

**COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION**

**Joint Petition of Kentucky-)
American Water Company,)
Thames Water Aqua Holdings, GmbH,)
RWE Aktiengesellschaft, Thames Water)
Aqua US Holdings, Inc., Apollo Acquisition) Case No. 2002-00317
Company and American Water Works Company,)
Inc. for Approval of a Change in Control of)
Kentucky-American Water Company)**

TESTIMONY OF STEPHEN SMITH

Q1. PLEASE STATE YOUR NAME AND BUSINESS TITLE.

A. My name is Stephen Smith, and I am currently employed as Director of Tax and Accounting for Thames Water, Plc ("Thames").

Q2. PLEASE DESCRIBE YOUR EDUCATION AND EMPLOYMENT HISTORY.

A. My education and employment history are set forth on the attached curriculum vitae.

Q3. PLEASE DESCRIBE YOUR CURRENT EMPLOYMENT RESPONSIBILITIES.

A. As Director of Tax and Accounting for Thames, I am currently responsible for tax strategy and structure and the provision of accounting services within the Water Division of RWE.

These responsibilities are set out in more detail on the attached curriculum vitae.

Q4. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to provide information relating to the specific intermediate holding company which Thames Water Aqua Holdings GmbH has established for use in the post-transaction corporate structure. The intermediate holding company formed in Delaware is named Thames Water Aqua US Holdings, Inc. ("TWUS"). TWUS business address, is 1101 Laurel Oak Rd., Suite 120 Voorhees, NJ 08043.

Q5. PLEASE DESCRIBE THE CORPORATE STRUCTURE FOR THE ACQUISITION OF AMERICAN, PARTICULARLY AS IT RELATES TO USE OF THE INTERMEDIATE HOLDING COMPANY.

A. The proposed corporate structure is shown on Exhibit I.

Q6. WHAT IS THE REASON FOR ESTABLISHING AN INTERMEDIATE HOLDING COMPANY AND WHY WASN'T SPECIFIC INFORMATION REGARDING THE INTERMEDIATE COMPANY PREVIOUSLY PROVIDED?

A. TWUS was established on June 26, 2002, to make it possible to file a consolidated U.S. tax return. TWUS was not specifically identified earlier because German law in effect at the time the transaction was entered into imposed a tax at each level within the corporate structure, making a relatively flat corporate structure desirable. That law changed in December of 2001, making it financially desirable to add TWUS to the corporate structure so that a U.S. consolidated tax return can be filed. TWUS was formed in June, rather than nearer the time of closing, as would be the normal course in a merger, to allow as full and complete disclosure of the transaction early in the process and to make clear for all interested parties that the use of TWUS would impact only corporate housekeeping issues, but would have no effect on the Commission's ability to regulate Kentucky-American or on its ratepayers. As more fully described below, other than allowing for the inclusion of Kentucky-American in the filing of a consolidated tax return, TWUS will have no impact on Kentucky-American.

Q7. WILL THE ADDITION OF TWUS TO THE CORPORATE STRUCTURE AFFECT KENTUCKY-AMERICAN'S ABILITY TO ATTRACT CAPITAL?

A. No. As a subsidiary of RWE, the financial strength of TWUS will come from its ultimate corporate parent, RWE. RWE is the ultimate source of capital for its subsidiaries and should be the entity considered in evaluating the transaction's financial effect on Kentucky-American as the Commission did in Case No. 2002-00018.

Q8. FROM AN OVERALL MANAGEMENT PERSPECTIVE, WOULD ANY CHANGE RESULT FROM THE CREATION OF TWUS?

A. No. Thames Water Plc ("Thames") operates, through its officers and employees, all of the water businesses of Thames Water Aqua Holdings GmbH. Thames will be responsible for the management of TWUS. I would further note that establishment of the intermediate holding company would not affect the post-transaction operation or management of Kentucky-American in any way, as the intermediate holding company's board of directors will be identical to American's post-acquisition board of directors.

Q9. WOULD FILING OF A CONSOLIDATED TAX RETURN ADVERSELY

AFFECT KENTUCKY-AMERICAN AND ITS CUSTOMERS?

