



**Public Utilities  
Commission**

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October 1, 2020

Docketing Division  
Public Utilities Commission of Ohio  
180 East Broad Street  
Columbus, OH 43215

RE: *In the Matter of the Application of Aqua Ohio, Inc. for Approval of a Financial Arrangement with Essential Utilities, Inc. for \$75,000,000 in Senior Unsecured Debt, Case No. 20-1291-WW-AIS*

Dear Docketing Division:

Enclosed please find Staff's Review and Recommendation in regard to the application of Aqua Ohio, Inc. for authority to issue long-term debt, Case No. 20-1291-WW-AIS.

A handwritten signature in black ink, appearing to read "DL", written over a horizontal line.

David Liphtratt  
Chief, Accounting and Finance Division  
Rates and Analysis Department  
Public Utilities Commission of Ohio

Enclosure

Cc: Parties of Record

BEFORE  
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Aqua	)	
Ohio, Inc. for Approval of a Financial	)	Case No. 20-1291-WW-AIS
Arrangement with Essential Utilities, Inc. for	)	
\$75,000,000 in Senior Unsecured Debt	)	

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**Staff Review and Recommendation**

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**APPLICATION DESCRIPTION**

On July 21, 2020, Aqua Ohio, Inc. ("Aqua Ohio") filed an application with exhibits ("Application"), pursuant to Ohio Revised Code ("R.C.") sections 4905.40 and 4905.41, requesting Public Utilities Commission of Ohio ("Commission") authorization to enter into a financial arrangement that will consist of two promissory notes (the "Notes"), one in the amount of \$34,954,666 and one in the amount of \$43,693,334, each payable to its parent company, Essential Utilities, Inc. ("Essential"). The principal amounts of the Notes include an aggregate amount of \$3,648,000 of existing debt that was previously issued by Aqua Ohio to its parent company on November 30, 2019.

The proceeds from the issuance of the Notes will be used by Aqua Ohio to rebalance its capitalization structure. The Notes will be issued in the following way: (a) one in the principal amount of \$34,954,666 with an annual interest rate of 3.566 percent and will be issued for a term that matures on May 1, 2029; and (b) one in the principal amount of \$43,693,334 with an annual interest rate of 4.276 percent and will be issued for a term that matures on May 1, 2049.

**REVIEW AND ANALYSIS**

On November 6, 2019, Aqua Ohio was authorized to enter into a financial arrangement consisting of issuing two promissory notes in the form of senior unsecured debt (the "2019 Notes") in an aggregate principal amount of \$3,648,000 payable to Aqua America, Inc. ("Aqua America"), which was the parent company of Aqua Ohio at that time.<sup>1</sup> The 2019 Notes consisted of one note with an aggregate principal amount of \$1,621,334 at an interest rate of 3.556 percent that will mature on May 1, 2029, and a second note for an aggregate principal amount of \$2,026,666 at an interest rate of 4.276 percent that will mature on May 1, 2049.

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<sup>1</sup> See *In the Matter of the Application of Aqua Ohio, Inc. and Aqua Ohio Wastewater, Inc. for Approval of a Financial Arrangement with Aqua America, Inc. for \$8,000,000 in Senior Unsecured Debt*, Case No. 19-1496-WS-AIS, Finding and Order (November 6, 2019)(2019 AIS Case).

The interest rate and maturity of the 2019 Notes are reflective of Aqua America's debt issuance as reported in its Form 8-K filing on April 26, 2019, with the Securities and Exchange Commission ("SEC"). On April 26, 2019, Aqua America closed on an issuance of an aggregate principal amount of \$900 million of long-term debt of which \$400 million was issued at 3.566 percent with 10-year maturity and \$500 million was issued at 4.276 percent with 30-year maturity ("2019 Issuance"). Through its Application, Aqua Ohio is requesting to adjust its capitalization by issuing the Notes under the same terms and pricing parameters of the 2019 Notes.

The following table summarizes Aqua Ohio's current capitalization structure and the projected capitalization reflecting the proposed issuance of \$75,000,000.

