

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

53. The following questions relate to the impending accounting move from U.S. GAAP to International Financial Reporting Standards ("IFRS").
- a. Please provide a narrative explanation of the anticipated impact of moving from U.S. GAAP to IFRS.
 - b. When does the Company expect to adopt IFRS?
 - c. Please provide all analyses, quantifications, reports, studies, etc. that the Company has conducted regarding the adoption of IFRS.
 - d. Please provide a specific discussion of how the change to IFRS will impact the Company's accounting calculations and entries relating to SFAS No. 143, FIN No. 47 and the existing regulatory liability for cost of removal, SFAS No. 71 and the difference between financial and regulatory accounting.
 - e. Please provide a specific discussion of how the change to IFRS will impact the Company's accounting calculations and entries relating to depreciation, accumulated depreciation, gross salvage and cost of removal. Include a discussion of any difference between financial and regulatory reporting relating to these items.
 - f. Please provide a specific discussion of how the change to IFRS will impact the Company's accounting calculations and entries relating to current income taxes, deferred income tax expense and accumulated deferred taxes. Include a discussion of any difference between financial and regulatory reporting relating to these items.
 - g. Identify all items and accounts currently classified as contra-accounts, deferred debits and credits, liabilities and assets which will or may flow to equity upon the replacement of GAAP with IFRS.

Response:

- a. At this time, the Company can not anticipate what that impact will be if the Company is required to move from U.S. GAAP to IFRS.

- b. On November 14th, 2008 the SEC published a Roadmap to IFRS adoption. The key provisions of the proposed Roadmap are fundamentally consistent with those included in the August 27th SEC announcement. The Roadmap includes several milestones leading to the SEC making a final decision in 2011 regarding mandatory IFRS reporting for US issuers. The Roadmap contemplates a phased transition to IFRS. The Company does not anticipate early adoption of IFRS. Current guidance suggests that the earliest the Company would be required to adopt IFRS is 2014. The Company anticipates adopting IFRS when it is required to do so by the Securities and Exchange Commission and/or Financial Accounting Standards Board.
- c. The Company has not performed any analyses, quantifications, studies, etc. regarding the adoption of IFRS.
- d. The Company has not analyzed how the change to IFRS will impact the Company's U.S. GAAP accounting calculations and entries relating to SFAS No. 143, FIN No. 47 and the existing regulatory liability for cost of removal, SFAS No. 71 and the difference between financial and regulatory accounting.
- e. The Company has not analyzed how the change to IFRS will impact the Company's U.S. GAAP accounting calculations and entries relating to depreciation, accumulated depreciation, gross salvage and cost of removal, or if it would have any impact at all on the regulatory accounting practices historically used by the Commission.
- f. The Company has not analyzed how the change to IFRS will impact the Company's U.S. GAAP accounting calculations and entries relating to current income taxes, deferred income tax expense and accumulated deferred taxes, or if it would have any impact at all on the regulatory accounting practices historically used by the Commission.
- g. The Company has not determined which contra-accounts, deferred debits and credits, liabilities and assets will or may flow to equity if the transition to IFRS is required.

For the electronic version, refer to KAW_R_AGDR3#53_020909.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller/John J. Spanos

54. Please refer to the response to AG 1-146. According to the response, the life and net salvage parameters shown in Exhibit 37B are from the depreciation study submitted in Case No. 2007-00143. However, the depreciation rates adopted in that case were not those proposed in that study – they were settled rates and differ from the rates proposed by the Company. The Settlement agreement shows only the rates – it does not show any parameters. Please provide the calculation of the Settlement rates showing how the parameters shown in Exhibit 37B factor into the rates. Show the plant and reserve balances, the ASL and curve, net salvage factor and remaining life that were used to calculate the Settlement rates. Please provide this calculation in Excel with all formulae intact.

Response:

Please refer to the Excel file named KAW_R_AGDR2#54_020909.xls filed contemporaneously with this response.

For the electronic version of this document, refer to KAW_R_AGDR2#54_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Sheila A. Miller/John Spanos

55. Please refer to the response to AG 1-162. The response and attachment appear to relate to Case No. 2007-00143 instead of the current case. Please provide the amount of net salvage incorporated into KAWC's depreciation expense claim in this case.

Response:

The net salvage incorporated into KAWC's depreciation expense is detailed in the working papers provided in response to PSCDR1#1 and labeled as KAW_R_PSCDR1#1a_WP1-3_111408 pages 1 through 5 of 9.

For the electronic version of this document, refer to KAW_R_AGDR2#55_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Michael A. Miller

56. Please refer to the response to AG 1-169. Please provide KAWC's depreciation rates calculated in the same manner as the depreciation rates recently adopted for Tennessee American Water and New Jersey American Water.

Response:

The Company objects to this question on the grounds that the requested information is not relevant to this case, is not readily available to the Company, and it would be extremely burdensome to produce such data, especially when the request calls for a calculation that the Commission has not recognized. The Company calculated its depreciation expense in this case consistent with the depreciation rates established in the settlement agreement between the Company and the AG in case number 2007-00143. The settlement agreement was subsequently approved by the Commission.

For the electronic version, refer to KAW_R_AGDR2#56_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Michael A. Miller

57. Please refer to the response to AG 1-186, Attachment page 1 of 99.

- a. Is this attachment a “management audit performed in compliance with Sarbanes-Oxley requirement” of AWWSC conducted by Booz Allen Hamilton? If not, please explain this document.

Response:

- a. The document is a management audit performed by Booz Allen Hamilton regarding AWWSC costs as directed by the TRA.

For the electronic version, refer to KAW_R_AGDR2#57_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Michael A. Miller

58. Please refer to the response to AG 1-188. Please limit the question and response to AWWSC, and explain and provide documentation of any actions initiated by the Company in response to the proposed findings.

Response:

Neither the Company nor AWWSC have responded or taken actions regarding the information provided in AGDR1#188. TAWC continues to address the management audit and associated areas of the TRA order on this subject, but to date, has not filed any documents or taken other actions addressed in the order in case number 2008-00039. PAWC has filed documents concerning the “management and operations audit” in Docket No. D-2008-2063484 which can be found on the Pennsylvania PUC website (www.puc.state.pa.us).

For the electronic version, refer to KAW_R_AGDR2#58_020909.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

59. Refer the response to AG 1-189.
- a. Please explain how to interpret the results shown in the attachments to that response.
 - b. Please describe any internal changes made as a result of the findings in the attachments to the response.

Response:

- a. The document referenced above was provided under confidential protection order. Without breaking the confidentiality of that response the Company provides the following response. The document assesses AWW's overall performance on a number of transactional performance indicators in relation to a substantial sample of other Companies' performance in those transactional areas. The document reviews AWW's overall performance to the sample group's top 25% quartile results and to the average of the sample group on each of the areas reviewed. A review of the document would indicate how AWW's overall performance in those transactional areas compared to the sample group of company's performance.
- b. The results of this review were a part of the basis on which AWW decided to move to the Shared Services Center organization in order to take advantage of economies of scale, efficiency gains, cost savings and other improvements in the manner in which AWW and its subsidiaries performed those transactional functions.

For the electronic version, refer to KAW_R_AGDR2#59_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Michael A. Miller

60. Please refer to the response to AG 1-191. Please provide a copy of the TRA verbal order mentioned in the response.

Response:

The requested information can be found at www.state.tn.us/tra.

For the electronic version, refer to KAW_R_AGDR2#60_020909.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

61. A reference is made to “Sarbanes-Oxley” at page 42 of American Water Works Company, Inc.'s Form 10-Q for the Period Ending 09/30/08 filed with the U.S. Securities and Exchange Commission. The 10-Q reference enumerates several material weaknesses in the Company’s control over financial reporting. Did these weaknesses extend to regulatory reporting? If not, why not.

Response:

The reference to “Sarbanes-Oxley” in the Form 10-Q for the period ending September 30, 2008 is specifically limited to Section 404 of the Act. Section 404 generally requires the maintenance of a system of internal control over financial reporting that provides reasonable assurance regarding the reliability of the financial statements. As such, the material weaknesses that were identified in 2006 pertain specifically to the financial statements of the Company.

It should also be noted that, historically, the year end consolidated financial statements of American Water Works Company, Inc. and Subsidiary Companies (formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies) and the separate company financial statements of KAWC have been audited and received an unqualified audit opinion from PricewaterhouseCoopers, LLP (PWC), an independent public accounting firm that is registered with the Public Company Accounting Oversight Board. As such, while it is possible for the material weaknesses to extend to the financial statements included in the regulatory reports, in the opinion of PWC, the amounts that have been included in the financial statements have been fairly stated in all material respects. Therefore, the material weaknesses did not impact the reliability of the financial statements. We have no reason to believe that we will not receive an unqualified opinion from PWC relating to the audit of the 2008 financial statements.

By definition, each of these material weaknesses could, individually or on an aggregated basis, materially affect the reliability of the financial statements. The Company has taken numerous steps to remediate the material weaknesses over the last two years. While we believe that the remediation of the control procedures that contain material weaknesses is complete, the testing procedures relating to the effectiveness of the control procedures have not yet been fully completed. We expect to complete the testing procedures during the first quarter of 2009. Therefore, at this time, we can make no assurances as to the success of the remediation efforts. However, the Company has no reason to believe that

the control procedures that have been implemented will not fully remediate the material weaknesses.

For the electronic version, refer to KAW_R_AGDR2#61_020909.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

62. By answering yes or no to the following questions with an explanation if the answer is yes, did these internal control weaknesses include:
- a. inadequate internal staffing and skills;
 - b. inadequate internal controls over internal financial reporting processes;
 - c. month-end closing processes, including account reconciliations;
 - d. maintenance of contracts and agreements;
 - e. segregation of duties and restriction of access to key accounting applications;
 - f. and tax accounting and accruals?

Response:

See response to AGDR2#61. The form 10-Q filed with the SEC for the period ending 9/30/08 identified the material weaknesses referenced in the question above. In addition to the explanation of the absence of any material impact from those control weaknesses present in 2006 on the audited financial statements of AWW and KAWC discussed in the response to AGDR2#61, the remediation efforts of AWW and its subsidiaries to address those control weaknesses identified are fully addressed on pages 42-43 of the referenced 10-Q of AWW.

For the electronic version, refer to KAW_R_AGDR2#62_020909.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

63. Did these internal control weaknesses extend to all aspects of the corporation including AWWSC? If not, why not?

Response:

The financial statements of AWW are audited on a consolidated basis, which is also the basis on which AWW is required to report under the Sarbanes Oxley legislation. Due to the centralized organization structure of AWW and the cross-functional nature of the Company's financial statement presentation processes, the material weaknesses identified in 2006 could extend to many areas of the Company, including but not limited to, AWWSC. The remediation actions taken by AWW and its subsidiaries to address the material weaknesses identified in 2006 would also apply to AWWSC. AWWSC financial information is also a part of the audited financial statements of AWW on which PwC has provided an unqualified opinion indicating the AWW financial statements have been fairly stated in all material respects.

For the electronic version, refer to KAW_R_AGDR2#63_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Michael A. Miller

64. Is the transfer of funds and the provision of services between the operating companies such as KAWC and AWWSC controlled by contracts and agreements?

Response:

Yes.

For the electronic version, refer to KAW_R_AGDR2#64_020909.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Dr. James H. Vander Weide

65. [Ref. Dr. Vander Weide's response to AG-1-135] Does Thomson Reuters also provide other data than simply the mean five-year projected earnings growth for each company (e.g., median 5-year earnings growth, high estimate, low estimate, number of estimates and coefficient of variance or some other dispersion measure)? If other statistics regarding the projected earnings growth rates are available from Thomson Reuters, please provide those data for each company in Dr. Vander Weide's sample groups.

Response:

The requested data are shown below.

Company	Ticker	INDUSTRY NAME	EPS LTG MEAN	EPS LTG #ESTS	EPS LTG HI EST	EPS LTG LO EST	LTG MEDIAN	EPS LTG STD DEV
American States Water	AWR	WUTILITY	4.00	1	4.00	4.00	4.00	#NA
Aqua America	WTR	WUTILITY	8.00	2	10.00	6.00	8.00	2.83
California Water Service Group	CWT	WUTILITY	7.67	3	10.00	4.00	9.00	3.22
Middlesex Water	MSE X	WUTILITY	8.00	1	8.00	8.00	8.00	#NA
SJW Corp.	SJW	WUTILITY	10.00	1	10.00	10.00	10.00	#NA
Southwest Water Co.	SWW C	WUTILITY	4.50	2	5.00	4.00	4.50	0.71
York Water Co.	YOR W	WUTILITY	8.00	1	8.00	8.00	8.00	#NA
AGL Resources	ATG	GASUTIL	5.25	2	6.00	4.50	5.25	1.06
Atmos Energy	ATO	GASUTIL	5.00	2	5.00	5.00	5.00	0.00
Energen Corp.	EGN	GASUTIL	10.75	2	16.00	5.50	10.75	7.43
Equitable Resources	EQT	GASUTIL	11.67	3	15.00	9.00	11.00	3.06
Nicor Inc.	GAS	GASUTIL	4.25	2	5.50	3.00	4.25	1.77
Northwest Nat. Gas	NWN	GASUTIL	4.83	3	6.00	3.50	5.00	1.26
ONEOK Inc.	OKE	GASUTIL	9.07	3	12.70	4.50	10.00	4.18
Piedmont Natural Gas	PNY	GASUTIL	5.75	4	7.00	4.00	6.00	1.50
South Jersey Inds.	SJI	GASUTIL	6.67	3	8.00	5.00	7.00	1.53
Questar Corp.	STR	GASUTIL	9.00	3	12.00	7.00	8.00	2.65
Southwest Gas	SWX	GASUTIL	6.00	2	6.00	6.00	6.00	0.00

For the electronic version, refer to KAW_R_AGDR2#65_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Dr. James H. Vander Weide

66. Dr. Vander Weide's cost of capital analysis was performed using data through August 2008, i.e., prior to more recent turbulence in the financial markets. Does Dr. Vander Weide intend to update his cost of equity capital recommendation in this proceeding? If so, when, and if not, please explain why not.

Response:

Dr. Vander Weide is continuing to monitor capital market conditions. If he believes that it is necessary, he will update his cost of capital recommendation as part of his rebuttal testimony.

For the electronic version, refer to KAW_R_AGDR2#66_020909.pdf.

**KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION**

Witness: Dr. James H. Vander Weide

67. Please provide a complete copy of any cost of capital testimony submitted by Dr. Vander Weide in any regulatory jurisdiction in November or December 2008, or January 2009. If Dr. Vander Weide has not submitted any such testimony, please so state.

Response:

The requested data are attached.

For the electronic version refer to KAW_R_AGDR2#67_020909.pdf.

ALBERTA UTILITIES COMMISSION

IN THE MATTER OF the *Alberta Utilities Commission Act*, S.A. 2007, c. A-37.2, as amended, and the regulations made thereunder; and

IN THE MATTER OF the *Gas Utilities Act* R.S.A. 2000, c. G-5, as amended, and the Regulations made thereunder; and

IN THE MATTER OF the *Public Utilities Act*, R.S.A. 2000, c. P-45, as amended, and the Regulations made thereunder; and

AND IN THE MATTER OF Alberta Utilities Commission 2009 Generic Cost of Capital Hearing, Application No. 1578571/Proceeding ID. 85

2009 GENERIC COST OF CAPITAL PROCEEDING

WRITTEN EVIDENCE

OF

JAMES H. VANDER WEIDE, PH.D.

FOR

**EPCOR DISTRIBUTION & TRANSMISSION INC.,
EPCOR ENERGY ALBERTA INC.,
FORTISALBERTA INC., AND
ALTALINK, L.P.**

NOVEMBER 20, 2008

WRITTEN EVIDENCE OF
JAMES H. VANDER WEIDE

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Appendix 3 The Sensitivity of the Forward-looking
Required Equity Risk Premium on Utility Stocks to
Changes in Interest Rates

1

WRITTEN EVIDENCE OF

2

JAMES H. VANDER WEIDE

3

I. Introduction

4

Q 1 What is your name, occupation, and business address?

