

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC JOINT APPLICATION OF AQUA	)	
AMERICA, INC., STEELRIVER	)	
INFRASTRUCTURE FUND NORTH AMERICA LP,	)	CASE NO.
STEELRIVER LDC INVESTMENTS LP, LDC	)	2018-00369
PARENT LLC, LDC FUNDING LLC, LDC	)	
HOLDINGS LLC, PNG COMPANIES LLC,	)	
PEOPLES GAS KY LLC, AND DELTA NATURAL	)	
GAS COMPANY, INC. FOR APPROVAL OF AN	)	
ACQUISITION OF OWNERSHIP AND CONTROL	)	
OF PNG COMPANIES LLC AND DELTA NATURAL	)	
GAS COMPANY, INC.	)	

ORDER

On November 20, 2018, Aqua America, Inc. (Aqua America), SteelRiver Infrastructure Fund North America LP (SRIFNA), and SteelRiver LDC Investments LP (SRLDCI), LDC Parent LLC (LDC Parent), LDC Funding LLC (LDC Funding), LDC Holdings LLC (LDC Holdings), PNG Companies, LLC (PNG), Peoples Gas KY LLC (Peoples KY), Delta Natural Gas Company, Inc. (Delta) (collectively, Joint Applicants), jointly filed an application (Application) for approval by the Commission of the acquisition of indirect ownership and control of Delta by Aqua America pursuant to KRS 278.020(6) and 278.020(7). As a result of the proposed acquisition, Aqua America will wholly own LDC Funding and indirectly own LDC Holdings, PNG, Peoples KY, and Delta. Pursuant to KRS 278.020(6)-(7), Commission approval is required only for the acquisition of Delta, a natural gas utility that is subject to the Commission’s jurisdiction, and not Peoples KY, which is a farm tap system.

The Attorney General of the Commonwealth of Kentucky, by and through the Office of Rate Intervention (Attorney General), is the only intervenor in this matter. Joint Applicants responded to two rounds of discovery. An evidentiary hearing was held on February 14, 2019. Joint Applicants filed responses to post-hearing data requests. Joint Applicants and the Attorney General filed simultaneous briefs. This matter now stands submitted to the Commission for a decision.

### JOINT APPLICANTS

#### Aqua America

Aqua America, a Delaware limited partnership based in Pennsylvania, is a publicly-traded holding company that is the second largest investor-owned water utility in the United States.<sup>1</sup> Aqua America's subsidiaries provide service to approximately three million customers in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Indiana, and Virginia. As of December 31, 2017, Aqua America owned, operated, and maintained approximately 12,500 miles of transmission and distribution mains, 21 surface water treatment plants, 3,000 well treatment locations, and 187 wastewater treatment plants.<sup>2</sup> Aqua America had total assets of \$5.4 billion and \$809 million in annual revenues as of 2017.<sup>3</sup> Beginning with a predecessor entity, Aqua America has 130 years of experience owning and managing public utilities, which includes experience with public

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<sup>1</sup> Application at 7; Direct Testimony of Christopher H. Franklin (Franklin Testimony) at page 6, lines 10–11.

<sup>2</sup> Application at 7.

<sup>3</sup> *Id.* at 12.

utility pipeline maintenance and replacement, and post-acquisition utility integration planning and execution.<sup>4</sup>

#### SRIFNA, SRLDCI, and LDC Funding

SRIFNA and SRLDCI are investment funds focused on infrastructure and local gas distribution assets. SRIFNA and SRLDCI indirectly own 100 percent of LDC Parent, which, in turn, wholly owns LDC Funding. LDC Funding wholly owns LDC Holdings, which, in turn, wholly owns PNG.

#### PNG, Delta, and Peoples KY

PNG, a Delaware limited liability company based in Pennsylvania that is wholly owned by LDC Holdings, manages the day-to-day business of operating companies that provide natural gas to over 700,000 retail customers in Pennsylvania, West Virginia, and Kentucky. PNG wholly owns Peoples KY and Delta.

Peoples KY, a Kentucky limited liability company wholly owned by PNG, is a farm tap system with 3,000 customers in 10 counties in Eastern Kentucky.<sup>5</sup> As a farm tap system, Peoples KY is not a utility as defined in KRS 278.010(3). Because KRS 278.020(6)-(7) applies to utilities as defined in KRS 278.010(3), Commission approval is not required for Aqua America to acquire indirect ownership of Peoples KY.