A. No. As is the case from an overall management perspective, there would be no change at all from the present situation. This is because American has historically filed a consolidated tax return, as TWUS proposes to do, while Kentucky-American's income tax calculation for ratemaking purposes has historically been computed on a "stand alone" basis.

Q10. WILL KENTUCKY-AMERICAN HAVE ANY COMMERCIAL TRANSACTIONS WITH TWUS OR OTHERWISE TRANSFER FUNDS DIRECTLY TO TWUS?

A. No. Kentucky-American will have no commercial transactions with TWUS. Its income tax payments will be sent to its corporate parent, American, as they have been in the past. Any transaction or transfer of funds to cover tax liabilities would be between American and TWUS. Kentucky-American will continue to make its stand-alone tax payments to American, as it has done for many years.

Q11. WOULD ESTABLISHMENT OF THE INTERMEDIATE COMPANY ADVERSELY AFFECT KENTUCKY-AMERICAN OR ITS CUSTOMERS IN ANY WAY?

A. No. No costs will be passed down to regulated entities by or as a result of formation of the intermediate holding company, and the proposed corporate structure would have absolutely no adverse impact on Kentucky-American's ability to provide adequate, reliable, efficient and least cost service, nor any impact on Kentucky-American's ability to attract capital or maintain a reasonable capital structure. RWE would continue to provide the organization's underlying financial strength, while Thames and American would continue to provide the water expertise.

Q12. IN YOUR OPINION, WOULD INCLUSION OF TWUS IN THE CORPORATE STRUCTURE BE TRANSPARENT TO THE KENTUCKY PUBLIC SERVICE COMMISSION AND KENTUCKY-AMERICAN'S CUSTOMERS?

A. Yes. Inclusion of TWUS as part of the corporate structure would not change anything that could impact either the Commission's ability to regulate Kentucky-American or that could in any way adversely impact rates or service for Kentucky-American's ratepayers. More specifically, I cannot conceive of any way in which use of the proposed intermediate holding company could have any impact whatsoever on the Commission's order in Case 2002-00018, which found the transaction between Thames Holdings and Kentucky-American to be in the public interest. This is because, as I have previously explained, TWUS, which will also own other existing Thames Holdings' U.S. subsidiaries, would be included in the corporate structure only to make it possible to file

a consolidated U.S. tax return for all of Thames Holdings' U.S. businesses. It would serve no other purpose with respect to Kentucky-American.

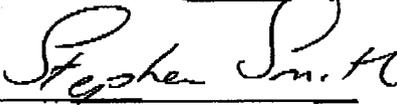
Q13. DOES THIS CONCLUDE YOUR TESTIMONY?

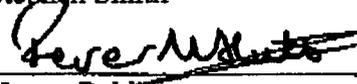
A. Yes.

VERIFICATION

Stephen Smith, after being sworn, states that the information contained in his testimony is true and correct to the best of his knowledge and belief.

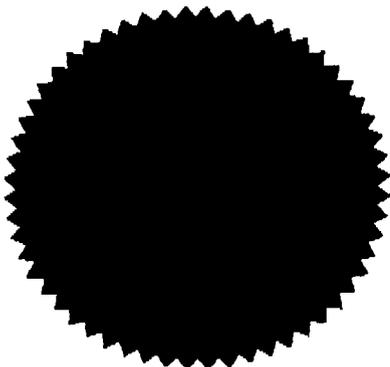
Sworn and acknowledged before me by Stephen Smith this the 18 day of September, 2002.



Stephen Smith


Notary Public

My commission expires: endless for life



PETER M. HUTT
NOTARY PUBLIC
FIELD SEYMOUR PARKES
1 LONDON STREET
READING, BERKS.

CIRRICULUM VITAE

NAME STEPHEN SMITH

DATE OF BIRTH 16 October 1958

STATUS Married

NATIONALITY British

EDUCATION Bristol Grammar School (1977)

9 O'Levels

3 A'Levels: Chemistry B

Physics B

Mathematics B

2 S'Levels: Chemistry 1

Mathematics 2

Birmingham University (1980)

B Comm (Accounting), 2:i

PROFESSIONAL ACA (1983)

QUALIFICATIONS ATII (1984)

All examinations passed at first attempt

CAREER HISTORY

Jan 93 to date **THAMES WATER PLC**

Thames Water Plc was acquired by RWE AG, a German multi utility company, in November 2000 and thus ceased to be a UK quoted company.