5

A 1 My name is James H. Vander Weide. I am Research Professor of

6

Finance and Economics at Duke University, Fuqua School of

7

Business. I am also President of Financial Strategy Associates, a

8

firm that provides strategic and financial consulting services to

9

corporate clients. My business address is 3606 Stoneybrook Drive,

10

Durham, North Carolina 27705.

11

Q 2 Please summarize your qualifications.

12

A 2 I received a Bachelor's Degree in Economics from Cornell University

13

and a Ph.D. in Finance from Northwestern University. After joining

14

the faculty of the School of Business at Duke University, I was named

15

Assistant Professor, Associate Professor, and then Professor. I have

16

published research in the areas of finance and economics and taught

17

courses in these fields at Duke for more than 35 years.

18

Q 3 Have you previously testified on financial or economic issues?

19

A 3 Yes. As an expert on financial and economic theory and practice, I

20

have participated in more than 400 regulatory and legal proceedings

21

before the U.S. Congress, the Canadian Radio-Television and

22

Telecommunications Commission, the National Energy Board, the

23

Federal Communications Commission, the National

24

Telecommunications and Information Administration, the Federal

25

Energy Regulatory Commission, the public service commissions of

26

42 states, the insurance commissions of five states, the Iowa State

27

Board of Tax Review, the National Association of Securities Dealers,

28

and the North Carolina Property Tax Commission. In addition, I have

29

provided expert testimony in proceedings before the U.S. District

30

Court for the District of Nebraska; the U.S. District Court for the

31

District of New Hampshire; the U.S. District Court for the Eastern

1 District of North Carolina; the U.S. District Court for the Northern
2 District of California; Montana Second Judicial District Court, Silver
3 Bow County; the Superior Court, North Carolina; the U.S. Bankruptcy
4 Court for the Southern District of West Virginia; and the U. S. District
5 Court for the Eastern District of Michigan. My resume is shown in
6 Appendix 1.

7 Q 4 What is the purpose of your testimony?

8 A 4 I have been asked by EPCOR Distribution & Transmission Inc.
9 (“EDTI”), EPCOR Energy Alberta Inc. (“EEAI”), FortisAlberta Inc.
10 (“FortisAlberta”), and AltaLink, L.P. (“AltaLink”) to: (1) assess the
11 continued validity of the generic return on equity adjustment formula
12 (“GCOC ROE Formula”) adopted by the Alberta Utilities
13 Commission’s (“AUC”) predecessor, the Alberta Energy and Utilities
14 Board (“EUB”), in the 2004 Generic Cost of Capital Proceeding;
15 (2) conduct an analysis of the generic cost of equity for Alberta
16 utilities; and (3) recommend appropriate deemed equity ratios for
17 EDTI, (including separate equity ratios for its distribution and
18 transmission operations), EEA, FortisAlberta, and AltaLink.

19 **II. The GCOC ROE Formula Is Not Valid.**

20 **A. The GCOC ROE Formula**

21 Q 5 Are you familiar with the EUB’s return on equity (“ROE”) adjustment
22 formula for the regulated electric and natural gas companies under its
23 jurisdiction?

24 A 5 Yes. The GCOC ROE Formula is given by the equation:

$$25 \text{ROE}_t = 9.60\% + [0.75 \times (\text{YLD}_t - 5.68\%)]$$

26 where:

27 YLD_t = the forecast long-term Canada bond yield for year t .

28 Q 6 What is the current forecasted yield on long-term Canada bonds for
29 2009?

1 A 6 At July 2008, the current forecasted yield on long-term Canada
2 bonds for 2009 from Consensus Economics is 4.30 percent.

3 Q 7 Using a 4.30 percent forecasted yield on long-term Canada bonds,
4 what ROE is implied by the GCOC ROE Formula?

5 A 7 The GCOC ROE Formula implies an ROE equal to 8.57 percent.
6 This result is calculated as follows: $8.57 = 9.60 + [0.75 \times (4.30 -$
7 $5.68)]$.

8 Q 8 What equity risk premium is implied by the GCOC ROE Formula?

9 A 8 The GCOC ROE Formula implies an equity risk premium equal to
10 4.27 percent ($8.57 - 4.30 = 4.27$).

11 **B. Six Tests of the Validity of the GCOC ROE Formula**

12 Q 9 Have you performed any tests of the validity of the GCOC ROE
13 Formula?

14 A 9 Yes. I have performed six tests of the validity of the GCOC ROE
15 Formula. First, I have examined evidence on the experienced returns
16 achieved by equity investors in two groups of Canadian utilities
17 compared to interest rates on long-term Canada bonds. My studies
18 indicate that the equity risk premium on an investment in Canadian
19 utilities is in the range 4.8 percent to 7.3 percent, with a midpoint
20 equal to 6.1 percent. This evidence strongly supports the conclusion
21 that Canadian utility investors require a significantly higher equity risk
22 premium than the 4.27 percent equity risk premium implied by the
23 GCOC ROE Formula.

24 Second, I have examined evidence on the allowed rates of return
25 on equity and allowed common equity ratios for U.S. electric and
26 natural gas utilities. My studies indicate that allowed rates of return
27 on equity and allowed equity ratios are both significantly higher for
28 U.S. electric and natural gas utilities than for Alberta utilities such as
29 EDTI, EEAI, FortisAlberta, and AltaLink. This evidence supports the
30 conclusion that the GCOC ROE Formula fails to provide returns that

1 are commensurate with returns on other investments of the same
2 risk.

3 Third, I have examined evidence on the sensitivity of the forward-
4 looking, or ex ante, required equity risk premium on utility stocks to
5 changes in interest rates. Specifically, while the ROE adjustment
6 formula implies that the cost of equity for Alberta utilities declines by
7 75 basis points for every 100-basis-point decline in the yield to
8 maturity on long Canada bonds, my evidence supports the
9 conclusion that the cost of equity declines by less than 50 basis
10 points for every 100-basis-point decline in the yield to maturity on
11 long Canada bonds. From my ex ante risk premium studies, I find
12 that the forward-looking required equity risk premium on utility stocks
13 is approximately 6.9 percent. Since the risk premium implied by the
14 GCOC ROE Formula is currently 4.27 percent, this evidence
15 supports the conclusion that the GCOC ROE Formula is not working.

16 Fourth, I have examined evidence on the sensitivity of the equity
17 risk premium implied by U.S. utility allowed rates of return on equity
18 to changes in the interest rate on long-term government bonds. My
19 studies indicate that U.S. utility allowed equity risk premiums are
20 significantly less sensitive to changes in interest rates on long-term
21 government bonds than the allowed equity risk premium implied by
22 the GCOC ROE Formula. Specifically, while the ROE adjustment
23 formula reduces the allowed ROE by 75 basis points when the yield
24 to maturity on long-term government bonds declines by 100 basis
25 points, U.S. regulators typically reduce the allowed ROE by less than
26 50 basis points when the yield to maturity on long-term government
27 bonds declines by 100 basis points. This evidence also supports the
28 conclusion that the GCOC ROE Formula is not working.

29 Fifth, I have examined evidence on the volatility of returns on
30 Canadian utility stocks compared to the volatility of returns on the
31 Canadian market index. My studies indicate that the volatility of
32 returns on Canadian utility stocks now exceeds or approximates the

1 volatility of returns on the Canadian market index. Because investors
2 demand a higher return for bearing more risk, this evidence also
3 supports the conclusion that the equity risk premium on Canadian
4 utility stocks is now higher than the equity risk premium implied by
5 the GCOC ROE Formula.

6 Sixth, I have examined whether the GCOC ROE Formula
7 produces an ROE result that is consistent with the increased risk
8 associated with today's volatile economic and capital market
9 conditions. I conclude that, contrary to a reasonable expectation, the
10 GCOC ROE Formula produces a lower ROE estimate at a time when
11 the increased risks of volatile economic and capital market conditions
12 are causing capital costs to increase dramatically.

13 **1. Evidence on Experienced Equity Risk Premiums on**
14 **Investments in Canadian Utility Stocks**

15 Q 10 How do you measure the experienced equity risk premium on an
16 investment in Canadian utility stocks?

17 A 10 I measure the experienced equity risk premium on an investment in
18 Canadian utility stocks from data on returns earned by investors in
19 Canadian utility stocks compared to interest rates on long-term
20 Canada bonds.

21 Q 11 How do you measure the return experienced by investors in
22 Canadian utility stocks?

23 A 11 I measure the return experienced by equity investors in Canadian
24 utility stocks from historical data on returns earned by investors in:
25 (1) the S&P/TSX utilities stock index^[1]; and (2) a basket of Canadian
26 utility stocks created by BMO Capital Markets ("BMO CM").

[1] The legacy S&P/TSX utilities index was discontinued by Standard & Poor's in Spring 2002 when Standard & Poor's introduced a new S&P/TSX Composite utilities index that included the GICs 5500 utilities. Standard & Poor's provided total return index value data going back to 1999. The historical data on returns earned by investors in the S&P/TSX utilities index therefore includes total returns on the S&P/TSX legacy utilities index through 1998 and total returns on the new S&P/TSX composite utilities index from 1999 through 2007.

1 Q 12 What companies are currently included in these indices of Canadian
2 utility stock performance?

3 A 12 The companies included in the S&P/TSX utilities stock index are
4 Algonquin Power Income Fund, Atco Ltd., Canadian Utilities Ltd.,
5 Emera Inc., Energy Savings Income Fund, Epcor Power, L.P.,
6 Fortis Inc., Northland Power Income Fund, and Transalta
7 Corporation. The index also included Calpine Power Units until
8 February 2007 and TransAlta Power, L.P., until December 2007. In
9 addition, Canadian Hydro Developers, Inc. was added to the index in
10 March 2008.

11 The BMO CM basket of utility and pipeline companies includes
12 Canadian Utilities Ltd., Emera Inc., Enbridge Inc., Fortis Inc., Pacific
13 Northern Gas, and TransCanada Corporation. The BMO CM basket
14 also includes return data for Westcoast Energy Inc. until December
15 2001 and Terasen Inc. through July 2005.

16 Q 13 What time periods do your experienced Canadian utility stock return
17 data cover?

18 A 13 The S&P/TSX utilities stock return data covers the period 1956
19 through 2007, and the BMO CM stock return data covers the period
20 1983 through 2007.

21 Q 14 Why do you analyze investors' experiences over such long time
22 periods?

23 A 14 I analyze investors' experiences over long time periods because
24 experienced returns over short periods can deviate significantly from
25 expectations. However, there is no reason to believe that
26 experienced returns would deviate significantly from expected returns
27 in the long run. Intuitively, over long time periods, periods when
28 experienced returns exceed expected returns should be offset by
29 periods when experienced returns fall short of expected returns.
30 Thus, to forecast expected future risk premiums from historical data,
31 it is best to use long periods of history.

1 Q 15 Would your study provide different risk premium results if you had
2 included different time periods?

3 A 15 Yes. The risk premium results do vary somewhat depending on the
4 historical time period chosen. My policy was to go back as far in
5 history as I could get reliable data. With regard to the S&P/TSX
6 utilities index, the data began in 1956, and for the BMO CM utility
7 stock basket, the data began in 1983.

8 Q 16 Why do you choose two sets of Canadian utilities stock return
9 performance data rather than simply relying on the S&P/TSX utilities
10 stock index data?

11 A 16 I choose two sets of Canadian utilities stock return performance data
12 because each data set provides different information on Canadian
13 utilities stock returns. The S&P/TSX utilities stock return database is
14 valuable because it provides information on the returns experienced
15 by investors in a portfolio of Canadian utilities stocks over a relatively
16 long period of time. However, some of the companies included in the
17 S&P/TSX database operate mainly in non-traditional utility markets.
18 The BMO CM utilities stock return database is valuable because it
19 provides information on the experienced returns for a sample of
20 Canadian companies that receive a higher percentage of revenues
21 from traditional utility operations than the companies in the S&P/TSX
22 index. However, the time period covered is not as long as the period
23 covered by the S&P/TSX database, and the sample size is relatively
24 small.

25 Q 17 How are the experienced returns on an investment in each utility data
26 set calculated?

27 A 17 The experienced returns on an investment in each utility data set are
28 calculated from the historical record of stock prices and dividends for
29 the companies in the data set. From the historical record of stock
30 prices and dividends, the index sponsors construct an index of
31 investors' wealth at the end of each period, assuming a \$100
32 investment in the index at the time the index was constructed. An

1 annual rate of return is calculated from the wealth index by dividing
2 the wealth index at the end of each period by the wealth index at the
3 beginning of the period and subtracting one [$r_t = (W_t \div W_{t-1}) - 1$].

4 Q 18 How do you measure the interest rate earned on long-term Canada
5 bonds in your experienced risk premium studies?

6 A 18 I use the interest rate data on long-term Canada bonds reported by
7 the Canadian Institute of Actuaries.

8 Q 19 What average risk premium results do you obtain from your analysis
9 of returns experienced by investors in Canadian utility stocks?

10 A 19 As shown in Table 1 below, for the S&P/TSX utilities index, I obtain
11 an experienced risk premium of 4.85 percent; and for the BMO CM
12 utility and pipeline data set, an experienced risk premium of
13 7.28 percent (the annual data that produce these results are shown
14 in Exhibit 1 and Exhibit 2).

15
16

TABLE 1
EX POST RISK PREMIUM RESULTS

COMPARABLE GROUP	PERIOD OF STUDY	AVERAGE STOCK RETURN	AVERAGE BOND YIELD	RISK PREMIUM
S&P/TSX Utilities	1956 – 2007	12.46	7.61	4.85
BMO CM Utilities Stock Data Set	1983 – 2007	15.08	7.81	7.28

17 Q 20 What conclusions do you draw from your experienced risk premium
18 analyses about the present required risk premium on an equity
19 investment in Canadian utility stocks?

20 A 20 My analyses provide strong evidence that investors today require an
21 equity return of at least 4.8 to 7.3 percentage points above the
22 interest rate on long-term Canada bonds.

23 Q 21 What equity risk premium is implied by the GCOC ROE Formula?

24 A 21 The EUB set the utility cost of equity at 9.60 percent in 2004 at a time
25 when the interest rate on long Canada bonds was 5.68 percent,
26 implying a utility equity risk premium of 392 basis points. The GCOC

1 ROE Formula assumes that the required equity risk premium
2 increases by 25 basis points whenever the yield to maturity on long
3 Canada bonds declines by 100 basis points. Since the yield to
4 maturity on long Canada bonds has declined by 138 basis points
5 since 2004, the GCOC ROE Formula implies that the equity risk
6 premium has increased by 0.25 times 138, or 35 basis points. Thus,
7 the GCOC ROE Formula implies that the present equity risk premium
8 on Canadian utility stocks is 427 basis points ($392 + 35 = 427$).

9 Q 22 How does your evidence on the experienced equity risk premium
10 support your conclusion that the GCOC ROE Formula is not working?

11 A 22 My analysis strongly supports the conclusion that investors require an
12 equity risk premium on Canadian utility stocks in the range
13 4.8 percent to 7.3 percent, with a midpoint of 6.1 percent. However,
14 the GCOC ROE Formula implies an equity risk premium of only 427
15 basis points. Thus, my evidence supports the conclusion that the
16 GCOC ROE Formula understates the required equity risk premium
17 on Canadian utility stocks by approximately 180 basis points.

18 **2. Evidence on Recent Allowed Rates of Return on**
19 **Equity for U.S. Utilities**

20 Q 23 Do you have evidence on recent allowed rates of return on equity for
21 U.S. Utilities?

22 A 23 Yes. I have evidence on recent allowed rates of return on equity for
23 U.S. electric and natural gas utilities from January 2006 to Q1 2008.
24 Since January 2006, the average allowed ROE for electric utilities is
25 10.4 percent, and for natural gas utilities, 10.3 percent (see
26 Exhibit 3).

