

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water)
Company for Authority to (1) Issue up to)
\$85,000,000 in Aggregate Principle Amount)
of Secured or Unsecured Long-Term Debt)
and (2) to Issue and Sell Additional Common)
Stock to, or Receive Additional Paid-in-Capital)
From, Its Parent Company in an Aggregate)
Amount up to \$15,000,000)

Case No. WF-2002-1096

ORDER APPROVING FINANCING

This order approves the proposed financing of Missouri-American Water Company with such conditions as have been proposed by Staff of the Missouri Public Service Commission.

On May 30, 2002, Missouri-American Water Company filed a verified application with the Missouri Public Service Commission requesting authority under Sections 393.190 and 393.200, RSMo 2000, and 4 CSR 240-2.60, to:

- (a) issue additional long-term taxable debt, in an aggregate principle amount not to exceed \$85,000,000, through its affiliate American Water Capital Corp.;
- (b) obtain low cost or tax advantaged funding from the State Environmental Improvement and Energy Resources Authority in the form of private activity bonds for qualifying projects and from the State Revolving Fund for qualifying facilities, provided the amount of such new debt in combination with the debt described in (a) does not exceed \$85,000,000; and
- (c) issue and sell to Applicant's parent company, American Water Works Company, Inc., additional common stock for cash, or receive additional paid-in-capital, for an aggregate sale price not to exceed \$15,000,000.

On July 25, 2002, Staff filed a memorandum, recommending that the Commission issue an order approving the application, with certain conditions. Applicant then, on August 2, 2002, filed a notice, informing the Commission of its intent to file a response to Staff's memorandum. Applicant averred that it had concerns with one or more of the conditions recommended by Staff and that if the concerns could not be addressed informally it would file a response. No such response was received; however, on August 9, 2002, Staff filed an amended memorandum. Under Staff's initial memorandum, Applicant would have been subject to a ceiling on the costs of its financing. The conditions, as amended in Staff's memorandum, allow Applicant to exceed the stated costs of financing but with prior Commission approval. On August 20, 2002, Applicant filed a response to Staff's amended memorandum, indicating that it had no objection to the memorandum as amended.

Missouri-American Water Company's Application

Applicant is a Missouri corporation with its principle office in St. Louis, Missouri. Applicant is a public utility, authorized to provide water and wastewater service to the public in over 100 municipalities within 12 counties throughout the state of Missouri. Applicant proposes to implement a financing program to issue and sell stock, or to receive additional paid-in-capital, in the amount of up to \$15,000,000 and to issue and sell long-term unsecured notes or additional general mortgage bonds in the amount of up to \$85,000,000. The proceeds of the stock, note and bond sales will be used to pay for general property acquisition, construction, extension and improvement of Applicant's plant and distribution facilities throughout its system in Missouri, the improvement or maintenance of service, the discharge or lawful refunding of indebtedness and to reimburse Applicant's treasury for certain costs previously

incurred. Applicant proposes to undertake this financing program in one or more transactions over a three-year period, commencing with the effective date of the Commission's order approving the application.

Currently, Applicant has separate mortgage indentures securing \$224,250,000 of outstanding First Mortgage and General Mortgage Bonds. Pursuant to its application, Applicant proposes to issue a total of \$85,000,000 in additional long-term debt. Some or all of the additional long-term debt will be implemented primarily through an affiliate, American Water Capital Corp., under the terms of a Financial Services Agreement. American Water Capital is a wholly owned subsidiary of American Water Works Company, Inc. American Water Capital was established for the purpose of providing financing services to American Water Works and its water and wastewater utility subsidiaries, including Applicant, by pooling the financing requirements of such companies, thereby creating larger and more cost-efficient debt issues in the public securities market at more attractive interest rates and lower transaction costs than would otherwise be available. Under the terms of the agreement, Applicant's indebtedness to American Water Capital will take the form of long-term unsecured notes.

Some portion of the \$85,000,000 in additional long-term debt may be financed through special low cost or tax advantaged government programs due to special public benefits associated with certain projects. For example, Applicant may have the opportunity to obtain funding through the State Environmental Improvement and Energy Resources Authority or other governmental programs, such as those administered by the Missouri Department of Natural Resources through its Water Pollution Control Program. Applicant's debt obligations undertaken pursuant to these governmental

programs may take the form of additional long-term bonded indebtedness under its Indenture of Mortgage, as security for revenue bonds issued by or on behalf of the State Environmental Improvement and Energy Resources Authority or the Department of Natural Resources for the benefit of Applicant, or other debt obligations, such as unsecured notes.

Applicant also proposes to issue and sell shares of common stock to American Water Works, or to receive additional paid-in-capital, in an aggregate amount not to exceed \$15,000,000.

Any bonded indebtedness proposed to be issued in conjunction with Applicant's financing program will mature not later than 35 years after its date of issue with interest costs of not more than 200 basis points over the Bond Buyer Revenue Bond Index, as published in the most current available issue of *The Bond Buyer* on the business day prior to the date on which the terms and conditions of the Energy Resources Authority's revenue bonds shall be determined. Any notes evidencing long-term unsecured indebtedness, issued as part of the Company's financing program, will mature not later than 35 years after the date of issuance, bearing interest at a rate not greater than 200 basis points above the yield on U.S. Government Treasury Bonds having similar terms of maturity as published in *The Wall Street Journal* on the date prior to the date the terms of the notes are determined. The application and attachments present additional details for the financing and copies of associated authorizations, agreements and implementing documentation in substantially final form. Reports concerning the final terms and conditions will be filed with the Commission when the proposed transactions are closed.

