

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Missouri American Water)	
Company for Authority to Issue up to)	<u>File No. WF-2019-0206</u>
\$350,000,000 of Long-Term Unsecured Debt)	

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Recommendation*, states as follows:

1. On January 10, 2019, Missouri-American Water Company (“MAWC” or “Company”) filed an application with the Commission for authority to issue up to \$350,000,000 of long-term unsecured indebtedness (“Application”).

2. On January 11, 2019, the Commission ordered Staff to file a recommendation or a status report indicating the date on which the recommendation would be filed. On January 28, 2019, Staff indicated its intention to file the recommendation on March 6, 2019.

3. On February 19, 2019, Staff issued additional discovery and the Company indicated the response would be unavailable before Staff’s filing deadline; as such, Staff sought and the Commission granted an extension of time to March 20, 2019.

4. Staff has reviewed MAWC’s *Application* and has summarized its conclusions in a *Memorandum* that is attached to this *Recommendation*, labeled Appendix A, and incorporated by reference.

5. § 393.200.1 RSMo 2000, provides, among other things, that a regulated water or sewer company may issue evidences of indebtedness “when necessary for the acquisition of property, the construction, completion, extension or improvement of its plant or system, or for the improvement or maintenance of its service or for the discharge or

lawful refunding of its obligations or for the reimbursement of moneys actually expended from income, or from any other moneys in the treasury of the corporation not secured or obtained from the issue of stocks, bonds, notes or other evidence of indebtedness of such corporation...” This statute also states, in part, that the Commission may issue an Order approving indebtedness if the money sought is “reasonably required” for the purposes approved by the Commission in its Order.

6. The Application indicated that the financial authority sought was based upon objectives articulated in the statute summarized in paragraph 5 above. Staff concluded in its *Recommendation* that the proposed transaction was reasonable, subject to the imposition of certain conditions.

WHEREFORE, based upon the foregoing, Staff respectfully recommends that the Commission enter an Order approving the Application with the following conditions:

A. That nothing in the Commission’s order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, which includes, but is not limited to, the capital structure, and that the Commission reserves the right to consider the rate making treatment to be afforded the financing transaction and its impact on cost of capital, in any later proceeding;

B. That the Company shall file with the Commission, all final terms and conditions of the proposed financing, including, but not limited to, the aggregate proceeds received, price information, and estimated expenses;

C. That the Company shall file with the Commission any information regarding communication with credit rating agencies concerning the proposed financing; and

D. That the Company file with the Commission, upon refunding of any outstanding debt, the net present value calculations indicating the amount of interest cost savings.

Respectfully submitted,

/s/ Mark Johnson

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or electronically mailed to all parties and or counsel of record on this 20th day of March, 2019.

/s/ Mark Johnson

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WF-2019-0206, Missouri-American Water Company

FROM: Peter Chari, Regulatory Auditor, Financial Analysis Dept.

/s/ Peter Chari 03/20/2019
Financial Analysis

/s/ Mark Johnson 03/20/2019
Staff Counsel's Office

SUBJECT: Staff Recommendation concerning the Application of Missouri-American Water Company, ("Missouri-American," "Company," or "Applicant"), for the authority to issue up to \$350,000,000 of long-term unsecured debt.

DATE: March 20, 2019

1. **Type of Issue:** Unsecured Long-Term Debt
2. **Amount:** Up to \$350,000,000.
3. **Rate:** The interest rate for notes evidencing the unsecured long-term debt, including any applicable discounts, will bear interest at a rate consistent with similar securities of comparable credit quality and maturities issued by other companies.
4. **Other Provisions:** The maturities will not exceed fifty years at market interest rates.
5. **Proposed Date of Transaction:** The Company is requesting that the financing approval granted by the Commission remain in effect for three years, starting on the effective date of the order in this case.
6. **Statement of Purpose of the Issues:** Missouri-American intends to use the net proceeds from the unsecured long-term debt for the acquisition of property, the construction, completion, extension or improvements or additions to its facilities, other capital investments, all of which shall be necessary and proper for the rendition of public water supply and wastewater service, the improvement or maintenance of its service, the discharge or lawful refunding of indebtedness outstanding and to reimburse its treasury for any costs heretofore incurred. Some of the proceeds from the debt issuances will be used to replace short-term borrowings accrued during the period of time Missouri-American's financing plan is in effect.
7. **From a financial perspective, does Staff deem this Statement of Purpose of the Issue reasonable?** Yes, with conditions imposed.
8. **Type of Transaction:** Unless Missouri-American issues debt through Special Government Programs, the debt will be in the form of affiliate promissory notes payable to American Water Capital Corporation.

9. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:** Yes
10. **Pro-forma Balance Sheet and Income Statement reviewed:** Yes
11. **Capital expenditure schedule reviewed:** Yes
12. **Journal entries required to be filed by Missouri-American to allow for the fee schedule to be applied:** Promptly after the issuance and sale of each series of unsecured long-term debt, a report setting forth the amount, price information and other terms and provisions concerning long-term indebtedness incurred by Missouri-American and setting forth information concerning the use of the proceeds from any such issuance will be late filed as Appendix 6 to the Application. Each of Missouri-American's reports will include a statement identifying the portion of the issuance of long-term indebtedness, if any, that is subject to the fee schedule.
13. **Recommendation of the Staff:** Conditional Approval granted pending receipt of definite terms of issuance (see Comments and Recommended Conditions)

COMMENTS:

Missouri-American is a Missouri corporation with its principal office and place of business at 727 Craig Road, St. Louis, Missouri 63141. Missouri-American is a wholly-owned subsidiary of American Water Works Company, Inc. (AWW). Applicant is qualified to conduct business as a public utility in the State of Missouri subject to the jurisdiction of the Commission as provided by law. Applicant is engaged, generally, in the business of furnishing water service to approximately 466,000 accounts and wastewater service to approximately 13,000 accounts. These services are provided in approximately one hundred sixty (160) communities located in twenty-seven (27) counties in the State of Missouri.