27 Q 24 Why do you examine data on allowed rates of return on equity for
28 U.S. utilities rather than Canadian utilities?

29 A 24 I examine data on allowed rates of return on equity for U.S. utilities
30 rather than Canadian utilities because allowed rates of return on
31 equity for U.S. utilities are based on cost of equity studies for utilities
32 at the time of each case rather than on an ROE formula such as the

1 GCOC ROE Formula. Thus, recent allowed rates of return on equity
2 for U.S. utilities are an independent test of whether the GCOC ROE
3 Formula is valid.

4 Q 25 Are allowed rates of return on equity the best measure of the cost of
5 equity at each point in time?

6 A 25 No. Since the cost of equity is determined by investors in the
7 marketplace, not by regulators, the cost of equity is best measured
8 using market models such as the equity risk premium and the
9 discounted cash flow model. However, as noted above, because
10 allowed rates of return in non-formula jurisdictions are based on
11 regulators' judgments regarding the cost of equity and fair rate of
12 return, they provide additional information on the validity of the
13 GCOC ROE Formula.

14 Q 26 How do the average allowed ROEs for U.S. electric and natural gas
15 utilities compare to the generic ROE implied by the GCOC ROE
16 Formula?

17 A 26 The average allowed rates of return on equity for U.S. utilities are in
18 the range 10.3 percent to 10.4 percent. As noted above, the GCOC
19 ROE Formula currently implies a generic ROE equal to 8.6 percent.
20 Thus, the average allowed returns for the U.S. utilities exceed the
21 generic ROE by approximately 170 to 180 basis points. [10.3 – 8.6 =
22 170; 10.4 – 8.6 = 180]

23 Q 27 Can the difference between allowed ROEs for U.S. utilities and the
24 ROE implied by the GCOC ROE Formula be explained by differences
25 in risk?

26 A 27 No. The risk of investing in electric and natural gas utilities is
27 approximately the same in the U.S. as it is in Canada.

28 Q 28 Why is the risk of investing in electric and natural gas utilities
29 approximately the same in the U.S. as it is in Canada?

30 A 28 The risk of investing in electric and natural gas utilities is similar in the
31 U.S. and Canada because: (1) U.S. electric and natural gas utilities
32 rely on essentially the same electric and natural gas technologies to

1 deliver their services to the public as electric and gas utilities in
2 Canada; (2) the economics of electric and natural gas transmission
3 and distribution is similar in the U.S. and Canada; and (3) U.S.
4 electric and gas utilities are regulated under similar cost-based
5 regulatory structures and fair rate of return principles as Canadian
6 utilities.

7 Q 29 Some witnesses argued in the 2004 proceeding that Canadian
8 utilities have lower risk than U.S. utilities because Canadian
9 regulators generally make greater use of deferral accounts than U.S.
10 regulators. Do you agree with this argument?

11 A 29 No. While deferral accounts may reduce to some extent the short-
12 run business risk of Canadian utilities compared to U.S. utilities,
13 Canadian utilities share the same long-run risk that they will not earn
14 sufficient revenue over the life of their investments to recover the cost
15 of the long-lived plant and equipment required to provide service. In
16 addition, the slight reduction in short-run risk that may arise from the
17 use of deferral accounts is more than offset by the greater financial
18 risk of Canadian utilities compared to U.S. utilities.

19 Q 30 Why do Canadian utilities have greater financial risk than U.S.
20 utilities?

21 A 30 Canadian utilities have greater financial risk than U.S. utilities
22 because U.S. utilities generally have allowed equity ratios in the
23 range 45 percent to 50 percent (see Exhibit 4), whereas Canadian
24 utilities generally have allowed equity ratios in the range 30 percent
25 to 40 percent.

26 Q 31 What conclusions do you draw from your evidence that allowed
27 ROEs for comparable U.S. utilities are significantly higher than the
28 ROE implied by the GCOC ROE Formula?

29 A 31 My evidence on allowed ROEs for U.S. utilities provides further
30 support for the conclusion that the GCOC ROE Formula is not
31 working.

1 **3. Evidence on the Sensitivity of the Forward-looking**
 2 **Required Equity Risk Premium on Utility Stocks to**
 3 **Changes in Interest Rates**

4 Q 32 How do you study the sensitivity of the forward-looking required
 5 equity risk premium on utility stocks to changes in interest rates?

6 A 32 I study the sensitivity of the forward-looking required equity risk
 7 premium on utility stocks to changes in interest rates in two steps.
 8 First, I estimate the forward-looking required equity risk premium on
 9 utility stocks in each month of my study period. Second, I perform a
 10 statistical regression analysis of the relationship between changes in
 11 the required equity risk premium and changes in interest rates.

12 Q 33 Please describe how you measure the forward-looking required
 13 equity risk premium on an equity investment in utility stocks in each
 14 month of your study period.

15 A 33 My estimate of the required equity risk premium is based on studies
 16 of the discounted cash flow ("DCF") expected return on comparable
 17 groups of utilities in each month of my study period compared to the
 18 interest rate on long-term government bonds. Specifically, for each
 19 month in my study period, I calculate the risk premium using the
 20 equation,

$$21 \qquad \qquad \qquad RP_{COMP} = DCF_{COMP} - I_B$$

22 where:

23 RP_{COMP} = the required risk premium on an equity investment
 24 in the comparable companies,

25 DCF_{COMP} = average DCF expected rate of return on a portfolio
 26 of comparable companies; and

27 I_B = the yield to maturity on an investment in long-term
 28 U.S. Treasury bonds.

29 Q 34 Please describe the DCF model you used to estimate the forward-
 30 looking, or ex ante, required risk premium on an equity investment in
 31 utility stocks.

1 A 34 The DCF model is based on the assumption that investors value an
2 asset on the basis of the future cash flows they expect to receive
3 from owning the asset. Under the assumption that future cash flows
4 grow at a constant rate, g , the resulting cost of equity equation is $k =$
5 $D_1/P_s + g$, where k is the cost of equity, D_1 is the equivalent future
6 value of the next four quarterly dividends at the end of the year, P_s is
7 the current price of the stock, and g is the constant annual growth
8 rate in earnings, dividends, and book value per share. A complete
9 description of my approach to calculating the DCF-estimated cost of
10 equity for my comparable group of utilities is contained in Appendix 2.

11 Q 35 What comparable companies did you use in your forward-looking
12 equity risk premium studies?

13 A 35 I used two sets of comparable U.S. utilities, an electric utilities
14 company group and a natural gas utilities company group. For my
15 electric group, I used the Moody's group of 24 electric companies
16 because they are a widely-followed group of utilities, and the use of
17 this constant group greatly simplified the data collection task required
18 to estimate the ex ante risk premium over the months of my study.
19 Simplifying the data collection task is desirable because my forward-
20 looking equity risk premium studies require that the DCF model be
21 estimated for every company in every month of the study period. For
22 my natural gas company group, I selected all the utilities in Value
23 Line's natural gas company groups that: (1) paid dividends during
24 every quarter and did not decrease dividends during any quarter of
25 the past two years; (2) had at least three analysts included in the
26 I/B/E/S mean growth forecast; (3) are not in the process of being
27 acquired; (4) have a Value Line Safety Rank of 1, 2, or 3; and
28 (5) have investment grade S&P bond ratings.

29 Q 36 Why do you use U.S. utilities rather than Canadian utilities in your
30 forward-looking, or ex ante, risk premium studies?

31 A 36 My ex ante risk premium studies rely on the DCF model to determine
32 the expected risk premium on utility stocks. As noted above, the

1 DCF model requires estimates of investors' growth expectations,
2 which are best measured from the average of analysts' growth
3 forecasts for each company. The difficulty with using Canadian
4 utilities is that there are very few, if any, analysts' growth forecasts
5 available for each Canadian utility over the 9-year time period of my
6 study.

7 Q 37 How do you test whether your forward-looking required equity risk
8 premium estimates are sensitive to changes in interest rates?

9 A 37 To test whether my estimated monthly equity risk premiums are
10 sensitive to changes in interest rates, I perform a regression analysis
11 of the relationship between the forward-looking equity risk premium
12 and the yield to maturity on 20-year U.S. Treasury bonds using the
13 equation:

$$14 \quad \text{RP}_{\text{COMP}} = a + (b \times I_B) + e$$

15 where:

16 RP_{COMP} = risk premium on comparable company group;

17 I_B = yield to maturity on long-term U.S. Treasury bonds;

18 e = a random residual; and

19 a, b = coefficients estimated by the regression procedure.

20 Q 38 What does your regression analysis reveal regarding the sensitivity of
21 the forward-looking required equity risk premium to changes in
22 interest rates?

23 A 38 My regression analysis reveals that the forward-looking required
24 equity risk premium increases by more than 50 basis points when the
25 yield to maturity on long-term government bonds declines by 100
26 basis points. These results suggest that, contrary to the GCOC ROE
27 Formula, the cost of equity for utilities declines by less than 50 basis
28 points when the yield on long-term government bonds declines by
29 100 basis points, rather than the 75-basis point decline in the cost of

1 equity that is implied by the GCOC ROE Formula. A more detailed
2 description of my regression analysis is contained in Appendix 3.
3 The risk premium data used in the regression analysis is shown in
4 Exhibit 5 and Exhibit 6.

5 Q 39 What risk premium estimates do you obtain from your forward-
6 looking risk premium studies?

7 A 39 For my electric utility comparable group, I obtain a forward-looking
8 risk premium equal to 6.94 percent; and for my natural gas
9 comparable group, I obtain a forward-looking risk premium equal to
10 7.03 percent.

11 Q 40 What do your forward-looking equity risk premium studies imply
12 about the validity of the GCOC ROE Formula?

13 A 40 Like my studies of experienced risk premiums on Canadian utility
14 stocks, my forward-looking equity risk premium studies imply that the
15 GCOC ROE Formula is not valid in today's capital market
16 environment.

17 **4. Evidence on the Sensitivity of the Allowed Equity**
18 **Risk Premium for U.S. Utilities to Changes in Interest**
19 **Rates**

20 Q 41 How do you define the allowed equity risk premium for U.S. utilities?

21 A 41 I define the allowed equity risk premium as the difference between
22 the average allowed return on equity for U.S. utilities and the yield to
23 maturity on long-term U.S. Treasury bonds.

24 Q 42 How do you test whether the allowed equity risk premium is sensitive
25 to changes in interest rates?

26 A 42 I test whether the allowed equity risk premium is sensitive to changes
27 in interest rates by performing a regression analysis of the
28 relationship between the allowed equity risk premium and the yield to
29 maturity on 20-year U.S. Treasury bonds over the period 1993 to
30 2007.

31 Q 43 What are the results of your regression analysis?

1 A 43 My allowed equity risk premium analysis confirms the results of my ex
2 ante risk premium analysis; namely, my results confirm that there is
3 an inverse relationship between equity risk premiums and the yield to
4 maturity on long-term government bonds. Specifically, I find that
5 when the yield to maturity on long-term government bonds increases
6 by 100 basis points, the allowed equity risk premium tends to
7 decrease by approximately 56 basis points; and when the yield to
8 maturity on long-term government bonds decreases by 100 basis
9 points, the allowed equity risk premium tends to increase by
10 approximately 56 basis points. These results imply that the allowed
11 return on equity for U.S. utilities declines by less than 50 basis points
12 when the yield to maturity on long-term government bonds declines
13 by 100 basis points. The allowed equity risk premium data in my
14 study and my regression results are shown in Exhibit 7.

15 Q 44 What forecasted allowed equity risk premium results do you obtain
16 from your allowed equity risk premium studies?

17 A 44 I obtain a forecasted allowed equity risk premium equal to
18 5.66 percent. This forecasted allowed equity risk premium for U.S.
19 utilities is approximately 140 basis points higher than the 427 basis
20 point equity risk premium implied by the GCOC ROE Formula.

21 Q 45 What conclusions do you reach from your analysis of the sensitivity
22 of allowed U.S. equity risk premiums to changes in interest rates?

23 A 45 I conclude that the GCOC ROE Formula is not working.

24 **5. Evidence on the Relative Risk of Returns on**
25 **Canadian Utility Stocks Compared to the Canadian**
26 **Market Index**

27 Q 46 What data did you examine on the relative risk of the Canadian
28 utilities compared to the risk of the Canadian market as a whole?

29 A 46 First, I examined the standard deviation, or volatility, of utility returns
30 compared to the standard deviation, or volatility, of the returns on the
31 TSX market index. In addition, I examined the realized returns on

1 Canadian utilities compared to the realized returns on the Canadian
2 market index.

3 Q 47 What has been the standard deviation, or volatility, of returns on
4 Canadian utility stocks compared to the standard deviation of returns
5 on the Canadian market index?

6 A 47 As shown below, over comparable annual time periods, the standard
7 deviation of returns for Canadian utilities has exceeded or
8 approximated the standard deviation of returns for the Canadian
9 market index.

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TABLE 2
STANDARD DEVIATION OF ANNUAL RETURNS
BMO CM UTILITIES STOCK DATA SET,
S&P/TSX UTILITIES, AND TSX MARKET INDEX

PERIOD	BMO CM UTILITIES STOCK DATA SET	S&P/TSX UTILITIES INDEX	TSX CANADIAN MARKET
1983 – 2007	17.18	17.51	14.45
1956 – 2007		15.25	15.74

14 Q 48 What have been the realized returns on Canadian utilities compared
15 to realized returns on the Canadian market index?

16 A 48 As shown below, the realized returns on Canadian utilities have
17 exceeded realized returns on the Canadian market index over the
18 periods 1956–2007 and 1983–2007.

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20
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TABLE 3
AVERAGE ANNUAL RETURNS
BMO CM UTILITIES STOCK DATA SET,
S&P/TSX UTILITIES, AND TSX MARKET INDEX

PERIOD	BMO CM UTILITIES STOCK DATA SET	S&P/TSX UTILITIES INDEX	TSX CANADIAN MARKET
1983 – 2007	15.08	16.60	11.86
1956 – 2007		12.46	11.13

1 Q 49 What conclusions do you draw from your evidence that the standard
2 deviation of annual returns on Canadian utility stocks has exceeded
3 or approximated the standard deviation of returns on the Canadian
4 market as a whole?

5 A 49 I conclude that the risk of the Canadian utilities compared to the risk
6 of the Canadian market as a whole is greater than is implied by the
7 GCOC ROE Formula.

8 Q 50 What conclusions do you draw from your evidence that the realized
9 returns on Canadian utilities have exceeded realized returns on the
10 Canadian market index over the periods 1956 – 2007 and 1983 –
11 2007?

12 A 50 This evidence corroborates my conclusion that Canadian utility
13 stocks are more risky relative to the Canadian market as a whole
14 than is implied by the GCOC ROE Formula.

15 **6. Evidence that the GCOC ROE Formula Produces Lower**
16 **Results in a Period of Increased Risk and Volatility in**
17 **the Capital Markets**

18 Q 51 Does an investor's required rate of return on investment depend on
19 investment risk?

20 A 51 Yes. Since investors are risk averse, their required rate of return on
21 an investment increases with the risk of the investment. That is to
22 say, the greater the risk, the higher the required rate of return.

23 Q 52 Does high volatility in economic and capital market conditions
24 produce greater risk for investors?

25 A 52 Yes. It is widely recognized that investment risk is related to volatility,
26 with higher volatility indicating higher investment risk.

27 Q 53 Do you have any evidence that investors' required rates of return
28 have increased in response to the high volatility in current economic
29 and capital market conditions?

30 A 53 Yes. Interest rates on utility bonds have increased in response to
31 current capital market conditions. In the United States, for example,
32 interest rates on A-rated utility bonds have increased from

1 6.0 percent in January, to 6.4 percent in July, to 7.5 percent in
2 October. The increase in interest rates on Baa-rated utility bonds
3 has been even greater, increasing from 6.4 percent in January, to
4 6.9 percent in July, to 8.5 percent in October. Similarly, in Canada,
5 the average yield on 10-year utility bonds has increased from
6 5.4 percent at year end 2007, to 7.1 percent in October 2008.