Director of Tax and Accounting effective August 1, 2002.

Water Division Accounting Services including:

Strategic finance issues

Corporate structure

Financial reporting programme management

Statutory accounting compliance

Accounting for corporate centre companies

Taxation strategy and structure for the water division as outlined in the tax manager role below

Corporate Finance and Tax Director

Appointed in February 2001 to a new role within Thames Water (TW). Reporting to the TW Group Finance Director and working closely with the TW Divisional Board.

Responsibilities include:

- Supporting the development and implementation of the division's business strategy.
- Advising on the financial and commercial implications of major projects and opportunities.
- Ensuring consistent and appropriate financial evaluation policies and procedures are used across the division.
- Representing the Group Finance Director in the Commercial Development and Contract Performance Review processes.

- Liaison with RWE corporate staff and external advisors.
- All the responsibilities previously undertaken in the tax manager role outlined below.

Tax and accounting manager, reporting to Group Finance Director

The tax department now consists of 6 professional staff and a secretary. Certain technical accounting responsibilities were acquired from January 1999.

Responsible for the tax affairs of the water division including:

- Corporate tax compliance.
- Tax implications and structuring of major contracts, acquisitions and disposals.
- Tax accounting for the group including statutory accounts, budgets, forecasts and business planning.
- Technical support to the personnel and payroll departments re PAYE issues including P11D dispensations and the management of a PAYE audit.
- UK VAT matters.
- Liaison with local management of overseas entities and external tax advisors in respect of overseas compliance and planning.

Specific activities include:

- Leading the financial due diligence of the RWE proposed \$7.6b acquisition of American Water Works. The transaction is subject to regulatory approval.
- Tax and financial review of the acquisition of a water concession contract in Chile for \$171m by TW.
- Due diligence work in connection with the RWE acquisition of TW.
- Restructuring of the TW group to minimise the exposure to German CFC legislation.
- ACT planning around surplus ACT of £159m.
- Tax structuring for \$1bn US acquisition.
- Tax implications and structuring of contracts for water and waste water infrastructure projects and long term concession contracts around the world and for PFI contracts in the UK.
- Chairman of a working party of the Water UK practitioners group set up to negotiate with the West Midlands LBO of the Inland Revenue on two major issues affecting the water industry.
- Appeal to the Special Commissioners.
- Creation of capital allowance data base covering expenditure of £350m p.a.
- Tailoring tax software to meet the specific accounting and Inland Revenue reporting needs of the group.
- Liaison with treasury manager regarding tax based treasury products.
- Dealing with the Inspector of Foreign Dividends and International Division to obtain clearance to pay interest to overseas companies without withholding tax.
- Obtaining Treasury Consent as required for investments overseas.
- Tax issues and negotiations in respect of share buy backs.
- Negotiations with International division regarding the Thames Water captive

insurance company.

In addition to the tax responsibilities set out above other responsibilities from January 1999 include:

- Technical accounting issues, new standards etc.
- Accounting implications of new projects, acquisitions and disposals.
- Other one off accounting issues.
- Member of the TW foreign exchange committee.

Jun 87 - Dec 92 **ARTHUR ANDERSEN, Bristol**

Tax Manager

The final 6 months were spent on secondment to Thames Water Plc.

Responsibility for the day to day tax affairs of nominated clients. A significant part

of the work load related to 'one off' consultancy projects.

Jul 86 - May 87 **MERVYN ANDREWS & CO, Bristol**

Tax Manager

Sole responsibility for the tax department of a small local firm with several good quality clients.

Oct 83 - Jun 86 **ARTHUR ANDERSEN, Birmingham**

Tax Manager

Joined Arthur Andersen's tax division immediately after qualifying. Promoted to Manager in January 1986.

Oct 80 - Sep 83 **PEAT MARWICK MITCHELL & CO, Birmingham**

Qualified as a Chartered Accountant, mainly working on audit assignments with some experience of insolvency work.

Proposed Corporate Structure