Applicant states that the total principle amount of the new general mortgage bonds subject to the fee schedule, as set out in Section 386.300, RSMo 2000, will be set forth in a post-closing report containing the terms of long-term bonded and other indebtedness, along with a net present value analysis showing interest cost savings with regard to redemption and refunding of outstanding indebtedness. Applicant further states that proceeds from the proposed transactions are reasonably required for the purposes described in the application, will be used for those purposes, and are not reasonably chargeable to operating expenses or to income as required by Section 393.200, RSMo 2000.

Staff's Memorandum

Staff reviewed the financial statements submitted by Applicant and determined that Applicant's financial structure will be affected by the proposed financing. The resulting capital structure will consist of 40.87 percent common equity, 0.58 percent preferred stock, and 58.64 percent long-term debt. Coverage ratios of Applicant will decline with this proposed financing; however, the ratios should remain well within the Standard & Poor's Guidelines for an "A" rating. Staff also noted that the financial statements indicate that Applicant will be able to retire \$60,253,343 in bank debt along with the associated interest expense of \$1,253,694. Based on this review, Staff found the proposed interest rate and capital structure reasonable.

In its amended memorandum, Staff recommended approval of the application with the following conditions:

- a. That nothing in the Commission's approval order shall be considered a finding by the Commission of the value of this transaction for rate-making purposes, and that the Commission reserves the right to consider the rate-making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.

- b. That Applicant shall file with the Commission any information concerning deviations from the stated use of the funds or any information that would materially change the capitalization and financial ratios.
- c. That at no time will Applicant's total borrowings, including all instruments, exceed its Missouri-regulated rate base.
- d. That the interest cost of financing obtained through the efforts of American Water Capital Corporation shall not exceed 200 basis points above the yield on U.S. Governments Treasury Bonds having similar terms of maturity as published in *The Wall Street Journal* on the date prior to the date or dates on which the terms and conditions of the indebtedness shall be determined. However, at no time shall the interest rate exceed 7.25 percent, without prior Commission approval.
- e. That the interest cost of the General Mortgage Bonds issued by the Environmental Improvement and Energy Resource Authority shall not exceed 200 basis points above the most current Bond Buyer Revenue Bond Index at the time of issuance. However, at no time shall the interest rate exceed 7.25 percent, without prior Commission approval.
- f. That the interest cost of financing obtained through the State Revolving Fund administered by the Department of Natural Resources shall not exceed 7.25 percent (i.e., the estimated interest rate utilized by Applicant for purposes of this filing), without prior Commission approval.
- g. That Applicant file with the Commission all final terms and conditions on the proposed financing, including but not limited to, the aggregate principle amount to be sold or borrowed, price information, estimated expenses, portion subject to the fee schedule and loan or indenture agreement concerning each issuance.
- h. That Applicant file with the Commission any information concerning use of the funds from the issuance(s) with regard to redemption of any outstanding debt, including Net Present Value calculations indicating the amount of interest cost savings.

Findings and Conclusion

The application and Staff's memorandum show that the proposed financial transactions for the issuance and sale of securities under the proposed terms are lawful and reasonable. Applicant's capital structure will be affected, but not in a manner that is adverse to the public interest. The Commission finds that the proposed financing program as described in the application is not detrimental to the public interest and should be approved.

The Commission finds that the purposes to which the proceeds will be applied include: the acquisition of property; the construction, completion, extension or improvement of Applicant's plant or system; the improvement or maintenance of Applicant's service; the discharge or lawful refunding of indebtedness outstanding at the time of closing; or the reimbursement of Applicant's treasury for certain costs previously incurred. The Commission further finds that the proposed financing is necessary to fulfill the above-named purposes. Finally, the Commission finds that the purposes to which the proceeds of the proposed financing are to be applied are not reasonably chargeable to operating expenses or income.

IT IS THEREFORE ORDERED:

1. That Missouri-American Water Company is authorized to act in accordance with the terms of the Financial Services Agreement with American Water Capital Corp., including the issuance and delivery to American Water Capital Corp. long-term unsecured notes as described in the application.

2. That Missouri-American Water Company is authorized to create, issue, sell, and deliver up to and including \$85,000,000 of aggregate principle amount in additional long-term bonded or unsecured indebtedness, in one or more series, as

described in the application over a period of three years from the effective date of this order.

3. That Missouri-American Water Company is authorized to issue and sell to its parent company, American Water Works, Inc., additional common stock for cash, or receive paid-in-capital, for an aggregate sale price not to exceed \$15,000,000 in one or more series, as described in the application over a period of three years from the effective date of this order.

4. That Missouri-American Water Company is authorized to create and make effective the lien of its Indenture of Mortgage on its property in the state of Missouri to secure each new series of general mortgage bonds issued in accordance with the terms of this order provided that the aggregate principle amount thereof does not exceed \$85,000,000, all as described in the application.

5. That Missouri-American Water Company is authorized to consummate the transactions contemplated in the application, subject to the conditions recommended by the Staff of the Commission and listed herein.

6. That this order shall become effective on September 9, 2002.

BY THE COMMISSION



Dale Hardy Roberts
Secretary/Chief Law Judge

(S E A L)

Kennard L. Jones, Regulatory Law Judge,
by delegation of authority pursuant to
Section 386.240, RSMo 2000.

Dated at Jefferson City, Missouri,
on this 30th day of August, 2002.