7 Q 54 Have interest rates on long-term government bonds increased in line
8 with interest rates on long-term utility bonds?

9 A 54 No. Interest rates on medium-term and long-term government bonds
10 have either declined or remained relatively constant over the past
11 year. In the United States, for example, the interest rate on 10-year
12 U.S. Treasury bonds declined from 4.5 percent in October 2007 to
13 3.8 percent in October 2008; and interest rates on 30-year U.S.
14 Treasury bonds declined from 4.8 percent in October 2007 to
15 4.1 percent in October 2008. Similarly, the yield on 10-year Canada
16 bonds declined from 4.4 percent to 3.7 percent from October 2007 to
17 October 2008, and the yield on long Canada bonds declined from
18 4.4 percent to 4.2 percent.

19 Q 55 Has the GCOC ROE Formula estimated ROE increased in line with
20 increased volatility in current economic and capital market
21 conditions?

22 A 55 No. Because the GCOC ROE Formula estimated ROE depends on
23 the yield on long Canada bonds rather than the yield on corporate
24 bonds, and government interest rates are either declining or
25 remaining relatively flat, the formula-estimated ROE has declined at
26 the same time that there is greater volatility in the capital markets.

27 Q 56 What conclusions do you draw from the evidence that the GCOC
28 ROE Formula estimated ROE has declined during this period of
29 greater volatility and risk in the capital markets?

30 A 56 I conclude that a GCOC ROE Formula based on government bonds
31 currently produces unreasonable results. While the costs of utility
32 capital have increased in line with increased risk and volatility in the

1 capital markets, the GCOC ROE Formula based on long Canada
2 bonds indicates that the required return on an equity investment in
3 Canadian utilities has declined.

4 Q 57 Have you conducted any studies of the spread between the average
5 utility company's cost of equity and its cost of debt?

6 A 57 Yes. I have conducted forward-looking (ex ante) studies of the
7 required risk premium on utility stocks compared to investments in
8 utility bonds. My studies indicate that the required risk premium on
9 utility stocks compared to utility bonds is in the range 4.5 percent to
10 5.0 percent.

11 **III. The Cost of Equity for Companies whose Risk is Similar to EDTI,**
12 **EEAI, FortisAlberta, and AltaLink Is Significantly Higher than the**
13 **Cost of Equity Implied by the GCOC ROE Formula.**

14 **A. Comparable Companies**

15 Q 58 What methods did you use to estimate the cost of equity for your
16 comparable companies?

17 A 58 I estimated the cost of equity for these companies by first identifying
18 companies of similar risk to EDTI, EEAI, FortisAlberta, and AltaLink
19 and then applying several standard cost of equity methodologies to
20 data for these companies.

21 Q 59 What criteria did you use to select companies whose risk is similar to
22 that of EDTI, EEAI, FortisAlberta, and AltaLink?

23 A 59 I used the following criteria to select groups of similar risk companies:
24 (1) must have stock that is publicly traded; (2) must have sufficient
25 available data to reasonably apply standard cost of equity estimation
26 techniques; (3) must be comparable in risk; and (4) taken together,
27 must constitute a relatively large sample of companies.

28 Q 60 Why must comparable companies be publicly traded?

29 A 60 Comparable companies must be publicly traded because information
30 on a company's stock price is a key input in standard cost of equity
31 estimation methods. If the company is not publicly traded, the

1 information required to estimate the cost of equity will not be
2 available.

3 Q 61 Why is data availability a concern in estimating the cost of equity for
4 EDTI, EEAI, FortisAlberta, and AltaLink?

5 A 61 Data availability is a concern because standard cost of equity
6 estimation methods like the equity risk premium and the DCF require
7 estimates of inputs, such as the required risk premium and the
8 expected growth rate, that are inherently uncertain. If there is
9 insufficient data available to estimate these inputs, there is little basis
10 for arriving at a reasonable estimate of the cost of equity for the
11 comparable risk companies.

12 Q 62 Is there any way to assure that the companies used to estimate the
13 cost of equity have exactly the same risk as EDTI, EEAI,
14 FortisAlberta, and AltaLink?

15 A 62 No. First, EDTI, EEAI, FortisAlberta, and AltaLink are pure regulated
16 electric utilities, and there are few, if any, pure regulated electric
17 utilities that have publicly-traded stock. Second, it is not possible to
18 measure the risk of EDTI, EEAI, FortisAlberta, and AltaLink precisely
19 because most generally accepted risk measures require that a
20 company have publicly-traded stock. Third, there is no single
21 generally agreed upon measure of risk.

22 Q 63 Recognizing the difficulty in identifying companies with exactly the
23 same risk as EDTI, EEAI, FortisAlberta, and AltaLink, what
24 companies did you consider as potential comparables for the
25 purpose of estimating the cost of equity for EDTI, EEAI, FortisAlberta,
26 and AltaLink?

27 A 63 I considered two groups of Canadian utilities and two groups of US
28 utilities.

29 Q 64 What two groups of Canadian utilities did you consider?

30 A 64 I considered the small group of Canadian utilities included in the
31 BMO CM's basket of utility and pipeline companies and a larger
32 group consisting of the companies in the S&P/TSX utilities index.

1 Q 65 What are the advantages of using the BMO CM basket of Canadian
2 utilities as comparables for the purpose of estimating the cost of
3 equity for EDTI, EEAI, FortisAlberta, and AltaLink?

4 A 65 The primary advantage of the BMO CM basket of Canadian utilities is
5 that it only includes companies that receive the majority of their
6 revenues from traditional utility operations.

7 Q 66 What are the advantages of using the S&P/TSX utilities index as
8 comparables in this proceeding?

9 A 66 The primary advantage of using the S&P/TSX utilities index is that
10 there are more companies in the index and return data for this index
11 is available for a longer period of time than for the BMO CM basket of
12 utility stocks.

13 Q 67 What are the advantages of using your two U.S. utilities groups as
14 comparables for the purpose of estimating the cost of equity for
15 EDTI, EEAI, FortisAlberta, and AltaLink?

16 A 67 The primary advantages of my U.S. utilities groups are that: (1) they
17 include a significantly larger sample of companies with traditional
18 utility operations than my Canadian groups; (2) reasonable estimates
19 of expected growth rates are available for these companies, whereas
20 the same data are not available for the Canadian utilities; and
21 (3) historical data for the U.S. utilities are available for a much greater
22 length of time than for the Canadian utilities.

23 Q 68 What conclusions do you draw from your investigation of alternative
24 groups of comparable companies?

25 A 68 I conclude that the AUC should give significantly greater weight to the
26 cost of equity results for the U.S. utilities groups than it has
27 previously. The U.S. utilities are more involved in traditional utility
28 operations than the companies included in the Canadian utilities
29 indices. In addition, the sample of U.S. regulated utilities is
30 significantly larger than the sample of Canadian regulated utilities,
31 and the data required to estimate the cost of equity is more readily
32 available for the U.S. utilities than for the Canadian utilities.

1 Furthermore, Canadian investors have greater access to international
2 stock market investments, including investments in the U.S., than
3 they did prior to the elimination of the foreign property rule in 2005.
4 For these reasons, the U.S. data provide important information on the
5 cost of equity for EDTI, EEAI, FortisAlberta, and AltaLink.

6 **B. Estimating the Cost of Equity**

7 Q 69 What methods did you use to estimate the cost of equity for EDTI,
8 EEAI, FortisAlberta, and AltaLink?

9 A 69 I used two generally accepted methods: the equity risk premium and
10 the discounted cash flow ("DCF"). The equity risk premium method
11 assumes that the investor's required rate of return on an equity
12 investment is equal to the interest rate on a long-term bond plus an
13 additional equity risk premium to compensate the investor for the
14 risks of investing in equities compared to bonds. The DCF method
15 assumes that the current market price of a firm's stock is equal to the
16 discounted value of all expected future cash flows.

17 **1. Equity Risk Premium Method**

18 Q 70 Please describe the equity risk premium method.

19 A 70 The equity risk premium method is based on the principle that
20 investors expect to earn a return on an equity investment that reflects
21 a "premium" over and above the return they expect to earn on an
22 investment in a portfolio of bonds. This equity risk premium
23 compensates equity investors for the additional risk they bear in
24 making equity investments versus bond investments.

25 Q 71 How did you measure the required risk premium on an equity
26 investment in your comparable risk companies?

27 A 71 I used two methods to estimate the required risk premium on an
28 equity investment in my comparable risk companies. The first is
29 called the ex post risk premium method and the second is called the
30 ex ante risk premium method.

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a) Ex Post Risk Premium

Q 72 Please describe your ex post risk premium method for measuring the required risk premium on an equity investment.

A 72 My ex post risk premium method measures the required risk premium on an equity investment in EDTI, EEAI, FortisAlberta, and AltaLink from historical data on the returns experienced by investors in Canadian utility stocks compared to investors in long-term Canada bonds.

Q 73 How did you measure the return experienced by investors in Canadian utility stocks?

A 73 I measured the return experienced by investors in Canadian utility stocks from historical data on returns earned by investors in: (1) the S&P/TSX utilities stock index; and (2) a basket of Canadian utility and pipeline stocks created by the BMO CM.

Q 74 Does your ex post risk premium cost of equity study use the same investor experienced return data that you discussed above when you described your tests of the validity of the GCOC ROE Formula?

A 74 Yes, it does.

Q 75 How did you measure the forecasted bond yield for your ex post risk premium studies?

A 75 I measured the forecasted bond yield from information on the forecasted yield on long-term Canada bonds as reported by Consensus Economics.

Q 76 What risk premium results did you obtain from your ex post risk premium method?

A 76 As shown below, for the S&P/TSX utilities index, I obtained an experienced risk premium of 4.8 percent; and for the BMO CM utility and pipeline stock data set, an experienced risk premium of 7.3 percent (as noted above, the annual data that produce these results are shown in Exhibit 1 and Exhibit 2).

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**TABLE 4
EX POST RISK PREMIUM RESULTS**

COMPARABLE GROUP	PERIOD OF STUDY	AVERAGE STOCK RETURN	AVERAGE BOND YIELD	RISK PREMIUM
S&P/TSX Utilities	1956 – 2007	12.46	7.61	4.85
BMO CM Utilities Stock Data Set	1983 – 2007	15.08	7.81	7.28

- 3 Q 77 What conclusions do you draw from your ex post risk premium
4 analyses about your comparable companies' cost of equity?
- 5 A 77 My studies provide strong evidence that investors in these companies
6 require an equity return of at least 4.8 to 7.3 percentage points above
7 the interest rate on long-term Canada bonds. The Consensus
8 Economics forecasted interest rate on long-term Canada bonds for
9 2009 as of July 2008 is 4.30 percent. Adding a 4.8 to 7.3 percentage
10 point risk premium to an expected yield of 4.30 percent on long-term
11 Canada bonds and including a 50-basis point flotation cost
12 allowance, as shown below, I obtain an expected return on equity in
13 the range 9.7 percent to 12.1 percent from my ex post risk premium
14 studies, with an average equal to 10.9 percent.

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**TABLE 5
SUMMARY OF EX POST RISK PREMIUM COST OF EQUITY**

COMPARABLE GROUP	RISK PREMIUM	FORECAST INTEREST RATE	FLOTATION COST ALLOWANCE	COST OF EQUITY
S&P/TSX Utilities	4.85	4.30	0.50	9.7
BMO CM Utility Stock Data Set	7.28	4.30	0.50	12.1
Average				10.9

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b) Ex Ante Risk Premium Method

- 18 Q 78 Please describe your ex ante risk premium approach for measuring
19 the required risk premium on an equity investment in EDTI, EEAI,
20 FortisAlberta, and AltaLink.
- 21 A 78 My ex ante risk premium method is based on studies of the expected
22 return on comparable groups of utilities in each month of my study
23 period compared to the interest rate on long-term government bonds.

1 Q 79 Does your ex ante risk premium cost of equity study use the same
2 forward looking, or ex ante, risk premium data that you discussed
3 above when you described your analysis of the sensitivity of the
4 forward looking required equity risk premium on utility stocks to
5 changes in interest rates?

6 A 79 Yes, it does.

7 Q 80 What risk premium estimates do you obtain from your ex ante risk
8 premium studies?

9 A 80 For my electric utility comparable group, I obtain an ex ante risk
10 premium equal to 6.94 percent, and for my natural gas comparable
11 group, I obtain an ex ante risk premium equal to 7.03 percent.

12 Q 81 What cost of equity results do you obtain from your ex ante risk
13 premium studies?

14 A 81 As described above, in the ex ante risk premium approach, one must
15 add the expected interest rate on long-term government bonds to the
16 estimated risk premium to calculate the cost of equity. Since EDTI,
17 EEAI, FortisAlberta, and AltaLink are Canadian utilities, I estimated
18 the expected yield on long-term government bonds using the
19 forecasted interest rate on long-term Canada bonds, 4.30 percent.
20 Adding this 4.30 percent interest rate to my 6.94 percent and
21 7.03 percent ex ante risk premium estimates, I obtain cost of equity
22 estimates of 11.2 percent ($4.30 + 6.94 = 11.2$ and $4.30 + 7.03 =$
23 11.3). A more detailed description of my ex ante risk premium
24 approach and results is described in Exhibit 5, Exhibit 6, and Exhibit
25 14, Appendix 3.

26 2. Discounted Cash Flow Model

27 Q 82 How did you use the DCF model to estimate the cost of equity on an
28 investment in your comparable risk companies?

29 A 82 I applied the DCF model to the Value Line electric and natural gas
30 utilities shown in Exhibit 8 and Exhibit 9.

31 Q 83 How did you select your comparable groups of Value Line utilities?

1 A 83 I selected all the utilities in Value Line's electric and natural gas
2 industry groups that: (1) paid dividends during every quarter and did
3 not decrease dividends during any quarter of the past two years;
4 (2) had at least three analysts included in the I/B/E/S mean growth
5 forecast; (3) are not in the process of being acquired; (4) have a
6 Value Line Safety Rank of 1, 2, or 3; and (5) have investment grade
7 S&P bond ratings.

8 Q 84 Why did you eliminate companies that have either decreased or
9 eliminated their dividend during the past two years?

10 A 84 The DCF model requires the assumption that dividends will grow at a
11 constant positive rate into the indefinite future. If a company has
12 decreased its dividend in recent years, an assumption that the
13 company's dividend will grow at the same positive rate into the
14 indefinite future is questionable.

15 Q 85 Why did you eliminate companies that have fewer than three
16 analysts' estimates included in the I/B/E/S mean forecast?

17 A 85 The DCF model also requires a reliable estimate of a company's
18 expected future growth. For most companies, the I/B/E/S mean
19 growth forecast is the best available estimate of the growth term in
20 the DCF Model. However, the I/B/E/S estimate may be less reliable if
21 the mean estimate is based on the inputs of very few analysts. On
22 the basis of my professional judgment, I believe that at least three
23 analysts' estimates are a reasonable minimum number.

24 Q 86 Why did you eliminate companies that are in the process of being
25 acquired?

26 A 86 I eliminated companies that are in the process of being acquired
27 because announcement of an acquisition frequently has a significant
28 impact on a company's stock price because of anticipated merger-
29 related cost savings and new market opportunities. Analysts' growth
30 forecasts, on the other hand, are necessarily related to companies as
31 they currently exist, and do not reflect investors' views of the potential
32 cost savings and new market opportunities associated with mergers.

1 The use of a stock price that includes the value of potential mergers
2 in conjunction with growth forecasts that do not include the growth
3 enhancing prospects of potential mergers produces DCF results that
4 tend to distort a company's cost of equity.

