

**STATE OF MISSOURI
PUBLIC SERVICE COMMISSION**

At a session of the Public Service
Commission held at its office in
Jefferson City on the 5th day of
April, 2007.

In the Matter of Missouri-American Water Company)
for Authority (1) to Issue up to \$200,000,000 of)
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 \$105,000,000)

Case No. WF-2007-0279

ORDER GRANTING FINANCING APPLICATION

Issue Date: April 5, 2007

Effective Date: April 15, 2007

On January 24, 2007, Missouri-American Water Company ("MAWC") filed an application seeking authority to issue notes in one or more series evidencing up to \$200,000,000 of long-term indebtedness payable to American Water Capital Corporation ("AWCC"). MAWC also proposes to issue and sell, from time to time, shares of common stock, no par value, to American Water Works Company, Inc. ("AWW"), or receive additional paid-in-capital, in an aggregate amount not to exceed \$105,000,000.¹

MAWC is engaged in the business of furnishing water and wastewater services in over one hundred municipalities within twelve counties throughout Missouri. MAWC is a wholly-owned subsidiary of AWW, and AWCC is AWW's wholly-owned financing subsidiary.

¹ MAWC seeks this approval pursuant to Section 393.190 and 393.200, RSMo 2000, and 4 CSR 240-2.060, 2.080 and 3.615.

MAWC intends to use the net proceeds from the unsecured new long-term debt and equity (from either paid-in capital or the actual sale of new shares to AWW) for the acquisition of property, the construction, completion, extension or improvements or additions to facilities, or other capital investments, all of which MAWC maintains will be necessary and proper for the provision of public water supply and wastewater service and the improvement or maintenance of its service. MAWC will also use the funds for the discharge or lawful refunding of outstanding indebtedness, and to reimburse its treasury for any costs incurred subsequent to five years prior to the date of filing of this Application. Some of the proceeds from the equity contribution and/or debt issuances will be used to replace maturing long-term debt at market rates and replace outstanding short-term borrowings.

On March 26, 2007, the Staff of the Missouri Public Service Commission filed its recommendation in this matter. Staff notes that while Section 393.200, RSMo 2000, mandates Commission approval for any water corporation or sewer corporation organized or existing or hereafter incorporated under or by virtue of the laws of this state to issue stocks, bonds, notes or other evidences of indebtedness, it is not clear that MAWC needs to request Commission authority to receive equity from its parent company because MAWC does not need to issue stock to its parent company in order to receive equity funds. Nevertheless, Staff recommends conditional approval of the financing application.

Staff states that the cost of the debt financing provided to MAWC under the proposed Promissory Note² would not be based on MAWC's stand-alone creditworthiness;

² This loan will be evidenced by a Promissory Note that MAWC filed in Case No. WF-2002-1096. Although not a part MO PSC Case No. WF-2007-0279 of this Application, AWCC also manages MAWC's cash through a Financial Services Agreement (see Appendix 2, attached to MAWC's Application in Case No. WF-2002-1096).

rather, it would be based on the creditworthiness of AWW.³ Staff did not perform a detailed analysis of the Company's credit quality by analyzing the major financial ratios evaluated by credit rating agencies, because MAWC does not have a credit rating and the cost of the debt it receives from AWCC is based on the credit quality of AWW. Consequently, Staff does not believe this type of analysis is warranted. However, Staff did review the Company's outstanding indentures to ensure that the Company can still avail itself of possible additional financing. Because the proposed debt proceeds in this Application amount to less than 5 percent of AWW's total outstanding debt as of December 31, 2005, Staff believes that this transaction will have minimal to no impact on AWW's credit quality, which drives the cost of the debt funds that MAWC receives from AWCC.

In paragraph 14, of its application, MAWC asserts that the new long-term debt issued, payable to AWCC, will be made for maturities not to exceed thirty-five years at market interest rates. Specifically, the interest cost of the debt instruments, including any applicable discounts, will not exceed 2.00 percentage points (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 or dates on which the terms and conditions of the indebtedness shall be determined.

To Staff's knowledge, MAWC must comply with three primary financial loan covenants. The first two are contained in either the original Indenture of Mortgage dated

³ This is 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) resulting in AWW's subsidiaries being assigned the same debt costs as if the debt proceeds they receive come from the same aggregate pool of funds. If AWW's subsidiaries are viewed as stand-alone subsidiaries for purposes of the cost of this debt, one would believe that differences in credit quality among the subsidiaries would result in cost differences, but because it is the parent company, AWW, that is providing the backing, *i.e.* a support agreement, for the ultimate payment of the aggregate debt issuance to the investor, the cost is based on the aggregate creditworthiness of AWW rather than that of the individual subsidiaries.