Delta, a Kentucky corporation wholly owned by PNG, provides natural gas utility service and is subject to the jurisdiction of the Commission. Delta serves 34,559 residential, commercial, and industrial customers in 23 counties in central and eastern

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<sup>4</sup> *Id.* at 12-13.

<sup>5</sup> *Id.* at 9.

Kentucky.<sup>6</sup> In addition to its regulated natural gas distribution business, Delta manages three unregulated companies that are wholly owned by PNG, Delta Resources, Inc., Delgasco, Inc., and Enrpro, Inc.

### OVERVIEW OF THE TRANSACTION

Under the terms of the purchase agreement, Aqua America will acquire indirect control over Delta's assets by acquiring 100 percent of LDC Funding and LDC Funding's subsidiaries, which include PNG, Peoples KY, and Delta. Under the proposed transaction, Delta will remain a wholly owned subsidiary of PNG, but, due to Aqua America's indirect ownership of PNG, will become an indirect subsidiary of Aqua America. PNG is the sole owner of Delta's stock; no additional stock will be issued because of the proposed transaction.<sup>7</sup>

Although Aqua America will be the ultimate parent, neither PNG's, Peoples KY's, nor Delta's corporate structure will change. Because PNG's current board of directors consists of SRIFNA executives, after the close of the proposed transaction PNG will have a newly formed board made up of Aqua America and PNG officers.<sup>8</sup> Aqua America stated it is still analyzing the proper makeup of the post-closing Delta Board.

The price of the proposed transaction is \$4.275 billion, which includes the assumption of \$1.3 billion in debt.<sup>9</sup> Also included in the \$4.275 billion cost is an estimated

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<sup>6</sup> Delta Annual Report for Calendar Year 2017 (filed July 6, 2018) at 5.

<sup>7</sup> Joint Applicants' response to Attorney General's First Request for Information (Response to Attorney General's First Request), Item 35.

<sup>8</sup> Response to Commission Staff's First Request for Information (Response to Staff's First Request), Item 3; Response to Attorney General's First Request, Item 19.

<sup>9</sup> Application at 11. After the closing of the proposed transaction, PNG's externally financed secured debt and intercompany debt owed to PNG by Peoples KY and Delta will remain.

\$2 billion premium for goodwill; Aqua America states that the goodwill will not be included in its asset base.<sup>10</sup> Aqua America intends to finance the acquisition through a combination of equity, capital, and third-party debt financing. Aqua America stated that it plans to issue \$2.2 billion to \$2.9 billion of common equity and equity-linked securities, with \$0.4 billion to \$0.9 billion of incremental Aqua America debt to fund the remainder of the transaction.<sup>11</sup> Aqua America does not request approval of financing as part of this proceeding.

As a publicly traded company, Aqua America will file quarterly and annual financial reports with the Securities and Exchange Commission on a consolidated basis if the proposed transaction is approved.<sup>12</sup>

In addition to Commission approval, the proposed transaction is subject to approval under the federal Hart-Scott-Rodino Antitrust Improvements Acts (Hart-Scott-Rodino), as well as approval from the Pennsylvania Public Utility Commission and West Virginia Public Service Commission.<sup>13</sup> Aqua America expects to receive all necessary approvals by mid-2019, with the proposed transaction closing shortly after that date.<sup>14</sup> Aqua America received required Hart-Scott-Rodino approvals; the Pennsylvania and West Virginia proceedings are pending as of the date of this Order.

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<sup>10</sup> Feb. 14, 2019 Hearing Video Transcript (HVT) at 10:09:12.

<sup>11</sup> Application at 11; Direct Testimony of Daniel J. Schuller (Schuller Testimony) at page 4, lines 7–17.

<sup>12</sup> Direct Testimony of John B. Brown (Brown Testimony) at page 8, line 21 – page 9, line 2; Response to Staff's First Request, Item 11.

<sup>13</sup> Application at 18; Schuller Testimony at page 5, lines 8–20.

<sup>14</sup> Schuller Testimony at page 5, lines 4–5; Response to Attorney General's Post-Hearing Request for Information (Response to Attorney General's Post-Hearing Request), Item 1, Form 10-K filed Feb. 26, 2019.

## COMMITMENTS

Aqua America made post-merger commitments regarding retention of PNG and Delta management and employees, community involvement, economic development, and corporate governance that are outlined in Joint Applicant's response to Staff's Post-Hearing Request, Item 1, and Joint Applicant's response to the Attorney General's Second Request, Item 25.