5 Q 87 Please summarize the results of your application of the DCF model to
6 your comparable groups of companies.

7 A 87 My application of the DCF model to my comparable group of natural
8 gas companies produces a result of 10.8 percent, and to my
9 comparable group of electric companies, 11.8 percent (see Exhibit 8
10 and Exhibit 9). The average DCF result for my two comparable
11 groups is 11.3 percent.

12 Q 88 Based on your application of the equity risk premium and DCF
13 methods to your comparable risk companies, what is your conclusion
14 regarding your comparable risk companies' cost of equity?

15 A 88 I conclude that my comparable companies' cost of equity is
16 11.2 percent. As shown below, 11.2 percent is the simple average of
17 the cost of equity results I obtain from my cost of equity models.

18 **TABLE 6**
19 **SUMMARY OF COST OF EQUITY RESULTS**

METHOD	COST OF EQUITY
Ex Post Risk Premium	10.9
Ex Ante Risk Premium	11.3
Discounted Cash Flow	11.3
Average	11.2

20 **IV. Comparable Risk Utilities Have Significantly Higher Allowed**
21 **Equity Ratios than EDTI, EEAI, FortisAlberta, and AltaLink**

22 Q 89 What common equity ratios did the EUB approve for EDTI,
23 FortisAlberta, and AltaLink in its 2004 generic cost of capital order?

24 A 89 The EUB approved a 35 percent equity ratio for the transmission
25 operations of EDTI, a 39 percent equity ratio for the distribution
26 operations of EDTI, a 37 percent equity ratio for FortisAlberta, and a

- 1 35 percent equity ratio for AltaLink. Since the time of the 2004
2 generic cost of capital order, AltaLink's approved equity ratio has
3 been reduced to 33 percent.
- 4 Q 90 Has the AUC also approved a common equity ratio for EEAI?
- 5 A 90 Yes. In its 2008 rate order for EEAI, the AUC approved a common
6 equity ratio for EEAI equal to 39 percent.
- 7 Q 91 How do the approved equity ratios for EDTI, EEAI, FortisAlberta, and
8 AltaLink compare to the approved equity ratios for U.S. utilities?
- 9 A 91 As noted above and as shown in Exhibit 4, the average approved
10 equity ratio for U.S. electric utilities during the period 2006 through
11 Q1 2008 is in the range 48.7 percent to 49.3 percent, and for U.S.
12 natural gas utilities, 48.3 percent to 53.1 percent. Thus, the average
13 approved equity ratio for U.S. utilities is significantly higher than the
14 approved equity ratios for EDTI, EEAI, FortisAlberta, and AltaLink
15 (48 percent to 53 percent versus 33 percent to 39 percent).
- 16 Q 92 How do the approved equity ratios for EDTI, EEAI, FortisAlberta, and
17 AltaLink compare to the market value equity ratios for U.S. utilities at
18 September 2008?
- 19 A 92 The average market value equity ratio for U.S. electric utilities at
20 September 2008 is 63 percent, and 71 percent for natural gas utilities
21 (See Exhibit 10).
- 22 Q 93 Why do you present evidence on market value equity ratios for U.S.
23 utilities as well as book value equity ratios?
- 24 A 93 I present evidence on market value equity ratios as well as book
25 value equity ratios because financial risk depends on the market
26 value percentages of debt and equity in a company's capital structure
27 rather than on the book value percentages of debt and equity in the
28 company's capital structure.
- 29 Q 94 How does the business risk of EDTI, EEAI, FortisAlberta, and
30 AltaLink compare to the average business risk of U.S. electric and
31 natural gas utilities?

1 A 94 The business risk of EDTI, EEAI, FortisAlberta, and AltaLink may be
2 slightly less than the average business risk of U.S. electric and
3 natural gas utilities because: (1) many U.S. electric utilities are
4 integrated utilities rather than transmission only utilities, distribution
5 only utilities, and/or regulated rate providers; and (2) in some cases,
6 Canadian regulators make greater use of deferral accounts than U.S.
7 regulators.

8 Q 95 How does the financial risk of EDTI, EEAI, FortisAlberta, and AltaLink
9 compare to the average financial risk of U.S. electric and natural gas
10 utilities?

11 A 95 Since EDTI, EEAI, FortisAlberta, and AltaLink have allowed equity
12 ratios in the range 33 percent to 39 percent, and the U.S. electric and
13 natural gas utilities have average allowed equity ratios in the range
14 48 percent to 53 percent, the financial risk of U.S. electric and natural
15 gas utilities is significantly less than the financial risk of these Alberta
16 utilities. This conclusion is further supported by the observation that
17 the average market value equity ratio for U.S. electric utilities is
18 63 percent, and for natural gas utilities, 71 percent. This observation
19 is important because financial risk is best measured using market
20 value equity ratios rather than book value equity ratios.

21 V. Summary and Recommendations

22 Q 96 Please summarize your written evidence in this proceeding.

23 A 96 My written evidence may be summarized as follows:

- 24 1. Experienced equity risk premiums on investments in Canadian
25 utilities stocks are in the range 4.8 percent to 7.3 percent with a
26 midpoint of 6.1 percent, whereas the GCOC ROE Formula implies
27 an equity risk premium of only 4.27 percent.
- 28 2. Recent average allowed returns for U.S. utilities are in the range
29 10.3 percent to 10.4 percent, whereas the GCOC ROE Formula
30 implies an ROE equal to 8.8 percent (based on capital market data
31 at July 2008).

- 1 3. The forward-looking required equity risk premium on utility stocks is
2 less sensitive to changes in government bond yields than is implied
3 by the GCOC ROE Formula.
- 4 4. The allowed equity risk premium for U.S. utilities is less sensitive to
5 changes in government bond yields than is implied by the GCOC
6 ROE Formula.
- 7 5. The risk of investing in Canadian utilities stocks is higher relative to
8 the Canadian market as a whole than is implied by the GCOC ROE
9 Formula.
- 10 6. The cost of equity for investments in comparable risk utilities is
11 11.2 percent based on ex post risk premium, ex ante risk premium,
12 and discounted cash flow studies.
- 13 7. Allowed equity ratios for U.S. utilities are in the range 48 percent to
14 53 percent, whereas the deemed equity ratios for EDTI, EEAI,
15 FortisAlberta, and AltaLink are in the range 33 percent to
16 39 percent.
- 17 8. The business risk of EDTI, EEAI, FortisAlberta, and AltaLink is
18 slightly less than the average business risk of U.S. utilities,
19 whereas the average financial risk of U.S. utilities is significantly
20 less than the financial risk of these Alberta utilities.
- 21 Q 97 What conclusion do you reach from this evidence?
- 22 A 97 I conclude that the allowed overall rate of return for EDTI, EEAI,
23 FortisAlberta, and AltaLink is significantly less than the overall return
24 that investors can earn on other investments of similar risk.
- 25 Q 98 Based on your evidence regarding average allowed ROEs and equity
26 ratios for U.S. utilities, what is your estimate of the average allowed
27 overall rate of return for comparable risk U.S. utilities?
- 28 A 98 I estimate that the average allowed overall rate of return for U.S.
29 utilities is approximately 8 percent (see Table 7).

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TABLE 7
ESTIMATE OF AVERAGE ALLOWED OVERALL RETURN
FOR U.S. UTILITIES

CAPITAL COMPONENT	% TOTAL	COST RATE	WEIGHTED COST
Debt	52.00%	6.00%	3.12%
Equity	48.00%	10.30%	4.94%
Total	100.00%		8.06%

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5 Q 99 Do the Alberta utilities need to be allowed an ROE of 10.30 percent
6 on an equity base of 48.0 percent in order to have the same allowed
7 overall rate of return as comparable risk U.S. utilities?

8 A 99 No. The Alberta utilities could be allowed any combination of ROE
9 and deemed equity ratio that produces an overall rate of return of at
10 least 8 percent. As noted above, one such combination is an ROE of
11 10.3 percent and a deemed equity ratio of 48 percent. An allowed
12 ROE of 11 percent and a deemed equity ratio of 40 percent also
13 produces an overall return of 8 percent (see Table 8).

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TABLE 8
ALTERNATIVE COST OF EQUITY AND EQUITY RATIO
THAT PRODUCES AN 8.0 PERCENT OVERALL ALLOWED RETURN

CAPITAL COMPONENT	% TOTAL	COST RATE	WEIGHTED COST
Debt	60.00%	6.00%	3.60%
Equity	40.00%	11.00%	4.40%
Total	100.00%		8.00%

18 Q 100 What is your specific recommendation regarding the rate of return on
19 equity and equity percentage for EDTI, EEAI, FortisAlberta, and
20 AltaLink?

21 A 100 I conservatively recommend that EDTI, EEAI, FortisAlberta, and
22 AltaLink be awarded an allowed ROE of 11.0 percent on an equity
23 base that is five percent above their last allowed deemed equity ratio.
24 My recommendation that the equity ratio be increased by five percent
25 is based on the results shown in Table 8, where an allowed return of

1 11.0 percent on an equity ratio that is five percent above the
2 benchmark Alberta utility equity ratio of 35 percent produces
3 approximately the same overall allowed rate of return as that for
4 comparable risk U.S. utilities. Specifically, absent any additional
5 factors, I recommend the equity ratios for EDTI, EEAI, FortisAlberta,
6 and AltaLink shown in the table below:

7 **TABLE 9**
8 **RECOMMENDED EQUITY RATIOS FOR EDTI, EEAI,**
9 **FORTISALBERTA, AND ALTALINK**

COMPANY	LAST APPROVED EQUITY RATIO (%)	RECOMMENDED EQUITY RATIO (%)
EDTI Transmission	35	40
EDTI Distribution	39	44
EEAI	37	42
FortisAlberta	37	42 ^[2]
AltaLink	33	38

10 Q 101 Have you presented evidence that your recommended allowed ROE
11 and deemed equity ratio is conservative?

12 A 101 Yes. I have provided evidence that the cost of equity for comparable
13 risk utilities is 11.2 percent and that the average equity ratio for these
14 utilities is significantly greater than 40 percent. However, to be
15 conservative, I recommend that the Alberta utilities be allowed at
16 least the same overall rate of return as the U.S. utilities.

[2] FortisAlberta has advised that it has ceased to receive an income tax component in its revenue requirement since the time its equity ratio was last approved. I have not taken that matter into account in my recommendation, but rather, recognize it as an additional factor to be considered in addition to my recommendation.

- 1 Q 102 Does this conclude your written evidence?
- 2 A 102 Yes, it does.

EXHIBIT 1
EXPERIENCED RISK PREMIUMS ON
S&P/TSX CANADIAN UTILITIES STOCK INDEX
1956—2007

LINE NO.	YEAR	S&P/TSX CANADIAN UTILITIES STOCK INDEX TOTAL RETURN	YIELD LONG-TERM CANADA BOND	RISK PREMIUM
1	1956	0.17	3.63	-3.45
2	1957	-3.43	4.11	-7.54
3	1958	9.81	4.15	5.66
4	1959	0.21	5.08	-4.86
5	1960	26.81	5.19	21.62
6	1961	19.17	5.05	14.12
7	1962	-0.72	5.11	-5.83
8	1963	6.19	5.09	1.10
9	1964	21.59	5.18	16.41
10	1965	4.23	5.21	-0.98
11	1966	-13.17	5.69	-18.86
12	1967	5.07	5.94	-0.87
13	1968	7.41	6.75	0.66
14	1969	-8.62	7.58	-16.20
15	1970	23.34	7.91	15.43
16	1971	4.29	6.95	-2.66
17	1972	-0.44	7.23	-7.68
18	1973	-4.14	7.56	-11.70
19	1974	14.38	8.90	5.48
20	1975	5.75	9.04	-3.28
21	1976	15.02	9.18	5.84
22	1977	19.00	8.70	10.30
23	1978	27.28	9.27	18.01
24	1979	12.61	10.21	2.40
25	1980	5.74	12.48	-6.74
26	1981	-0.55	15.22	-15.77
27	1982	35.90	14.26	21.65
28	1983	40.97	11.79	29.17
29	1984	24.31	12.75	11.56
30	1985	10.04	11.04	-1.00
31	1986	11.48	9.52	1.96
32	1987	1.07	9.95	-8.88
33	1988	5.63	10.22	-4.59
34	1989	22.07	9.92	12.15
35	1990	0.58	10.85	-10.28

LINE NO.	YEAR	S&P/TSX CANADIAN UTILITIES STOCK INDEX TOTAL RETURN	YIELD LONG- TERM CANADA BOND	RISK PREMIUM
36	1991	27.02	9.76	17.25
37	1992	-2.24	8.77	-11.00
38	1993	23.52	7.85	15.67
39	1994	-6.04	8.63	-14.68
40	1995	18.44	8.28	10.16
41	1996	32.68	7.50	25.18
42	1997	37.33	6.42	30.91
43	1998	36.55	5.47	31.09
44	1999	-27.14	5.69	-32.83
45	2000	50.06	5.89	44.17
46	2001	10.83	5.78	5.05
47	2002	6.33	5.66	0.67
48	2003	24.94	5.28	19.66
49	2004	9.42	5.08	4.34
50	2005	38.29	4.39	33.90
51	2006	7.01	4.30	2.71
52	2007	11.89	4.34	7.55
53	Average	12.46	7.61	4.85

EXHIBIT 2
EXPERIENCED RISK PREMIUMS ON BMO CAPITAL MARKETS
UTILITIES STOCK DATA SET
1983—2007

LINE NO.	YEAR	BMO CAPITAL MARKETS UTILITIES TOTAL RETURN	YIELD LONG- TERM CANADA BOND	RISK PREMIUM
1	1983	25.63	11.79	13.84
2	1984	5.46	12.75	-7.29
3	1985	18.95	11.04	7.90
4	1986	-3.48	9.52	-13.00
5	1987	9.97	9.95	0.02
6	1988	7.84	10.22	-2.38
7	1989	18.36	9.92	8.44
8	1990	6.31	10.85	-4.54
9	1991	4.01	9.76	-5.75
10	1992	-0.36	8.77	-9.12
11	1993	31.52	7.85	23.68
12	1994	-2.64	8.63	-11.27
13	1995	14.73	8.28	6.45
14	1996	30.56	7.50	23.05
15	1997	48.52	6.42	42.10
16	1998	4.06	5.47	-1.40
17	1999	-24.03	5.69	-29.72
18	2000	57.77	5.89	51.89
19	2001	14.72	5.78	8.93
20	2002	13.93	5.66	8.27
21	2003	27.75	5.28	22.47
22	2004	15.00	5.08	9.92
23	2005	32.02	4.39	27.64
24	2006	16.61	4.30	12.31
25	2007	3.88	4.34	-0.45
26	Average	15.08	7.81	7.28

EXHIBIT 3
ALLOWED RETURNS ON EQUITY FOR
U.S. ELECTRIC AND NATURAL GAS UTILITIES
2006 – Q1 2008^[3]

Date	Company	State	ROE
5-Jan-06	Northern States Power (WI)	WI	11.00
27-Jan-06	United Illuminating (CT)	CT	9.75
3-Mar-06	Interstate Power & Light (MN)	MN	10.39
17-Apr-06	PacifiCorp (WA)	WA	10.20
18-Apr-06	MidAmerican Energy	IA	11.90
26-Apr-06	Sierra Pacific Power	NV	10.60
12-May-06	Idaho Power	ID	10.60
6-Jun-06	Delmarva Power & Light	DE	10.00
27-Jun-06	Upper Penninsula Power	MI	10.75
6-Jul-06	Maine Public Service	ME	10.20
24-Jul-06	Central Hudson Gas & Electric	NY	9.60
26-Jul-06	Appalachian Power	WV	10.50
28-Jul-06	Commonwealth Edison	IL	10.05
23-Aug-06	NY State Electric & Gas	NY	9.55
1-Sep-06	Northern States Power	MN	10.54
14-Sep-06	PacifiCorp	OR	10.00
6-Oct-06	Unitil Energy Systems	NH	9.67
21-Nov-06	Central Illinois Public Service	IL	10.08
21-Nov-06	Central Illinois Light	IL	10.08
21-Nov-06	Illinois Power	IL	10.12
1-Dec-06	PacifiCorp	UT	10.25
1-Dec-06	Public Service Colorado	CO	10.50
7-Dec-06	Central Vermont Public Service	VT	10.75
21-Dec-06	Empire District Electric Co.	MO	10.90
21-Dec-06	Kansas City Power & Light	MO	11.25
22-Dec-06	Green Mountain Power	VT	10.25
5-Jan-07	Oklahoma G & E	AR	10.00
5-Jan-07	Puget Sound Energy	WA	10.40
11-Jan-07	Metropolitan Edison	PA	10.10
11-Jan-07	Pennsylvania Electric	PA	10.10
11-Jan-07	Wisconsin Public Service	WI	10.90
12-Jan-07	Portland General Electric	OR	10.10
19-Jan-07	Wisconsin Power & Light	WI	10.80
22-Mar-07	Rockland Electric	NJ	9.75
15-May-07	Appalachian Power	VA	10.00
17-May-07	Aquila MPS	MO	10.25
17-May-07	Aquila LP	MO	10.25
22-May-07	Union Electric	MO	10.20
22-May-07	Monongahela	WV	10.50
23-May-07	Nevada Power	NV	10.70

^[3] Regulatory Research Associates, Inc., "Major Rate Case Decisions—January 2006—December 2007," January 8, 2008; "Major Rate Case Decisions—January—March 2008," April 2, 2008.