	<b>As of 06/30/2020</b>	<b>(%)</b>	<b>Pro-forma* as of 12/31/2020</b>	<b>(%)</b>
Long Term Debt	\$117,453,614	38.1%	\$190,453,614	48.4%
Common Equity	\$190,910,570	61.9%	\$203,165,369	51.6%
Total Capitalization	\$308,364,184	100.0%	\$393,618,983	100.0%

*\* Pro-forma totals reflect the issuance of \$75 million of new debt through the Notes, less debt amortizations of \$2 million on existing debt plus anticipated equity accumulation of approximately \$12 million.*

As shown in the table above, the impacts of issuing the proposed Notes on Aqua Ohio's capitalization results in the maintenance of a balanced capital structure that is similar to its most recent base rate case.<sup>2</sup>

For reasons of economic advantages, Essential supports its utility operating companies through the provision of both short-term and long-term financing. Essential initially pays for capital improvements on its revolving credit facility. Support for such capital improvements are tracked through an intercompany payable account with each operating company. Essential converts the debt to permanent long-term debt when the credit facility is getting close to its capacity. Functioning this way enables Essential to pool the debt requirements of its subsidiaries and market more attractive debt issuances to investors. Once issued, debt is then allocated from time to time to the subsidiary operating companies through an intercompany note(s) matching the pricing and terms of the Essential issuance based upon the need and availability of unallocated debt.

Staff acknowledges that the pooling of capital requirements of operating companies by a parent company is widely used in the utility industry to maximize pricing efficiencies and provides economic benefits to the utility companies and the customers those utilities serve. Staff believes

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<sup>2</sup> See *In the Matter of the Application of Aqua Ohio, Inc., to Increase its Rates and Charges for Its Waterworks Service*, Case No. 16-0907-WW-AIR, Application (Section 1) at 179 (May 31, 2016).

that Aqua Ohio benefits from issuing debt through Essential, as demonstrated by Staff's recommendation regarding the 2019 Notes.<sup>3</sup>

During Staff's review of the Application, Staff was made aware of a more recent debt issuance by Essential. On April 13, 2020, Essential priced a debt offering in two tranches: (a) \$500 million 2.704 percent senior notes due in 2030; and (b) \$600 million 3.351 percent senior notes due in 2050 ("2020 Issuance"). Essential filed an 8-K with the SEC notifying that it had closed on the 2020 Issuance on April 15, 2020. As evidenced by the 2020 Issuance, debt markets have been pricing interest rate coupons more favorably in recent months when compared to April 2019. When asked by Staff why Aqua Ohio is seeking authorization to issue debt at the rates tied to the 2019 Notes, Aqua Ohio responded by explaining that Essential generally follows a "first-in-first-out" inventory approach in determining what debt gets allocated to its subsidiaries. Aqua Ohio has indicated that the 2019 Issuance has not yet been fully allocated to Essential's subsidiaries, which is why it has requested authorization to use the pricing and maturity parameters of the 2019 Notes.

Aqua Ohio's request to adjust its indebtedness and capitalization is explicitly provided for in R.C. 4905.40(A)(2), and Staff believes the requested principal amount of \$75 million is not unreasonable. However, Staff generally recommends that issuances of stocks, bonds, and other evidences of indebtedness be on the best terms obtainable based upon market conditions at time of issuance. Since the time of Essential's 2019 Issuance, debt capital markets have experienced a material change. Staff does not consider the interest rates associated with the 2019 Issuance to be a reflection of current market rates, and as such, Staff avers they do not represent just and reasonable interest rates given current market conditions. Therefore, Staff does not consider it appropriate to recommend the Application as it has been submitted.

## **RECOMMENDATION**

Upon review of the Application, Staff considers it to be unreasonable to recommend that Aqua Ohio be authorized to issue the Notes at interest rates proposed in the Application. As such, Staff does not recommend that the Commission approve the Application.

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<sup>3</sup> 2019 AIS Case, Staff's Review and Recommendations (Oct. 23, 2019).

**This foregoing document was electronically filed with the Public Utilities**

**Commission of Ohio Docketing Information System on**

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**in**

**Case No(s). 20-1291-WW-AIS**

Summary: Staff Review and Recommendation in regard to the application of Aqua Ohio, Inc. for authority to issue long-term debt electronically filed by Zee Molter on behalf of PUCO Staff