Aqua America stated that the costs associated with the proposed transaction would not have the effect of increasing Delta's or Peoples KY's<sup>15</sup> rates for gas service because it would not seek to recover in rates, now or in the future, any costs directly or indirectly associated with the proposed transaction or transition.<sup>16</sup> Aqua America committed that Delta and Peoples KY will maintain rates in effect at the close of the proposed transaction.<sup>17</sup> Aqua America further committed that Delta will seek Commission approval before entering into a service agreement with Aqua America or its affiliates.<sup>18</sup>

Finally, Aqua America committed that Delta and Peoples KY, and their ratepayers, will not incur any additional costs, liabilities, or obligations in conjunction with the proposed transaction; will not incur additional indebtedness or pledge assets to finance the proposed transaction; will not bear costs associated with operating Aqua America's utility subsidiaries; will not be required to pledge assets to finance the debt or purchases

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<sup>15</sup> Although Commission approval of the acquisition of Peoples KY is not required under applicable law, the Commission has limited jurisdiction over Peoples KY as a farm tap system under KRS 278.485, including statutory authority to ensure that Peoples KY's rates are fair, just, and reasonable.

<sup>16</sup> Application at 19–20; Schuller Testimony at page 12, lines 20–22; Response to Staff's Request, Item 5.

<sup>17</sup> Application at 20.

<sup>18</sup> Application at 20; Response to Attorney General's Post-Hearing Request, Item 4.

of any affiliates; will not be required to grant liens or encumbrances, or pledge any assets, to finance any cost of the proposed transaction; and will give clear and conspicuous notice to Delta's and Peoples KY's ratepayers prior to any change in service resulting from the proposed transaction.<sup>19</sup>

In his Post-Hearing Final Comments, the Attorney General emphasized that Aqua America, PNG, and Delta should be required to honor the commitments they agreed to keep in the course of this proceeding.<sup>20</sup>

### DISCUSSION

The Commission reviews the proposed transaction pursuant to KRS 278.020(6) and KRS 278.020(7).

#### Approval Pursuant to KRS 278.020(6)

KRS 278.020(6) provides that:

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

On February 26, 2019, Aqua America provided evidence, including its most recent audited financial statement and Form 10-K filed with the Securities and Exchange Commission, to show that it has the financial ability to provide reasonable service.<sup>21</sup> Aqua America has \$5.9 billion in total assets and \$838 million in annual revenues as of

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<sup>19</sup> Response to Staff's First Request, Items 5–6.

<sup>20</sup> Attorney General's Final Comments (filed Mar. 5, 2019) at 2.

<sup>21</sup> Response to Attorney General's Request, Item 22; Supplemental Response to Attorney General's Post-Hearing Request, Item 1.

December 31, 2018.<sup>22</sup> Aqua America pointed to its substantial experience in raising debt and equity capital, as well as its experience with major acquisitions and integration of utilities.<sup>23</sup> Aqua America stated that Delta will not be required to guarantee the credit of any Aqua America affiliates, pledge any of its assets, grant liens or encumbrances, or incur additional indebtedness to finance this transaction or to finance the debt or purchases of its affiliates, and that it would agree that Delta would maintain its existing capital structure of 41 percent debt and 59 percent equity.<sup>24</sup> Based on its financial position and ability to raise capital, Aqua America asserted that it could provide the level of capital needed to continue Delta's pipeline replacement program and the expansion of Delta's service area.<sup>25</sup> Aqua America noted that it raised \$500 million to fund an annual infrastructure replacement program and invested \$3.5 billion to install and replace water and wastewater infrastructure in its existing eight-state footprint.<sup>26</sup> The Commission expects that Aqua America's strong record in accessing capital from public and private capital resources will be a benefit to Delta and its customers.

Aqua America acknowledged that it has not previously owned or managed a gas distribution company. Aqua America asserted that its significant experience in operating 1,486 pipe-based water systems that produced more than 82 billion gallons of drinking

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<sup>22</sup> Supplemental Response to Attorney General's Post-Hearing Request, Item 1, Form 10-K at 57–58; Delta's Post-Hearing Brief (filed Mar. 5, 2019) at 3; Aqua America's Post-Hearing Brief (filed Mar. 5, 2019) at 4.

<sup>23</sup> Aqua America's Post-Hearing Brief at 4–5.

<sup>24</sup> Response to Staff's First Request, Items 5, 6, and 10.

<sup>25</sup> Feb.14, 2019 HVT at 9:36:56.

