

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

In the Matter of Missouri American Water Company	)	
For Authority to Issue up to \$190,000,000 of	)	<b><u>File No. WF-2015-0207</u></b>
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 February 27, 2015, Missouri-American Water Company ("MAWC" or "Company") filed an application with the Commission for authority to issue up to \$190,000,000 of long-term unsecured indebtedness.

2. Staff filed two *Status Reports*, on May 14, 2015 and on June 2, 2015. On June 3, 2015, the Commission directed Staff to file a third status report or recommendation by June 25, 2015.

3. 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.

4. § 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.

5. The application indicated that the financial authority sought was based upon objectives articulated in the statute summarized in paragraph 4 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 concerning communication with credit rating agencies concerning the proposed financing;

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/ Marcella L Mueth**

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**CERTIFICATE OF SERVICE**

I hereby certify that true and correct copies of the foregoing were served electronically to all counsel of record this 25<sup>th</sup> day of June, 2015.

**/s/ Marcella L. Mueth**

## MEMORANDUM

TO: Missouri Public Service Commission Official Case File  
Case No. WF-2015-0207, Missouri-American Water Company

FROM: Shana Griffin, Financial Analysis

/s/ Shana Griffin 06/25/2015  
Project Coordinator / Date

/s/ Marcella Mueth 06/25/2015  
Staff Counsel's Office / Date

SUBJECT: Staff Recommendation concerning the Application of Missouri-American Water Company, ("Missouri-American," "Company," or "Applicant"), for the authority to issue up to \$190,000,000 of long-term unsecured debt.

DATE: June 25, 2015

1.
  - (a) **Type of Issue:** Unsecured Long-Term Debt
  - (b) **Amount:** Up to \$190,000,000.
  - (c) **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. The Applicant, with respect to the issuance of the unsecured long-term debt, requests authority to enter into agreements in order to use, at its discretion, derivative instruments such as interest rate swaps, treasury locks, forward-starting swaps, caps, collars or other derivatives to manage the risk associated with interest rate fluctuations and other financial exposures that may occur before the issuance of the unsecured long-term debt.
  - (d) **Other Provisions:** The maturities will not exceed fifty years at market interest rates.
2. **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.
3.
  - (a) **Statement of Purpose of the Issues:** Missouri-American intends to apply 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 maturing or other long-term debt at market rates and replace short-term borrowings accrued during the period of time Missouri-American's financing plan is in

effect. Without limiting the scope of the foregoing, Missouri-American proposes to refund certain of its outstanding secured indebtedness.

(b) **From a financial perspective, does Staff deem this Statement of Purpose of the Issue reasonable?:** Yes, with conditions imposed.

4. **Type of Transaction:** Missouri-American proposes to receive unsecured debt proceeds from American Water Capital Corporation.
5. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:** Yes
6. **Pro-forma Balance Sheet and Income Statement reviewed:** Yes
7. **Capital expenditure schedule reviewed:** Yes
8. **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.
9. **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 457,000 customers and wastewater service to approximately 4,750 customers. These services are provided in approximately one hundred sixty (160) communities located in twenty-four (24) counties in the State of Missouri.

Missouri-American has filed an Application requesting that the Commission authorize the Company to issue up to \$190,000,000 in aggregate principal amount of unsecured long-term debt through American Water Capital Corporation (AWCC). 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 Note 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 should result in AWW's subsidiaries being assigned the same debt cost as the debt charged to AWCC from the third-party purchaser of the AWCC debt issuances.

If AWW's subsidiaries were being 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.

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. However, Staff did review the Company's outstanding indentures to ensure that the Company can still avail itself of possible Environmental Improvement and Energy Resources Authority ("EIERA") financing. Because the proposed debt proceeds in this Application amount to less than 4 percent of American Water's total outstanding debt as of December 31, 2014, 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 Missouri-American receives from AWCC.

Financial Loan Covenants. To Staff's knowledge, Missouri-American must comply with two primary financial loan covenants. These covenants are contained in either the original Indenture of Mortgage dated May 1, 1968, (1968 Indenture) or one of its supplements. The first financial covenant in the 1968 Indenture requires Missouri-American's "long-term debt" to not exceed 65 percent of the Applicant's "total capitalization" before Missouri-American can issue any additional General Mortgage Bonds. According to page 5, of Appendix 4, attached to Missouri-American's Application, Missouri-American will be able to remain in compliance with this financial loan covenant.

The second financial covenant, in the Eighteenth Supplemental Indenture attached to the 1968 Indenture, requires net income (as calculated by the indenture's method) to "equal at least one and one-half times the aggregate annual interest charges on all Long-Term Debt outstanding immediately after such bonds are issued." According to the pro forma financial statements, the Company will also be in compliance with this financial covenant.

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

*Estimate of Capital Needs.* Staff analyzed Missouri-American's responses to Staff Data Request Nos. 0002 and 0002.1, as well as follow-up financial data provided in email communications to evaluate whether Missouri-American's requested amount of \$190,000,000 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 financing is reasonably required.

**OTHER ISSUES:**

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

The 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.

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

In the Matter of Missouri-American Water     )  
Company For Authority to Issue up to     )     Case No. WF-2015-0207  
\$190,000,000 of Long-Term Unsecured Debt   )

**AFFIDAVIT OF SHANA GRIFFIN**

STATE OF MISSOURI     )  
                                      )     ss.  
COUNTY OF COLE     )

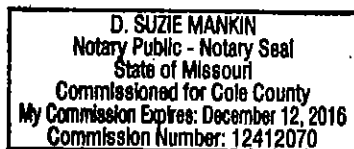
**COMES NOW** Shana Griffin and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing Staff Recommendation in Memorandum form; and that the same is true and correct according to her best knowledge and belief.

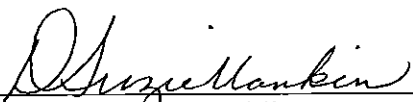
Further the Affiant sayeth not.

  
\_\_\_\_\_  
SHANA GRIFFIN

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 24<sup>th</sup> day of June, 2015.



  
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Notary Public