

**STATE OF MISSOURI
PUBLIC SERVICE COMMISSION**

At a session of the Public Service
Commission held at its office in
Jefferson City on the 2nd day of
March, 2011.

In the Matter of Missouri-American Water Company for)
Authority to Issue up to \$212,500,000 of Long-Term,) **File No. WF-2011-0173**
Unsecured Debt)

ORDER GRANTING FINANCING APPLICATION

Issue Date: March 2, 2011

Effective Date: March 12, 2011

On December 17, 2010, Missouri-American Water Company ("MAWC") filed an application seeking authority to issue notes in one or more series evidencing up to \$212,500,000 in aggregate principal amount of unsecured of long-term debt through American Water Capital Corporation ("AWCC").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 American Water Works Company, Inc. ("AWW"), and AWCC is AWW's wholly-owned financing subsidiary.

MAWC 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 waste water service, the improvement or maintenance of its service, the discharge or lawful refunding of indebtedness outstanding and to reimburse its treasury for any costs hereto 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

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

financing plan is in effect. Without limiting the scope of the foregoing, Missouri-American proposes to refund certain of its outstanding bonded indebtedness at favorable market rates.

On February 16, 2011, the Commission's Staff filed its recommendation in this matter. 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; 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 March 31, 2010, 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.

² This loan will be evidenced by a Promissory Note that MAWC filed in Case No. WF-2002-1096. Although not a part 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).

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.

In paragraph 15, of its application, MAWC asserts that the new long-term debt will be issued as promissory notes which will be determined based on market conditions applicable at the time. Such issuance will result in the lowest overall cost to MAWC for securities of comparable type, maturity and terms. The maturities will not exceed thirty years at market interest rates. The interest rate for notes evidencing the new long-term debt, including any applicable discounts, will not, without the consent of the Commission, exceed 3.00 percentage points (300 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 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

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.

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.
- 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 February 25, 2011, MAWC filed a response to Staff's recommendation. MAWC had no objection to Staff's conditions.

The Commission has reviewed and considered MAWC's verified application and the Staff's verified memorandum and recommendation. The Commission concludes it is not detrimental to the public interest for MAWC to issue notes of long-term indebtedness through AWCC in the amounts delineated in its application. Consequently, the Commission will 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, 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 \$212,500,000 of long-term indebtedness payable to American Water Capital Corporation, is approved.

2. The new long-term debt will be issued as promissory notes which will be determined based on market conditions applicable at the time. Such issuance will result in the lowest overall cost to MAWC for securities of comparable type, maturity and terms. The maturities will not exceed thirty years at market interest rates. The interest rate for notes evidencing the new long-term debt, including any applicable discounts, will not, without the consent of the Commission, exceed 3.00 percentage points (300 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 comply with Staff's recommended conditions as delineated in the body of this order.

5. 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

Missouri-American Water Company's capital structure. 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.

6. This order shall become effective on March 12, 2011.

BY THE COMMISSION

A handwritten signature in black ink, appearing to read 'S. C. Reed', is positioned above the printed name of the Secretary.

Steven C. Reed
Secretary

(S E A L)

Gunn, Chm., Clayton, Davis, Jarrett,
and Kenney, CC., concur.

Stearley, Senior Regulatory Law Judge