May 1, 1968, or one of its supplements. The first covenant requires MAWC's "long-term debt" to not exceed 65 percent of the Applicant's "total capitalization" before it can issue any additional General Mortgage Bonds. The second covenant requires MAWC's net income to equal at least one and one-half times the aggregate annual interest charges on all outstanding long-term debt immediately after such bonds are issued. MAWC will remain in compliance with these financial loan covenants.⁴

The other primary financial loan covenant is contained in an Indenture originally dated December 1, 1942, which was originally issued by St. Louis County Water Company, which merged into MAWC with MAWC surviving. This loan covenant only applies to the issuance of additional bonds under the 1942 Indenture. Because the issuance of additional First Mortgage Bonds under the St. Louis County Water Company Indenture is prohibited by the Applicant's Indenture of Mortgage dated May 1, 1968, except for transfers, exchanges or substitutions, Staff did not give this loan covenant any weight in its analysis.

Based upon its investigation, Staff recommends that the Commission approve MAWC's application subject to four conditions. Specifically, Staff recommends that the Commission impose 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 ratemaking 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 these financing transactions and their effect on cost of capital, in any later proceeding.
- 2) That MAWC file with the Commission any information concerning communication with credit rating agencies concerning the proposed financing.

⁴ Staff emphasizes that both of these covenants only restrict MAWC from issuing additional debt under the General Mortgage Bonds. They do not restrict MAWC from receiving debt from AWCC, which MAWC has stated in the past would be its primary source of long-term debt and short-term debt.

- 3) That MAWC 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.
- 4) That MAWC file with the Commission, upon refunding of any outstanding debt, the net present value calculations indicating the amount of interest cost savings.

On April 2, 2007, MAWC filed a response to Staff's recommendation. MAWC had no objection to conditions 1 and 3, and stated that these conditions were largely consistent with commitments already proposed in their application. With regard to condition 2, MAWC did express concern with filing confidential communications that it has with credit rating agencies on the Commission's EFIS system. However, it does not object to submitting that information directly to the Commission's Financial Analysis Department. Similarly, with condition 4, MAWC had no objection to submitting information concerning the refunding of any outstanding debt and the net present value calculations indicating the amount of interest cost savings to the Commission's Financial Analysis Department.

The only parties to this action besides MAWC are the Commission's Staff and the Office of Public Counsel. The Commission sees no reason preventing MAWC from utilizing Commission Rule 4 CSR 240-2.135 and submitting the information required in Staff's conditions to the Commission's EFIS system while designating that information as being highly confidential. This designation should alleviate any concerns that MAWC has with regard to the filing of this sensitive financial information.

The Commission has reviewed and considered MAWC's verified application and the Staff's verified memorandum and recommendation, which are hereby admitted into evidence. The Commission concludes it is not detrimental to the public interest for MAWC to issue notes of long-term indebtedness payable to AWCC, or to issue and sell shares of common stock to AWW, or to receive additional paid-in-capital, in the amounts delineated

in its application. Consequently, the Commission shall approve MAWC's application subject to the conditions requested by Staff. As required by Section 392.200, RSMo 2000, the Commission finds that the long-term indebtedness, issuance of stock to AWW or receipt of paid-in capital as proposed in MAWC's application is, or will be reasonably required, for the purposes specified in the application and that such purposes are not in whole, or in part, reasonably chargeable to operating expenses or to income.

IT IS ORDERED THAT:

1. Missouri-American Water Company's application seeking authority to issue notes in one or more series evidencing up to \$200,000,000 of long-term indebtedness payable to American Water Capital Corporation and to issue and sell, from time to time, shares of common stock, no par value, to American Water Works Company, Inc. ("AWW"), or receive additional paid-in-capital, in an aggregate amount not to exceed \$105,000,000, is approved.

2. The new long-term debt issued, payable to American Water Capital Corporation, shall be made for maturities not to exceed thirty-five years at market interest rates. Specifically, the interest cost of the debt instruments, including any applicable discounts, shall not exceed 2.00 percentage points (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 or dates on which the terms and conditions of the indebtedness shall be determined.

3. Missouri-American Water Company is authorized to enter into and execute all documents necessary for the above-described transactions.

4. Missouri-American Water Company shall submit to the Commission, utilizing the EFIS filing system as directed in the body of this order, any information concerning communication with credit rating agencies concerning the proposed financing.

5. Missouri-American Water Company shall submit to the Commission, utilizing the EFIS filing system as directed in the body of this order, all final terms and conditions of the proposed financing, including, but not limited to, the aggregate proceeds received, price information and estimated expenses.

6. Upon refunding of any outstanding debt, Missouri-American Water Company shall submit to the Commission, utilizing the EFIS filing system as directed in the body of this order, the net present value calculations indicating the amount of interest cost savings.

7. All subsequent filings concerning this matter shall be filed under Case No. WF-2007-0289.

8. Nothing in this order shall be considered a finding by the Commission of the value of this transaction for ratemaking 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 these financing transactions and their effect on cost of capital, in any later proceeding.

9. This order shall become effective on April 15, 2007.

(S E A L)

BY THE COMMISSION

A handwritten signature in black ink, appearing to read 'Colleen M. Dale', is written over a horizontal line.

Colleen M. Dale
Secretary

Davis, Chm., Murray, Gaw, Clayton and Appling, CC., concur

Stearley, Regulatory Law Judge