Missouri-American has filed an Application requesting that the Commission authorize the Company to issue up to \$350,000,000 in aggregate principal amount of long-term affiliate promissory notes through American Water Capital Corporation (AWCC) or notes through Special Government Programs. AWCC is a wholly-owned financing subsidiary of AWW and an affiliate of the Applicant.

Issuance of Debt. The long-term borrowings will be evidenced by a Promissory Note, payable to AWCC, attached as Appendix 1 to the Company's Application. Although not a part of this Application, AWCC also manages Missouri-American's cash through a Financial Services Agreement (see Appendix 2, attached to Missouri-American's Application in Case No. WF-2002-1096).

The cost of the debt financing provided to Missouri-American under the proposed Promissory Notes would not be based on Missouri-American's stand-alone creditworthiness; rather, it would be based on the creditworthiness of AWW. This is the case because AWW pools the financing requirements of its water and wastewater utility subsidiaries and then issues an aggregate amount of debt to an investor(s). This results in AWW's subsidiaries being assigned the same debt cost as originally charged to AWW by the third-party lenders.

If AWW's subsidiaries were performing their own debt financing functions, then to the extent that these subsidiaries were viewed as separate creditors, this may result in cost differences. However, because it is the parent company, AWW, that supports the AWCC debt, the cost is based on the consolidated creditworthiness of AWW rather than that of the individual subsidiaries.

Issuance of Debt to Special Government Programs. Applicant states that they may have the opportunity to finance certain projects through special low cost government programs. The agreement with AWCC does not restrict or prohibit the Applicant from borrowing from these special government programs or other parties. See paragraph 16 on pages 5 and 6 for terms, conditions, and the various special low cost government programs.

Effect on Credit Quality. Normally, Staff would perform a detailed analysis of the Company's credit quality by analyzing the major financial ratios evaluated by credit rating agencies, but because Missouri-American does not have a credit rating and the cost of the debt it receives from AWCC is based on the credit quality of AWW, Staff does not believe this analysis is warranted. Because the proposed debt proceeds in this Application amount to less than 4.5 percent of American Water's total outstanding debt as of September 30, 2018, it is Staff's opinion that this transaction will have minimal to no impact on AWW's credit quality which drives the cost of the debt funds that Missouri-American receives from AWCC.

WIFIA Loans. The Application identifies Missouri-American's expected \$187 million of loan proceeds from the Water Infrastructure and Innovation Act (WIFIA). The Company plans to use \$84 million of the WIFIA proceeds for St. Louis area water main replacement and \$103 million for its planned Joplin water reservoir. However, because Missouri-American will not be the direct borrower of the funds from WIFIA, Missouri-American is not requesting Commission authority to execute the loan contracts with WIFIA in this Application. The Application indicates that WIFIA will have a contract with AWCC, and AWCC will then loan these funds to Missouri-American by evidence of promissory notes. While Missouri-American does not expect to access these loans during its requested term of financing authority in this case, its Application identifies the possibility of WIFIA proceeds being utilized. Should Missouri-American make any borrowings under the WIFIA program during the term of financing authority requested in this case, they will be part of the requested borrowing authority.

Estimate of Capital Needs. Staff analyzed Missouri-American's responses to Staff Data Request Nos. 0004 and 0008, as well as follow-up financial data provided in email communications, to evaluate whether Missouri-American's requested amount of \$350,000,000 is reasonably required over the period of requested authority. Staff did so by analyzing Missouri-American's projected

financial statements over the period of the requested authority. Based on Staff's analysis of Missouri-American's projected capital expenditures, net of funds it expects to receive from its operations after the payment of dividends to AWW, the requested amount of affiliate debt financing is reasonably required. However, Staff notes that while it estimated Missouri-American will need in excess of \$350,000,000 in total capital, whether equity or debt, Staff's acceptance of the requested debt authority recognizes Staff's past rate case capital structure recommendations that recognize leverage consistent with that of AWW.

OTHER ISSUES:

Staff also emphasizes that although it is recommending approval of this financing transaction, it is in no way recommending Missouri-American's capital structure as the appropriate capital structure for ratemaking purposes. Although this qualification is covered generally in Condition 1 below, it is important to emphasize this specific point.

Staff has verified that the Company has filed its annual report and is not delinquent on any assessment.

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve the Application submitted by Missouri-American in this case subject to the following conditions:

1. That nothing in the Commission's order shall be considered a finding by the Commission of the value of this transaction for rate making purposes, which includes, but is not limited to, the capital structure, and that the Commission reserves the right to consider the rate making treatment to be afforded the financing transaction and its impact on cost of capital, in any later proceeding;
2. That the Company shall file with the Commission, all final terms and conditions of the proposed financing, including, but not limited to, the aggregate proceeds received, price information, and estimated expenses;
3. That the Company shall file with the Commission any information concerning communication with credit rating agencies concerning the proposed financing; and,
4. That the Company file with the Commission, upon refunding of any outstanding debt, the net present value calculations indicating the amount of interest cost savings.