Date	Company	State	ROE
25-May-07	Public Service NH	NH	9.67
15-Jun-07	Entergy AR	AR	9.90
21-Jun-07	PacifiCorp	WA	10.20
22-Jun-07	Appalachian Power	WV	10.50
28-Jun-07	AZ Public Service	AZ	10.75
12-Jul-07	Granite State Electric	NH	9.67
19-Jul-07	DelMarva P & L	MD	10.00
19-Jul-07	Potomac Electric Power	MD	10.00
15-Aug-07	Southern Indiana G & E	IN	10.40
9-Oct-07	Public Service Oklahoma	OK	10.00
18-Oct-07	Orange and Rockland	NY	9.10
31-Oct-07	Electric Transmission Texas	TX	9.96
29-Nov-07	Cheyenne Light	WY	10.90
6-Dec-07	Kansas City Power & Light	MO	10.75
13-Dec-07	AEP Texas	TX	9.96
14-Dec-07	South Carolina Electric & Gas	SC	10.70
14-Dec-07	Madison Gas and Electric	WI	10.80
19-Dec-07	Avista Corporation	WA	10.20
20-Dec-07	Bangor Hydro-Electric	ME	10.20
20-Dec-07	Duke Energy Carolinas	NC	11.00
21-Dec-07	San Diego Gas & Electric	CA	11.10
21-Dec-07	Pacific Gas and Electric	CA	11.35
21-Dec-07	Southern California Edison	CA	11.50
28-Dec-07	PacifiCorp	ID	10.25
31-Dec-07	Georgia Power	GA	11.25
8-Jan-08	Northern States Power	WI	10.75
17-Jan-08	Wisconsin Electric Power	WI	10.75
28-Jan-08	Connecticut Light & Power	CT	9.40
30-Jan-08	Potomac Electric Power	DC	10.00
31-Jan-08	Central Vermont	VT	10.71
6-Feb-08	Interstate Power & Light	IA	11.70
29-Feb-08	Fitchburg Gas & Electric	MA	10.25
12-Mar-08	PacifiCorp	WY	10.25
25-Mar-08	Consolidated Edison	NY	9.10
	Average		10.4

EXHIBIT 3 (CONTINUED)
ALLOWED RETURNS ON EQUITY
FOR U.S. ELECTRIC AND NATURAL GAS UTILITIES
2006 – Q1 2008

NATURAL GAS UTILITIES

Date	Company	State	ROE
5-Jan-06	Northern States Power	WI	11.00
25-Jan-06	Wisconsin Electric Power	WI	11.20
25-Jan-06	Wisconsin Gas	WI	11.20
3-Feb-06	Public Service Colorado	CO	10.50
23-Feb-06	Southwest Gas	AZ	9.50
1-Mar-06	Aquila	IA	10.40
26-Apr-06	Sierra Pacific Power	NV	10.60
25-May-06	Atmos Energy	LA	10.40
24-Jul-06	Central Hudson Gas & Electric	NY	9.60
20-Sep-06	Knight Inc.	WY	11.00
26-Sep-06	Chesapeake Utilities	MD	10.75
20-Oct-06	Orange & Rockland Utilities	NY	9.80
2-Nov-06	Centerpoint Energy MN Gas	MN	9.71
9-Nov-06	Public Service E & G	NJ	10.00
21-Nov-06	Consumers Energy	MI	11.00
5-Dec-06	Chatanooga Gas	TN	10.20
5-Jan-07	Puget Sound Energy	WA	10.40
9-Jan-07	Semco Energy Gas	MI	11.00
11-Jan-07	Wisconsin Public Service	WI	10.90
19-Jan-07	Wisconsin Power & light	WI	10.80
26-Jan-07	Fitchburg Gas & Electric	MA	10.00
8-Feb-07	PPL Gas Utilities	PA	10.40
14-Mar-07	Connecticut Natural Gas	CT	10.10
20-Mar-07	Delmarva Power & Light	DE	10.25
22-Mar-07	Southern Union	MO	10.50
29-Mar-07	Atmos Energy	TX	10.00
5-Jun-07	Cascade Natural Gas	OR	10.10
13-Jun-07	Northern States Power	ND	10.75
29-Jun-07	Public Service New Mexico	NM	9.53
29-Jun-07	Yankee Gas Services	CT	10.10
3-Jul-07	Public Service Colorado	CO	10.25
13-Jul-07	Arkansas Western Gas	AR	9.50
24-Jul-07	Aquila	NE	10.40
1-Aug-07	Southern Indian Gas & Electric	IN	10.15
29-Aug-07	Columbia Gas of Kentucky	KY	10.50
10-Sep-07	Northern States Power	MN	9.71
19-Sep-07	Washington Gas Light	VA	10.00
25-Sep-07	Consolidated Edison	NY	9.70
8-Oct-07	Atmos Energy	TN	10.48
19-Oct-07	Delta Natural Gas	KY	10.50
25-Oct-07	Centerpoint Energy Resources	AR	9.65
15-Nov-07	Washington Gas Light	MD	10.00
20-Nov-07	Arkansas Oklahoma Gas	AR	9.90

Date	Company	State	ROE
27-Nov-07	UNS Gas	AZ	10.00
29-Nov-07	Cheyenne Light Fuel & Power	WY	10.90
14-Dec-07	Madison Gas & Electric	WI	10.80
18-Dec-07	Northwestern Energy Div.	NE	10.40
19-Dec-07	Avista Corp.	WA	10.20
21-Dec-07	Brooklyn Union Gas	NY	9.80
21-Dec-07	Keyspan Gas East	NY	9.80
21-Dec-07	National Fuel Gas Distribution	NY	9.10
21-Dec-07	Pacific Gas & Electric	CA	11.35
21-Dec-07	San Diego Gas & Electric	CA	11.10
8-Jan-08	Northern States Power	WI	10.75
17-Jan-08	Wisconsin Electric Power	WI	10.75
17-Jan-08	Wisconsin Gas	WI	10.75
5-Feb-08	North Shore Gas	IL	9.99
5-Feb-08	Peoples Gas Light & Coke	IL	10.19
13-Feb-08	Indiana Gas	IN	10.20
	Average		10.3

EXHIBIT 4
ALLOWED EQUITY RATIOS FOR
U.S. ELECTRIC AND NATURAL GAS UTILITIES
2006 – Q1 2008^[4]

Date	Company	State	% Equity
5-Jan-06	Northern States Power (WI)	WI	53.66%
27-Jan-06	United Illuminating (CT)	CT	48.00%
3-Mar-06	Interstate Power & Light (MN)	MN	49.10%
17-Apr-06	PacifiCorp (WA)	WA	46.00%
26-Apr-06	Sierra Pacific Power	NV	40.76%
6-Jun-06	Delmarva Power & Light	DE	47.72%
27-Jun-06	Upper Peninsula Power	MI	47.12%
6-Jul-06	Maine Public Service	ME	50.00%
24-Jul-06	Central Hudson Gas & Electric	NY	45.00%
28-Jul-06	Commonwealth Edison	IL	42.86%
23-Aug-06	NY State E & G	NY	41.60%
1-Sep-06	Northern States Power	MN	51.67%
14-Sep-06	PacifiCorp	OR	50.00%
6-Oct-06	Unitil Energy Systems	NH	43.10%
21-Nov-06	Central Illinois Light	IL	45.57%
21-Nov-06	Central Illinois Public Service	IL	48.92%
21-Nov-06	Illinois Power	IL	51.56%
30-Nov-06	Duquesne Light	PA	45.00%
1-Dec-06	Public Service Colorado	CO	60.00%
7-Dec-06	Central Vermont Public Service	VT	55.57%
21-Dec-06	Empire District Electric Co.	MO	49.74%
21-Dec-06	Kansas City Power & Light	MO	53.69%
22-Dec-06	Green Mountain Power	VT	52.76%
5-Jan-07	Puget Sound Energy	WA	44.00%
11-Jan-07	Metropolitan Edison	PA	49.00%
11-Jan-07	Pennsylvania Electric	PA	49.00%
11-Jan-07	Wisconsin Public Service	WI	57.46%
12-Jan-07	Portland General Electric	OR	50.00%
19-Jan-07	Wisconsin Power & Light	WI	54.13%
22-Mar-07	Rockland Electric	NJ	46.51%
17-May-07	Aquila MPS	MO	48.17%
17-May-07	Aquila LP	MO	48.17%
22-May-07	Monongahela	WV	46.07%
22-May-07	Union Electric	MO	52.22%
23-May-07	Nevada Power	NV	47.29%
25-May-07	Public Service NH	NH	47.66%
21-Jun-07	PacifiCorp	WA	46.00%
22-Jun-07	Appalachian Power	WV	42.88%

[4] Regulatory Research Associates, Inc., "Major Rate Case Decisions—January 2006—December 2007," January 8, 2008; "Major Rate Case Decisions—January—March 2008," April 2, 2008. Data not included for companies whose ratios are identified as including "cost-free items or tax credit balances at the overall rate of return." This does not substantially affect the average result.

Date	Company	State	% Equity
28-Jun-07	AZ Public Service	AZ	54.50%
12-Jul-07	Granite State Electric	NH	50.00%
19-Jul-07	Potomac Electric Power	MD	47.69%
19-Jul-07	DelMarva P & L	MD	48.63%
9-Oct-07	Public Service Oklahoma	OK	46.02%
18-Oct-07	Orange and Rockland	NY	47.54%
31-Oct-07	Electric Transmission Texas	TX	40.00%
29-Nov-07	Cheyenne Light	WY	54.00%
6-Dec-07	Kansas City Power & Light	MO	57.62%
13-Dec-07	AEP Texas	TX	40.00%
14-Dec-07	South Carolina Electric & Gas	SC	53.32%
14-Dec-07	Madison Gas and Electric	WI	57.36%
19-Dec-07	Avista Corporation	WA	46.00%
20-Dec-07	Duke Energy Carolinas	NC	53.00%
21-Dec-07	Southern California Edison	CA	48.00%
21-Dec-07	San Diego Gas & Electric	CA	49.00%
21-Dec-07	Pacific Gas and Electric	CA	52.00%
28-Dec-07	PacifiCorp	ID	50.40%
8-Jan-08	Northern States Power	WI	52.51%
17-Jan-08	Wisconsin Electric Power	WI	54.36%
28-Jan-08	Connecticut Light & Power	CT	48.99%
30-Jan-08	Potomac Electric Power	DC	46.55%
31-Jan-08	Central Vermont	VT	50.02%
29-Feb-08	Fitchburg Gas & Electric	MA	42.80%
12-Mar-08	PacifiCorp	WY	50.80%
25-Mar-08	Consolidated Edison	NY	47.98%
	Average 2006		48.7%
	Average 2007		49.2%
	Average Q1 2008		49.3%
	Average 2006 – Q1 - 2008		49%

EXHIBIT 4 (CONTINUED)
ALLOWED EQUITY RATIOS FOR
U.S. ELECTRIC AND NATURAL GAS UTILITIES
2006 – Q1 2008^[5]

NATURAL GAS UTILITIES

Date	Company	State	% Equity
5-Jan-06	Northern States Power	WI	53.66%
25-Jan-06	Wisconsin Gas	WI	50.20%
25-Jan-06	Wisconsin Electric Power	WI	56.34%
3-Feb-06	Public Service Colorado	CO	55.49%
23-Feb-06	Southwest Gas	AZ	40.00%
1-Mar-06	Aquila	IA	51.39%
26-Apr-06	Sierra Pacific Power	NV	40.76%
25-May-06	Atmos Energy	LA	48.00%
24-Jul-06	Central Hudson Gas & Electric	NY	45.00%
20-Sep-06	Knight Inc.	WY	43.56%
26-Sep-06	Chesapeake Utilities	MD	53.00%
20-Oct-06	Orange & Rockland Utilities	NY	48.00%
2-Nov-06	Centerpoint Energy MN Gas	MN	46.14%
9-Nov-06	Public Service E & G	NJ	47.40%
5-Dec-06	Chatanooga Gas	TN	44.80%
5-Jan-07	Puget Sound Energy	WA	44.00%
11-Jan-07	Wisconsin Public Service	WI	57.46%
19-Jan-07	Wisconsin Power & light	WI	54.13%
8-Feb-07	PPL Gas Utilities	PA	51.79%
14-Mar-07	Connecticut Natural Gas	CT	53.60%
20-Mar-07	Delmarva Power & Light	DE	46.90%
22-Mar-07	Southern Union	MO	36.06%
29-Mar-07	Atmos Energy	TX	48.10%
5-Jun-07	Cascade Natural Gas	OR	45.00%
13-Jun-07	Northern States Power	ND	51.59%
29-Jun-07	Yankee Gas Services	CT	50.30%
29-Jun-07	Public Service New Mexico	NM	51.80%
3-Jul-07	Public Service Colorado	CO	60.17%
24-Jul-07	Aquila	NE	50.73%
10-Sep-07	Northern States Power	MN	51.98%
25-Sep-07	Consolidated Edison	NY	48.00%
8-Oct-07	Atmos Energy	TN	44.20%
15-Nov-07	Washington Gas Light	MD	53.02%

[5] Regulatory Research Associates, Inc., "Major Rate Case Decisions—January 2006—December 2007," January 8, 2008; "Major Rate Case Decisions—January—March 2008," April 2, 2008. Data not included for companies whose ratios are identified as including "cost-free items or tax credit balances at the overall rate of return." This does not substantially affect the average result.

