovery of purchase prices of utilities in excess of net book value in lieu of net book value, particularly in instances where the previous owner of the assets paid next to nothing for them and no significant capital has been expended in decades.

WHEREFORE, the Attorney General requests the Commission find that the applicants in this matter have failed to meet their burden of proof and that it deny the proposed transaction.

³⁴ VTE at 5:12:50

Respectfully submitted,

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Attorney General's Appendix A
Post-Hearing Brief
Case No. 2019-00104

1. Prior to entering into any service company agreement or cost allocation manual, Bluegrass Water Utility Operating Company, LLC ("Bluegrass UOC") will file an application with the Kentucky Public Service Commission ("Commission") to obtain its prior approval.
2. Bluegrass UOC will honor all contractual and regulatory commitments the Kentucky selling utilities entered into prior to the closing of the transaction(s) that are subject to or contemplated within the proposed transaction(s).
3. Bluegrass UOC will not seek recovery for any costs to achieve the transaction(s) or costs to achieve initial savings associated with the proposed transaction(s) from Bluegrass UOC's post-closing ratepayers.
4. Bluegrass UOC will give clear and conspicuous notice to its customers prior to any material change in services resulting from the proposed transaction(s).
5. Post-closing ratepayers of Bluegrass UOC will not be responsible for any costs arising from any affiliates of Bluegrass UOC located outside or inside of Kentucky. For purposes of these commitments, affiliates of Bluegrass UOC include, but are not limited to, all such affiliates identified in the record of the instant case, whether direct or indirect.
6. If the Commission approves the contemplated transaction(s), post-closing ratepayers of Bluegrass UOC will not be asked or required to guarantee the credit of any Bluegrass UOC affiliate.
7. Bluegrass UOC will not be required to pledge any of its assets to finance the debt or any purchases of any other affiliate.
8. Bluegrass UOC will not be required to grant liens or encumbrances, or otherwise pledge any of their assets to finance any or all of the costs of the proposed transaction(s).
9. Neither Bluegrass UOC nor its ratepayers, will directly or indirectly incur any additional costs, liabilities, or obligations in conjunction with the proposed transaction(s) in connection with the repayment and refinancing of closing indebtedness.
10. Neither Bluegrass UOC nor its ratepayers, will directly or indirectly incur any additional costs, liabilities, or obligations related to the proposed acquisition(s).

11. Bluegrass UOC agrees to ring-fence itself to ensure Bluegrass UOC is insulated from costs arising from the out-of-state utility businesses of Bluegrass UOC and/or its affiliated entities.
12. Bluegrass UOC agrees to maintain a minimum debt to capitalization ratio of 40% and a maximum debt to capitalization ratio of 60%.
13. Bluegrass UOC will agree to abstain from: (a) guaranteeing debt or credit facilities of any Bluegrass UOC affiliate; (b) mortgaging utility assets on behalf of such an affiliate; and (c) loaning funds or otherwise extending credit to any such affiliate.
14. If the proposed transaction(s) closes, the Joint Applicants will provide the Commission and parties to this case, as a filing in this docket, the post-closing accounting entries for each of the Joint Applicants and the direct affiliates involved in the transaction(s), including those that provide post-closing capital.
15. Bluegrass UOC will maintain its books and records within the Commonwealth of Kentucky.
16. If Bluegrass UOC's affiliates are the sources for any charges to Bluegrass UOC, Bluegrass UOC and those affiliates agree to allow the Commission or its agent to audit the accounting records of those affiliates.
17. The accounting and rate-making treatments of the assets-subject-to-the-proposed-transaction's excess deferred income taxes, if there are any, shall not be affected by the transaction.
18. Bluegrass UOC's post-closing customers will experience no adverse change in service if the transaction(s) is approved.
19. Bluegrass UOC and its affiliates will not achieve savings at the expense of degrading the adequacy and reliability of the customers' retail service.
20. The proposed transaction(s) will not result in any write-ups, write-offs or restatements of financial results.
21. In the event the contemplated transaction(s) is not consummated, the Kentucky selling utilities' ratepayers will not be responsible for any termination and/or other fees or expenses.

22. No early termination costs, change in control payments, or retention bonuses paid to any employee or agent of a Kentucky selling utility as a result of the proposed transaction(s) will be allocated to or recovered from any ratepayers.
23. Bluegrass UOC will not be the employer or purchaser of last resort for employees, assets, services and/or products associated with any affiliate of Bluegrass UOC.
24. No later than March 31st of every year, Bluegrass UOC shall file with the Commission a detailed organizational chart showing all subsidiaries and affiliates as of the end of the previous calendar year.
25. Post-closing, Bluegrass UOC shall adequately fund and maintain the systems subject to the proposed transaction(s).
26. In the event Bluegrass UOC and its affiliates should conduct any future water, or wastewater utility mergers or acquisitions, it will notify the Commission in those future matters of any and all potential synergies and benefits from such transaction(s), together with a proposed methodology for allotting an appropriate share of the potential synergies and benefits to ratepayers.
27. When Bluegrass UOC files its annual report with the Commission it will also file a report of its distributions and other monetary transfers to and from Bluegrass Water Utility Holding Company.
28. CSWR shall file with the Commission in the record of this matter a letter stating and providing evidence that it has appointed an agent for service of process of any action that the Commission may bring to enforce the provisions of any order in this matter and that it avails itself of Commission jurisdiction for purposes of compliance with any order arising from this matter.