<sup>26</sup> Application at 16.

water in 2017 translates to natural gas systems.<sup>27</sup> Aqua America argued that its experience owning and managing pipe-based public utilities and prudently implementing pipeline replacement programs, combined with the knowledge and expertise of PNG and Delta management and employees who will be retained, will ensure that Delta's customers continue to receive quality natural gas service.<sup>28</sup> PNG has extensive experience in operating regulated natural gas distribution utilities that serve 700,000 gas customers in Pennsylvania and West Virginia, as well as its experience operating Delta and Peoples KY. Since its acquisition by PNG, Delta installed 30 miles of pipeline and added approximately 600 new customers without raising rates.<sup>29</sup> The Commission expects this record of expanding Delta's service area will continue after the proposed transaction closes.

Aqua America stated that the proposed transaction would benefit Delta and its customers in the following ways:

- Provide access to a broad range of capital necessary to ensure the timely and effective continuation of Delta's pipeline-replacement program.
- Continue PNG's upgrade of Delta's computer systems to improve the level of customer service and provide tools to better manage Delta's resources, including integrated work management system for dispatch, customer scheduling, and emergency response.

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<sup>27</sup> Feb. 14, 2019 HVT at 9:52:57; Delta's Post-Hearing Brief at 4; Aqua America's Post-Hearing Brief at 6.

<sup>28</sup> Delta's Post-Hearing Brief at 4; Aqua America's Post-Hearing Brief at 7–8.

<sup>29</sup> Response to Attorney General's First Request, Item 27; Delta's Post-Hearing Brief at 4–5. Of the 30 miles of pipeline, there were 12.8 miles of new extensions and 17.2 miles of replacements and relocations.

- Leverage Aqua America's experience in pipeline replacement to improve the efficiency in Delta's gas pipeline replacement program.
- Continue PNG's efforts to provide Delta employees with the most state-of-the-art tools in order to continue to improve the safety of providing services to current and future Delta customers, including a more current geographic information system for mapping and managing pipeline facilities, Department of Transportation-compliant GPS equipment, and an up-to-date SCADA system.
- Expand Delta's partnerships and working relationships with economic development leaders within the communities it serves and within government to help drive and support the further success and growth of the communities within the Delta footprint.

The Attorney General countered that the proposed transaction solely benefits the Joint Applicants at the expense of Delta's ratepayers, who will receive no benefits from the proposed transaction.<sup>30</sup> The Attorney General recommended that, if the proposed transaction is approved, the Commission carefully analyze future capital expenditures that exceed Delta's current level of capital expense, exempting from analysis only capital projects necessary for significant system growth or those due to extraordinary circumstances.<sup>31</sup>

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<sup>30</sup> Attorney General's Final Comments at 1.

<sup>31</sup> *Id.* at 1-2.

Approval Pursuant to KRS 278.020(7)

KRS 278.020(7) provides, in relevant part, that the Commission shall approve a proposed acquisition of control upon a finding that the proposed transaction is “made in accordance with law, for a proper purpose and is consistent with the public interest.”

Aqua America stated that the proposed transaction would be made in accordance with the law because Aqua America’s board of directors and SRIFNA’s investors approved the transaction, all necessary federal and state regulatory filings were made on a timely basis, and required governmental approvals have been received or will be received before the proposed transaction closes.<sup>32</sup> Aqua America asserted that the proposed transaction is for a proper purpose because, due to benefits described above and below, the proposed transaction will permit Delta to continue to meet its commitment to provide reasonable service to Delta’s customers.<sup>33</sup>

Aqua America avowed that the proposed transaction is consistent with the public interest because the proposed transaction will benefit Delta’s customers. In addition to the commitments and benefits discussed above, Aqua America maintained that Delta’s customers would benefit from economies of scale resulting from a larger customer base, which allows for increased investment in technology for enhanced customer service tools, work efficiency tools, infrastructure management programs, and pipeline mapping that is not economical on a standalone basis.<sup>34</sup> For example, Delta’s expenses could be

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<sup>32</sup> Application at 17–18; Feb. 14, 2019 HVT at 10:09:45; Delta’s Post-Hearing Brief at 6; Aqua America’s Post-Hearing Brief at 9.

<sup>33</sup> Application at 18.

<sup>34</sup> Application at 18–20; Schuller Testimony at page 12, lines 5–10; Feb. 14, 2019 HVT at 9:36:56 and 11:01:05.

decreased by integrating Delta's purchase of main replacement materials with Aqua America's, which could result in lower materials pricing due to economies of scale.