Date	Company	State	% Equity
27-Nov-07	UNS Gas	AZ	50.00%
29-Nov-07	Cheyenne Light Fuel & Power	WY	54.00%
14-Dec-07	Madison Gas & Electric	WI	57.36%
19-Dec-07	Avista Corp.	WA	46.00%
21-Dec-07	National Fuel Gas Distribution	NY	44.35%
21-Dec-07	San Diego Gas & Electric	CA	49.00%
21-Dec-07	Pacific Gas & Electric	CA	52.00%
8-Jan-08	Northern States Power	WI	52.51%
17-Jan-08	Wisconsin Gas	WI	46.64%
17-Jan-08	Wisconsin Electric Power	WI	54.36%
5-Feb-08	North Shore Gas	IL	56.00%
5-Feb-08	Peoples Gas Light & Coke	IL	56.00%
	Average 2006		48.3%
	Average 2007		50.1%
	Average Q1 2008		53.1%
	Average 2006 – Q1 2008		50%

EXHIBIT 5
COMPARISON OF DCF EXPECTED RETURN ON AN INVESTMENT IN
ELECTRIC UTILITIES TO THE INTEREST RATE
ON LONG-TERM GOVERNMENT BONDS

LINE NO.	DATE	DCF	TREASURY BOND YIELD	RISK PREMIUM
1	Sep-99	0.1169	0.0650	0.0519
2	Oct-99	0.1177	0.0666	0.0511
3	Nov-99	0.1208	0.0648	0.0560
4	Dec-99	0.1258	0.0669	0.0589
5	Jan-00	0.1250	0.0686	0.0564
6	Feb-00	0.1295	0.0654	0.0641
7	Mar-00	0.1336	0.0638	0.0698
8	Apr-00	0.1257	0.0618	0.0639
9	May-00	0.1242	0.0655	0.0587
10	Jun-00	0.1266	0.0628	0.0638
11	Jul-00	0.1276	0.0620	0.0656
12	Aug-00	0.1247	0.0602	0.0645
13	Sep-00	0.1180	0.0609	0.0571
14	Oct-00	0.1182	0.0604	0.0578
15	Nov-00	0.1187	0.0598	0.0589
16	Dec-00	0.1169	0.0564	0.0605
17	Jan-01	0.1205	0.0565	0.0640
18	Feb-01	0.1210	0.0562	0.0648
19	Mar-01	0.1215	0.0549	0.0666
20	Apr-01	0.1277	0.0578	0.0699
21	May-01	0.1304	0.0592	0.0712
22	Jun-01	0.1309	0.0582	0.0727
23	Jul-01	0.1324	0.0575	0.0749
24	Aug-01	0.1330	0.0558	0.0772
25	Sep-01	0.1356	0.0553	0.0803
26	Oct-01	0.1334	0.0534	0.0800
27	Nov-01	0.1338	0.0533	0.0805
28	Dec-01	0.1335	0.0576	0.0759
29	Jan-02	0.1314	0.0569	0.0745
30	Feb-02	0.1327	0.0561	0.0766
31	Mar-02	0.1286	0.0593	0.0693
32	Apr-02	0.1250	0.0585	0.0665
33	May-02	0.1258	0.0581	0.0677
34	Jun-02	0.1257	0.0565	0.0692
35	Jul-02	0.1322	0.0551	0.0771
36	Aug-02	0.1269	0.0519	0.0750
37	Sep-02	0.1288	0.0487	0.0801
38	Oct-02	0.1292	0.0500	0.0792
39	Nov-02	0.1238	0.0504	0.0734
40	Dec-02	0.1208	0.0501	0.0707

LINE NO.	DATE	DCF	TREASURY BOND YIELD	RISK PREMIUM
41	Jan-03	0.1172	0.0502	0.0670
42	Feb-03	0.1210	0.0487	0.0723
43	Mar-03	0.1171	0.0482	0.0689
44	Apr-03	0.1131	0.0491	0.0640
45	May-03	0.1072	0.0452	0.0620
46	Jun-03	0.1027	0.0434	0.0593
47	Jul-03	0.1034	0.0492	0.0542
48	Aug-03	0.1035	0.0539	0.0496
49	Sep-03	0.1006	0.0521	0.0485
50	Oct-03	0.0989	0.0521	0.0468
51	Nov-03	0.0978	0.0517	0.0461
52	Dec-03	0.0949	0.0511	0.0438
53	Jan-04	0.0923	0.0501	0.0422
54	Feb-04	0.0919	0.0494	0.0425
55	Mar-04	0.0916	0.0472	0.0444
56	Apr-04	0.0927	0.0516	0.0411
57	May-04	0.0966	0.0546	0.0420
58	Jun-04	0.0967	0.0545	0.0422
59	Jul-04	0.0959	0.0524	0.0435
60	Aug-04	0.0964	0.0507	0.0457
61	Sep-04	0.0956	0.0489	0.0467
62	Oct-04	0.0953	0.0485	0.0468
63	Nov-04	0.0911	0.0489	0.0422
64	Dec-04	0.0931	0.0488	0.0443
65	Jan-05	0.0933	0.0477	0.0456
66	Feb-05	0.0930	0.0461	0.0469
67	Mar-05	0.0925	0.0489	0.0436
68	Apr-05	0.0927	0.0475	0.0452
69	May-05	0.0922	0.0456	0.0466
70	Jun-05	0.0927	0.0435	0.0492
71	Jul-05	0.0913	0.0448	0.0465
72	Aug-05	0.0923	0.0453	0.0470
73	Sep-05	0.0950	0.0451	0.0499
74	Oct-05	0.0962	0.0474	0.0488
75	Nov-05	0.1005	0.0483	0.0522
76	Dec-05	0.1012	0.0473	0.0539
77	Jan-06	0.1015	0.0465	0.0550
78	Feb-06	0.1126	0.0473	0.0653
79	Mar-06	0.1111	0.0491	0.0620
80	Apr-06	0.1122	0.0522	0.0600
81	May-06	0.1118	0.0535	0.0583
82	Jun-06	0.1157	0.0529	0.0628
83	Jul-06	0.1151	0.0525	0.0626
84	Aug-06	0.1138	0.0508	0.0630
85	Sep-06	0.1164	0.0493	0.0671
86	Oct-06	0.1154	0.0494	0.0660
87	Nov-06	0.1158	0.0478	0.0680

LINE NO.	DATE	DCF	TREASURY BOND YIELD	RISK PREMIUM
88	Dec-06	0.1145	0.0478	0.0667
89	Jan-07	0.1120	0.0495	0.0625
90	Feb-07	0.1110	0.0493	0.0617
91	Mar-07	0.1120	0.0481	0.0639
92	Apr-07	0.1074	0.0495	0.0579
93	May-07	0.1108	0.0498	0.0610
94	Jun-07	0.1161	0.0529	0.0632
95	Jul-07	0.1179	0.0519	0.0660
96	Aug-07	0.1169	0.0500	0.0669
97	Sep-07	0.1135	0.0484	0.0651
98	Oct-07	0.1129	0.0483	0.0646
99	Nov-07	0.1108	0.0456	0.0652
100	Dec-07	0.1129	0.0457	0.0672
101	Jan-08	0.1229	0.0435	0.0794
102	Feb-08	0.1143	0.0449	0.0694
103	Mar-08	0.1178	0.0436	0.0742
104	Apr-08	0.1137	0.0444	0.0693
105	May-08	0.1142	0.0460	0.0682
106	Jun-08	0.1123	0.0474	0.0649
107	Jul-08	0.1172	0.0462	0.0710
108	Average	0.1132	0.0523	0.0609

Notes: See written evidence above and Appendix 3 for a description of the ex ante methodology and data employed. Government bond yield information from the Federal Reserve. DCF results are calculated using a quarterly DCF model as follows:

- d_0 = Latest quarterly dividend per Value Line
 P_0 = Average of the monthly high and low stock prices for each month per Thomson Reuters.
FC = Flotation costs expressed as a percent of gross proceeds.
g = I/B/E/S forecast of future earnings growth for each month.
k = Cost of equity using the quarterly version of the DCF model.

$$k = \left[\frac{d_0(1+g)^{\frac{1}{4}}}{P_0(1-FC)} \right]^4 - 1$$

EXHIBIT 6
COMPARISON OF DCF EXPECTED RETURN ON AN INVESTMENT IN
NATURAL GAS UTILITIES TO THE INTEREST RATE
ON LONG-TERM GOVERNMENT BONDS

LINE NO.	DATE	DCF	TREASURY BOND YIELD	RISK PREMIUM
1	Jun-98	0.1154	0.0580	0.0574
2	Jul-98	0.1186	0.0578	0.0608
3	Aug-98	0.1234	0.0566	0.0668
4	Sep-98	0.1273	0.0538	0.0735
5	Oct-98	0.1260	0.0530	0.0730
6	Nov-98	0.1211	0.0548	0.0663
7	Dec-98	0.1185	0.0536	0.0649
8	Jan-99	0.1195	0.0545	0.0650
9	Feb-99	0.1243	0.0566	0.0677
10	Mar-99	0.1257	0.0587	0.0670
11	Apr-99	0.1260	0.0582	0.0678
12	May-99	0.1221	0.0608	0.0613
13	Jun-99	0.1208	0.0636	0.0572
14	Jul-99	0.1222	0.0628	0.0594
15	Aug-99	0.1220	0.0643	0.0577
16	Sep-99	0.1226	0.0650	0.0576
17	Oct-99	0.1233	0.0666	0.0567
18	Nov-99	0.1240	0.0648	0.0592
19	Dec-99	0.1280	0.0669	0.0611
20	Jan-00	0.1301	0.0686	0.0615
21	Feb-00	0.1344	0.0654	0.0690
22	Mar-00	0.1344	0.0638	0.0706
23	Apr-00	0.1316	0.0618	0.0698
24	May-00	0.1292	0.0655	0.0637
25	Jun-00	0.1295	0.0628	0.0667
26	Jul-00	0.1317	0.0620	0.0697
27	Aug-00	0.1290	0.0602	0.0688
28	Sep-00	0.1257	0.0609	0.0648
29	Oct-00	0.1260	0.0604	0.0656
30	Nov-00	0.1251	0.0598	0.0653
31	Dec-00	0.1239	0.0564	0.0675
32	Jan-01	0.1261	0.0565	0.0696
33	Feb-01	0.1261	0.0562	0.0699
34	Mar-01	0.1275	0.0549	0.0726
35	Apr-01	0.1227	0.0578	0.0649
36	May-01	0.1302	0.0592	0.0710
37	Jun-01	0.1304	0.0582	0.0722
38	Jul-01	0.1338	0.0575	0.0763
39	Aug-01	0.1327	0.0558	0.0769
40	Sep-01	0.1268	0.0553	0.0715

LINE NO.	DATE	DCF	TREASURY BOND YIELD	RISK PREMIUM
41	Oct-01	0.1268	0.0534	0.0734
42	Nov-01	0.1268	0.0533	0.0735
43	Dec-01	0.1254	0.0576	0.0678
44	Jan-02	0.1236	0.0569	0.0667
45	Feb-02	0.1241	0.0561	0.0680
46	Mar-02	0.1189	0.0593	0.0596
47	Apr-02	0.1159	0.0585	0.0574
48	May-02	0.1162	0.0581	0.0581
49	Jun-02	0.1170	0.0565	0.0605
50	Jul-02	0.1242	0.0551	0.0691
51	Aug-02	0.1234	0.0519	0.0715
52	Sep-02	0.1260	0.0487	0.0773
53	Oct-02	0.1250	0.0500	0.0750
54	Nov-02	0.1221	0.0504	0.0717
55	Dec-02	0.1216	0.0501	0.0715
56	Jan-03	0.1219	0.0502	0.0717
57	Feb-03	0.1232	0.0487	0.0745
58	Mar-03	0.1195	0.0482	0.0713
59	Apr-03	0.1162	0.0491	0.0671
60	May-03	0.1126	0.0452	0.0674
61	Jun-03	0.1114	0.0434	0.0680
62	Jul-03	0.1127	0.0492	0.0635
63	Aug-03	0.1139	0.0539	0.0600
64	Sep-03	0.1127	0.0521	0.0606
65	Oct-03	0.1123	0.0521	0.0602
66	Nov-03	0.1089	0.0517	0.0572
67	Dec-03	0.1071	0.0511	0.0560
68	Jan-04	0.1059	0.0501	0.0558
69	Feb-04	0.1039	0.0494	0.0545
70	Mar-04	0.1037	0.0472	0.0565
71	Apr-04	0.1041	0.0516	0.0525
72	May-04	0.1045	0.0546	0.0499
73	Jun-04	0.1036	0.0545	0.0491
74	Jul-04	0.1011	0.0524	0.0487
75	Aug-04	0.1008	0.0507	0.0501
76	Sep-04	0.0976	0.0489	0.0487
77	Oct-04	0.0974	0.0485	0.0489
78	Nov-04	0.0962	0.0489	0.0473
79	Dec-04	0.0970	0.0488	0.0482
80	Jan-05	0.0990	0.0477	0.0513
81	Feb-05	0.0979	0.0461	0.0518
82	Mar-05	0.0979	0.0489	0.0490
83	Apr-05	0.0988	0.0475	0.0513
84	May-05	0.0981	0.0456	0.0525
85	Jun-05	0.0976	0.0435	0.0541
86	Jul-05	0.0966	0.0448	0.0518
87	Aug-05	0.0969	0.0453	0.0516

LINE NO.	DATE	DCF	TREASURY BOND YIELD	RISK PREMIUM
88	Sep-05	0.0980	0.0451	0.0529
89	Oct-05	0.0990	0.0474	0.0516
90	Nov-05	0.1049	0.0483	0.0566
91	Dec-05	0.1045	0.0473	0.0572
92	Jan-06	0.0982	0.0465	0.0517
93	Feb-06	0.1124	0.0473	0.0651
94	Mar-06	0.1127	0.0491	0.0636
95	Apr-06	0.1100	0.0522	0.0578
96	May-06	0.1056	0.0535	0.0521
97	Jun-06	0.1049	0.0529	0.0520
98	Jul-06	0.1087	0.0525	0.0562
99	Aug-06	0.1041	0.0508	0.0533
100	Sep-06	0.1053	0.0493	0.0560
101	Oct-06	0.1030	0.0494	0.0536
102	Nov-06	0.1033	0.0478	0.0555
103	Dec-06	0.1035	0.0478	0.0557
104	Jan-07	0.1013	0.0495	0.0518
105	Feb-07	0.1018	0.0493	0.0525
106	Mar-07	0.1018	0.0481	0.0537
107	Apr-07	0.1007	0.0495	0.0512
108	May-07	0.0967	0.0498	0.0469
109	Jun-07	0.0970	0.0529	0.0441
110	Jul-07	0.1006	0.0519	0.0487
111	Aug-07	0.1021	0.0500	0.0521
112	Sep-07	0.1014	0.0484	0.0520
113	Oct-07	0.1080	0.0483	0.0597
114	Nov-07	0.1083	0.0456	0.0627
115	Dec-07	0.1084	0.0457	0.0627
116	Jan-08	0.1113	0.0435	0.0678
117	Feb-08	0.1139	0.0449	0.0690
118	Mar-08	0.1147	0.0436	0.0711
119	Apr-08	0.1167	0.0444	0.0723
120	May-08	0.1069	0.0460	0.0609
121	Jun-08	0.1062	0.0474	0.0588
122	Jul-08	0.1086	0.0462	0.0624
123	Average	0.1142	0.0530	0.0612

Notes: Government bond yield information from the Federal Reserve. DCF results are calculated using a quarterly DCF model as follows:

- d_0 = Latest quarterly dividend per Value Line
 P_0 = Average of the monthly high and low stock prices for each month per Thomson Reuters.
FC = Flotation costs expressed as a percent of gross proceeds.
g = I/B/E/S forecast of future earnings growth for each month
k = Cost of equity using the quarterly version of the DCF model.

$$k = \left[\frac{d_0(1+g)^{\frac{1}{4}}}{P_0(1-FC)} \right]^4 - 1$$

EXHIBIT 7
IMPLIED ALLOWED EQUITY RISK PREMIUM^[6]

YEAR	AVERAGE ALLOWED RETURN	20-YEAR U.S. TREASURY BOND	RISK PREMIUM
1994	0.1134	0.0629	0.0505
1995	0.1151	0.0749	0.0402
1996	0.1129	0.0695	0.0434
1997	0.1134	0.0683	0.0451
1998	0.1159	0.0669	0.0490
1999	0.1074	0.0572	0.0502
2000	0.1141	0.0620	0.0521
2001	0.1105	0.0623	0.0482
2002	0.1110	0.0563	0.0547
2003	0.1098	0.0543	0.0555
2004	0.1067	0.0496	0.0571
2005	0.1050	0.0504	0.0546
2006	0.1039	0.0464	0.0575
2007	0.1030	0.0500	0.0530
Average	0.1102	0.0594	0.0508

**IMPLIED ALLOWED EQUITY RISK PREMIUM
REGRESSION RESULTS**

INTERCEPT COEFFICIENT	0.0839
Slope Coefficient	(0.5581)
Treasury Bond Yield	0.049
Slope x Bond Yield	(0.0273)
Forecasted Risk Premium	0.0566

Treasury bond yield is July 2009 forecast from July 2008 Consensus Economics.

