

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

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

**STAFF RECOMMENDATION**

**COMES NOW** the Staff of the Missouri Public Service Commission (“Staff”), by and through its attorney, and states, for its *Staff Recommendation*, to the Missouri Public Service Commission (“Commission”), as follows.

1. On December 17, 2010, Missouri American Water Company filed with the Commission an *Application for Authority to Issue up to \$212,500,000 of Long Term Debt* (“*Application*”).

2. On December 17, 2010, the Commission issued an *Order* which directed Staff to file a pleading by December 28, 2010 stating when it anticipates filing its recommendation in this matter.

3. On December 28, 2010, the Commission ordered Staff to file a recommendation regarding the *Application* by February 17, 2011.

4. Staff recommends that this *Application* be approved with conditions as defined in Appendix A attached and incorporated by reference herein, which is a Memorandum prepared by Zephania Marevangeo, Utility Regulatory Auditor, in the Commission’s Financial Analysis Department.

**WHEREFORE**, the Staff respectfully submits this *Staff Recommendation* to the Commission for its information and consideration, and recommends that the *Application* be approved with conditions as set out in Appendix A of this *Staff Recommendation*.

Respectfully submitted,

**/s/ Rachel M. Lewis**

Rachel M. Lewis

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### **Certificate of Service**

I hereby certify that copies of the foregoing have been mailed or hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record on this 16th day of February, 2011.

**/s/ Rachel M. Lewis**

MEMORANDUM

TO: Missouri Public Service Commission Official Case File  
Case No. WF-2011-0173, Missouri-American Water Company

FROM: Zephania Marevangeo, Financial Analysis Department

/s/ Zephania Marevangeo 02/16/11                      /s/ Rachel Lewis 02/16/11  
Financial Analysis Department                      Staff Counsel's Office

SUBJECT: Staff Recommendation to approve the Application of Missouri-American Water Company (Missouri-American) for the authority to issue up to \$212,500,000 of long-term unsecured debt.

DATE: February 16, 2011

**Missouri-American Water Company**

1. (a) **Type of Issue:** Unsecured Long-Term Debt.  
(b) **Amount:** Up to \$212,500,000.  
(c) **Rate:** The interest rate on the unsecured long-term debt will not exceed 300 basis points above the yield on U.S Treasury Bonds having similar terms of maturity.
2. **Proposed Date of Transaction:** As soon as the Commission so authorizes.
3. (a) **Statement of Purpose of the Transaction:** 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 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 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.  
  
(b) **From a financial perspective, does Staff deem this purpose reasonable?**  
Yes      X                        No
4. **Type of Transaction:** Missouri-American proposes to receive unsecured debt proceeds from American Water Capital Corporation.

**5. Copies of executed instruments defining terms of the proposed transaction:**

- ☒ (a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.
- ☐ (b) If such instruments have not been executed at the time of filing, a commitment to provide the terms and conditions of the instruments when they are available has been made.
- ☐ (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

**6. Certified copy of resolution of the directors of applicant, or other legal documents authorizing the proposed transaction reviewed:**

Yes ☒ No

**7. Capital expenditure schedule reviewed:**

Yes No ☒

**8. Recommendation of the Staff:**

- ☒ Grant by session order (see Comments)
- ☐ Conditional Approval granted pending receipt of definite terms of transaction (see Comments)
- ☐ Require additional and/or revised data before approval can be granted (see Comments)
- ☐ Formal hearing required (see Comments)
- ☐ Recommend dismissal (see Comments)

**COMMENTS:**

Missouri-American Water Company (Missouri-American, Applicant or Company) 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 and wastewater service to the public in over one hundred (100) municipalities within twelve (12) counties throughout the State of Missouri.

Missouri-American has filed an Application requesting that the Commission authorize the Company to issue up to \$212,500,000 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.

Acquisition Transactions. Missouri-American filed two acquisition applications near the date on which this Application was filed. However, in response to Staff Data Request No. 1, Missouri-American indicated that acquisition transactions will be financed by general funds of the company and/ or short-term debt, which could be refinanced at a future date.

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 results in AWW's subsidiaries being assigned the same debt costs if the debt proceeds they receive come from the same aggregate pool of funds.

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 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, 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 EIARA financing. Because the proposed debt proceeds in this Application amount to less than 5 percent of American Water'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 Missouri-American receives from AWCC.

Financial Loan Covenants. To Staff's knowledge, Missouri-American must comply with three primary financial loan covenants. The first two 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 6, 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 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.

The other primary financial loan covenant is contained in an Indenture originally dated December 1, 1942, this was originally issued by St. Louis County Water Company, which merged into Missouri-American with Missouri-American 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.

Other Analyses. Other than reviewing the above issues, Staff has not performed any quantitative analysis of the proposed transaction on Missouri-American’s financial statements, because it is the impact that the proposed financing would have on AWW’s consolidated operations that is most relevant to the cost of debt available to Missouri-American from AWCC.

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.

## **RECOMMENDED CONDITIONS:**

Staff recommends that this Application be approved with 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 ratemaking treatment to be afforded these financing transactions and their effect on cost of capital, in any later proceeding.
2. That the Company file with the Commission any information concerning communication with credit rating agencies concerning the proposed financing.
3. That the Company 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 the Company file with the Commission, upon refunding of any outstanding debt, the net present value calculations indicating the amount of interest cost savings.

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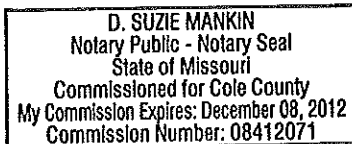
**AFFIDAVIT OF ZEPHANIA MAREVANGEPO**

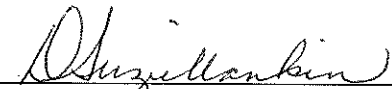
STATE OF MISSOURI     )  
                                  )  
COUNTY OF COLE     )     ss.

Zephania Marevangepo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.

  
\_\_\_\_\_  
ZEPHANIA MAREVANGEPO

Subscribed and sworn to before me this 16<sup>th</sup> day of February, 2011.



  
\_\_\_\_\_  
Notary Public