As set forth above, the Attorney General challenges the assertion that the proposed transaction will benefit Delta's ratepayers, arguing that the benefits accrue entirely to Aqua America.<sup>35</sup>

Joint Applicants countered that the proposed transaction will provide Delta with greater access to capital and would result in Delta being part of a larger utility system with the resources to maintain and enhance its performance.<sup>36</sup> By way of example, Joint Applicants argued that the greater access to capital will ensure that Delta can maintain, if not accelerate, the rate at which aging infrastructure is replaced through its pipeline replacement program.<sup>37</sup>

The Commission notes that the arguments in support of a finding that the proposed transaction is consistent with the public interest turn primarily upon the commitments Aqua America made to the Commission and to the Attorney General in its Application and through discovery.

## FINDINGS

The Commission, based on the evidence of record and being otherwise sufficiently advised, finds that:

1. Aqua America has the financial, technical, and managerial abilities to provide reasonable utility service.

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<sup>35</sup> Attorney General's Final Comment at 1.

<sup>36</sup> Delta's Post-Hearing Brief at 6–7; Aqua America's Post-Hearing Brief at 10–11.

<sup>37</sup> Delta's Post-Hearing Brief at 8.

2. The proposed acquisition of Delta by Aqua America and the associated transfer of control resulting from this transaction is in accordance with law, for a proper purpose, and will be consistent with the public interest only if Aqua America, PNG, and Delta adhere to the commitments discussed herein and developed through the processing of this proceeding.

3. Joint Applicants have agreed to be bound by commitments made during the course of this proceeding.

4. Aqua America should arrange for meetings between its chief executive and the Commission and/or Commission Staff at least once every two years.

IT IS THEREFORE ORDERED that:

1. Joint Applicants' request for approval of the acquisition as set forth in the joint Application is granted.

2. Within five days of consummation of the acquisition, Aqua America shall file a written notice setting forth the date of acquisition.

3. Within 20 days of the consummation of the acquisition, Aqua America shall file the journal entries it proposes to record the acquisition. The acquisition shall be recorded in accordance with the Uniform System of Accounts.

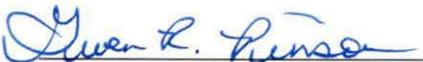
4. Any document filed in the future pursuant to ordering paragraphs 2 and 3 shall reference this case number and shall be retained in the post-case correspondence file.

5. This case is closed and removed from the Commission's docket.

By the Commission

ENTERED  
**MAR 13 2019**  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

  
Executive Director

Case No. 2018-00369

\*Allison Brown  
Wyatt, Tarrant & Combs, LLP  
500 West Jefferson Street  
Suite 2800  
Louisville, KENTUCKY 40202-2898

\*Monica Braun  
STOLL KEENON OGDEN PLLC  
300 West Vine Street  
Suite 2100  
Lexington, KENTUCKY 40507-1801

\*Peoples Gas KY, LLC  
375 North Shore Drive  
Suite 600  
Pittsburgh, PA 15212

\*Delta Natural Gas Company, Inc.  
3617 Lexington Road  
Winchester, KY 40391

\*Honorable Byron J Leet  
Wyatt, Tarrant & Combs, LLP  
250 West Main Street  
Suite 1600  
Lexington, KENTUCKY 40507-1746

\*Rebecca W Goodman  
Assistant Attorney General  
Office of the Attorney General Office of Rate  
700 Capitol Avenue  
Suite 20  
Frankfort, KENTUCKY 40601-8204

\*Frank Mellen  
Wyatt, Tarrant & Combs, LLP  
500 West Jefferson Street  
Suite 2800  
Louisville, KENTUCKY 40202-2898

\*Richard Northern  
Wyatt, Tarrant & Combs, LLP  
500 West Jefferson Street  
Suite 2800  
Louisville, KENTUCKY 40202-2898

\*Justin M. McNeil  
Office of the Attorney General Office of Rate  
700 Capitol Avenue  
Suite 20  
Frankfort, KENTUCKY 40601-8204

\*Honorable Robert M Watt, III  
Attorney At Law  
STOLL KEENON OGDEN PLLC  
300 West Vine Street  
Suite 2100  
Lexington, KENTUCKY 40507-1801

\*Kent Chandler  
Assistant Attorney General  
Office of the Attorney General Office of Rate  
700 Capitol Avenue  
Suite 20  
Frankfort, KENTUCKY 40601-8204

\*Larry Cook  
Assistant Attorney General  
Office of the Attorney General Office of Rate  
700 Capitol Avenue  
Suite 20  
Frankfort, KENTUCKY 40601-8204