[6] Regulatory Research Associates, Inc., "Major Rate Case Decisions—January 2006—December 2007," January 8, 2008; "Major Rate Case Decisions—January—March 2008," April 2, 2008. Treasury bond yield is July 2009 forecast from July 2008 Consensus Economics.

EXHIBIT 8
SUMMARY OF DISCOUNTED CASH FLOW ANALYSIS
FOR VALUE LINE ELECTRIC COMPANIES

Line No.	Company	d ₀	P ₀	Growth	Cost of Equity
1	Ameren Corp.	0.635	43.840	4.00%	10.6%
2	Amer. Elec. Power	0.410	41.683	5.96%	10.5%
3	Dominion Resources	0.395	45.887	8.30%	12.3%
4	Consol. Edison	0.585	40.111	3.00%	9.5%
5	Edison Int'l	0.305	51.197	8.45%	11.2%
6	Entergy Corp.	0.750	116.833	12.18%	15.4%
7	Exelon Corp.	0.500	86.810	9.79%	12.4%
8	FirstEnergy Corp.	0.550	78.208	8.33%	11.5%
9	FPL Group	0.445	65.893	9.73%	12.9%
10	G't Plains Energy	0.415	25.923	6.45%	14.0%
11	Hawaiian Elec.	0.310	25.323	5.50%	11.2%
12	Alliant Energy	0.350	35.458	5.40%	9.8%
13	MDU Resources	0.145	32.580	12.67%	14.9%
14	NiSource Inc.	0.230	17.710	2.91%	8.7%
15	NSTAR	0.350	33.173	6.00%	10.8%
16	Northeast Utilities	0.213	26.095	8.06%	11.8%
17	PG&E Corp.	0.390	39.410	6.90%	11.4%
18	Progress Energy	0.615	42.003	6.12%	13.0%
19	Pinnacle West Capital	0.525	32.795	4.38%	11.7%
20	Pepco Holdings	0.270	25.601	8.67%	13.6%
21	Portland General	0.245	23.455	6.48%	11.2%
22	SCANA Corp.	0.460	38.275	5.09%	10.5%
23	Southern Co.	0.420	35.842	5.36%	10.6%
24	Sempra Energy	0.350	56.743	7.59%	10.3%
25	TECO Energy	0.200	19.873	5.73%	10.3%
26	Vectren Corp.	0.325	29.777	5.77%	10.8%
27	Wisconsin Energy	0.270	46.182	9.39%	12.1%
28	Westar Energy	0.290	22.700	4.61%	10.2%
29	Xcel Energy Inc.	0.238	20.595	6.12%	11.3%
30	Market-Wtd. Ave.				11.8%

Notes:

- d₀ = Most recent quarterly dividend.
d₁, d₂, d₃, d₄ = Next four quarterly dividends, calculated by multiplying the last four quarterly dividends per *Value Line* by the factor (1 + g).
P₀ = Average of the monthly high and low stock prices during the three months ending July 2008 per Thomson Reuters.
FC = Flotation costs expressed as a percent of gross proceeds.
g = I/B/E/S forecast of future earnings growth July 2008.
k = Cost of equity using the quarterly version of the DCF model.

$$k = \frac{d_1(1+k)^{-75} + d_2(1+k)^{-50} + d_3(1+k)^{-25} + d_4}{P_0(1-FC)} + g$$

EXHIBIT 9
SUMMARY OF DISCOUNTED CASH FLOW ANALYSIS
FOR VALUE LINE NATURAL GAS COMPANIES

Line No.	Company	d ₀	P ₀	Growth	Cost of Equity
1	AGL Resources	0.420	34.757	5.25%	10.7%
2	Atmos Energy	0.325	27.155	4.67%	10.1%
3	Energen Corp.	0.120	72.712	10.25%	11.0%
4	Equitable Resources	0.220	67.193	10.50%	12.1%
5	Nicor Inc.	0.465	40.615	4.50%	9.7%
6	Northwest Nat. Gas	0.375	45.603	4.83%	8.5%
7	ONEOK Inc.	0.380	48.372	9.07%	12.7%
8	Piedmont Natural Gas	0.260	26.393	5.75%	10.2%
9	South Jersey Inds.	0.270	37.762	7.00%	10.2%
10	Questar Corp.	0.123	65.213	9.00%	9.9%
11	Southwest Gas	0.225	29.778	6.00%	9.4%
12	Market-Weighted Average				10.8%

Notes:

- d₀ = Most recent quarterly dividend.
d₁, d₂, d₃, d₄ = Next four quarterly dividends, calculated by multiplying the last four quarterly dividends per *Value Line* by the factor (1 + g).
P₀ = Average of the monthly high and low stock prices during the three months ending July 2008 per Thomson Reuters.
FC = Flotation costs expressed as a percent of gross proceeds.
g = I/B/E/S forecast of future earnings growth July 2008.^[7]
k = Cost of equity using the quarterly version of the DCF model.

$$k = \frac{d_1(1+k)^{-.75} + d_2(1+k)^{-.50} + d_3(1+k)^{-.25} + d_4}{P_0(1-FC)} + g$$

[7] Although I normally specify that the I/B/E/S long-term earnings growth forecast must include the forecasts of at least three analysts, in July 2008 there are only six companies with growth forecasts from at least three analysts. In this study, therefore, I also include results for companies that had growth forecasts based on two analysts' growth forecasts.

EXHIBIT 10
MARKET VALUE EQUITY RATIOS FOR U.S. ELECTRIC AND
NATURAL GAS COMPANIES AT SEPTEMBER 2008

COMPANY	LONG-TERM DEBT	PREFERRED EQUITY	MARKET CAP \$ (MIL)	% MARKET EQUITY
Ameren Corp.	5,691	195	9,015	61%
Amer. Elec. Power	14,202	61	16,024	53%
Dominion Resources	13,235	257	25,732	66%
Consol. Edison	7,611	213	11,343	59%
Edison Int'l	9,016	915	15,261	61%
Entergy Corp.	9,728	311	20,237	67%
Exelon Corp.	11,965	87	50,707	81%
FirstEnergy Corp.	8,869	0	22,610	72%
FPL Group	11,280	0	24,979	69%
G't Plains Energy	1,103	39	2,052	64%
Hawaiian Elec.	1,192	34	2,254	65%
Alliant Energy	1,405	244	3,921	70%
MDU Resources	1,147	15	6,114	84%
NiSource Inc.	5,594	0	4,588	45%
NSTAR	2,501	43	3,643	59%
Northeast Utilities	2,945	116	4,299	58%
PG&E Corp.	8,171	252	14,976	64%
Progress Energy	8,737	93	11,580	57%
Pinnacle West Capital	3,127	0	3,631	54%
Pepco Holdings	4,735	0	5,158	52%
Portland General	1,313	0	1,623	55%
SCANA Corp.	2,879	113	4,651	61%
Southern Co.	14,143	1,080	29,267	66%
Sempra Energy	4,553	193	14,411	75%
TECO Energy	3,158	0	3,816	55%
Vectren Corp.	1,245	0	2,270	65%
Wisconsin Energy	3,173	30	5,488	63%
Westar Energy	1,890	21	2,498	57%
Xcel Energy Inc.	6,342	105	8,993	58%
Composite	170,950	4,418	331,141	65%
Average				63%

Data are from The Value Line Investment Analyzer, September 2008.

EXHIBIT 10 (CONTINUED)
MARKET VALUE EQUITY RATIOS FOR U.S. ELECTRIC AND
NATURAL GAS COMPANIES AT SEPTEMBER 2008

COMPANY	LONG-TERM DEBT	PREFERRED EQUITY	MARKET CAP \$ (MIL)	% MARKET EQUITY
AGL Resources	1,674	0	2,559	60%
Atmos Energy	2,126	0	2,501	54%
Energen Corp.	562	0	4,145	88%
Equitable Resources	754	0	6,649	90%
Nicor Inc.	423	1	2,113	83%
Northwest Nat. Gas	512	0	1,304	72%
ONEOK Inc.	4,215	0	4,567	52%
Piedmont Natural Gas	825	0	2,138	72%
South Jersey Inds.	358	0	1,069	75%
Questar Corp.	1,021	0	9,139	90%
Southwest Gas	1,366	0	1,325	49%
Composite	13,836	1	37,507	73%
Average				71%

EXHIBIT 11
APPENDIX 1
QUALIFICATIONS OF JAMES H. VANDER WEIDE, PH.D.

James H. Vander Weide is Research Professor of Finance and Economics at Duke University, the Fuqua School of Business. Dr. Vander Weide is also founder and President of Financial Strategy Associates, a consulting firm that provides strategic, financial, and economic consulting services to corporate clients, including cost of capital and valuation studies.

Educational Background and Prior Academic Experience

Dr. Vander Weide holds a Ph.D. in Finance from Northwestern University and a Bachelor of Arts from Cornell University. He joined the faculty at Duke University and was named Assistant Professor, Associate Professor, Professor, and then Research Professor of Finance and Economics.

Since joining the faculty at Duke, Dr. Vander Weide has taught courses in corporate finance, investment management, and management of financial institutions. He has also taught courses in statistics, economics, and operations research, and a Ph.D. seminar on the theory of public utility pricing. In addition, Dr. Vander Weide has been active in executive education at Duke and Duke Corporate Education, leading executive development seminars on topics including financial analysis, cost of capital, creating shareholder value, mergers and acquisitions, real options, capital budgeting, cash management, measuring corporate performance, valuation, short-run financial planning, depreciation policies, financial strategy, and competitive strategy. Dr. Vander Weide has designed and served as Program Director for several executive education programs, including the Advanced Management Program, Competitive Strategies in Telecommunications, and the Duke Program for Manager Development for managers from the former Soviet Union.

Publications

Dr. Vander Weide has written a book entitled *Managing Corporate Liquidity: An Introduction to Working Capital Management* published by John Wiley and Sons, Inc. He has also written a chapter titled, "Financial Management in the Short Run" for *The Handbook of Modern Finance*, and written research papers on such topics as portfolio management, capital budgeting, investments, the effect of regulation on the performance of public utilities, and cash management. His articles have been published in *American Economic Review*, *Financial Management*, *International Journal of Industrial Organization*,

Journal of Finance, Journal of Financial and Quantitative Analysis, Journal of Bank Research, Journal of Portfolio Management, Journal of Accounting Research, Journal of Cash Management, Management Science, Atlantic Economic Journal, Journal of Economics and Business, and Computers and Operations Research.

Professional Consulting Experience

Dr. Vander Weide has provided financial and economic consulting services to firms in the electric, gas, insurance, telecommunications, and water industries for more than 25 years. He has testified on the cost of capital, competition, risk, incentive regulation, forward-looking economic cost, economic pricing guidelines, depreciation, accounting, valuation, and other financial and economic issues in more than 400 cases before the United States Congress, the Canadian Radio-Television and Telecommunications Commission, the Federal Communications Commission, the National Telecommunications and Information Administration, the Federal Energy Regulatory Commission, the public service commissions of 42 states and the District of Columbia, the insurance commissions of five states, the Iowa State Board of Tax Review, the National Association of Securities Dealers, and the North Carolina Property Tax Commission. In addition, he has testified as an expert witness in proceedings before the United States District Court for the District of New Hampshire; United States District Court for the Northern District of California; United States District Court for the District of Nebraska; United States District Court for the Eastern District of North Carolina; Superior Court of North Carolina, the United States Bankruptcy Court for the Southern District of West Virginia; and United States District Court for the Eastern District of Michigan. With respect to implementation of the Telecommunications Act of 1996, Dr. Vander Weide has testified in 30 states on issues relating to the pricing of unbundled network elements and universal service cost studies and has consulted with Bell Canada, Deutsche Telekom, and Telefónica on similar issues. He has also provided expert testimony on issues related to electric and natural gas restructuring. He has worked for Bell Canada/Nortel on a special task force to study the effects of vertical integration in the Canadian telephone industry and has worked for Bell Canada as an expert witness on the cost of capital. Dr. Vander Weide has provided consulting and expert witness testimony to the following companies:

Telecommunications Companies

ALLTEL and its subsidiaries
AT&T (old)
Bell Canada/Nortel
Centel and its subsidiaries
Cisco Systems
Concord Telephone Company
Deutsche Telekom

Ameritech (now AT&T new)
Verizon (Bell Atlantic) and subsidiaries
BellSouth and its subsidiaries
Cincinnati Bell (Broadwing)
Citizens Telephone Company
Contel and its subsidiaries
GTE and subsidiaries (now Verizon)

Heins Telephone Company
Minnesota Independent Equal Access Corp.
Pacific Telesis and its subsidiaries
Pine Drive Cooperative Telephone Co.
Siemens
Sherburne Telephone Company
The Stentor Companies
Telefónica
Woodbury Telephone Company
U S West (Qwest)

Lucent Technologies
NYNEX and its subsidiaries (Verizon)
Phillips County Cooperative Tel. Co.
Roseville Telephone Company (SureWest)
SBC Communications (now AT&T new)
Southern New England Telephone
Sprint/United and its subsidiaries
Union Telephone Company
United States Telephone Association
Valor Telecommunications (Windstream)

Electric, Gas, and Water Companies

Alcoa Power Generating, Inc.
Alliant Energy
Ameren
American Water Works
Atmos Energy
Central Illinois Public Service
Citizens Utilities
Consolidated Natural Gas and its subsidiaries
Dominion Resources
Duke Energy
Empire District Electric Company
Interstate Power Company
Iowa-American Water Company
Iowa-Illinois Gas and Electric
Iowa Southern
Kentucky-American Water Company
Kentucky Power Company
MidAmerican Energy and its subsidiaries
Nevada Power Company
NICOR
North Carolina Natural Gas
Northern Natural Gas Company

NOVA Gas Transmission Ltd.
North Shore Gas
PacifiCorp
PG&E
Peoples Energy and its subsidiaries
The Peoples Gas, Light and Coke Co.
Progress Energy
Public Service Company of North Carolina
PSE&G
Sempra Energy
South Carolina Electric and Gas
Southern Company and subsidiaries
Tennessee-American Water Company
Trans Québec & Maritimes Pipeline Inc.
United Cities Gas Company

Insurance Companies

Allstate
North Carolina Rate Bureau
United Services Automobile Association (USAA)
The Travelers Indemnity Company
Gulf Insurance Company

Other Professional Experience

Dr. Vander Weide conducts in-house seminars and training sessions on topics such as creating shareholder value, financial analysis, competitive strategy, cost of capital, real options, financial strategy, managing growth, mergers and acquisitions, valuation, measuring corporate performance, capital budgeting, cash management, and financial planning. Among the firms for whom he has designed and taught tailored programs and training sessions are ABB Asea Brown Boveri, Accenture, Allstate, Ameritech, AT&T, Bell Atlantic/Verizon, BellSouth, Progress Energy/Carolina Power & Light, Contel, Fisons, GlaxoSmithKline, GTE, Lafarge, MidAmerican Energy, New Century Energies, Norfolk Southern, Pacific Bell Telephone, The Rank Group, Siemens, Southern New England Telephone, TRW, and Wolseley Plc. Dr. Vander Weide has also hosted a nationally prominent conference/workshop on estimating the cost of capital. In 1989, at the request of Mr. Fuqua, Dr. Vander Weide designed the Duke Program for Manager Development for

managers from the former Soviet Union, the first in the United States designed exclusively for managers from Russia and the former Soviet republics.

In the 1970's, Dr. Vander Weide helped found University Analytics, Inc., which at that time was one of the fastest growing small firms in the country. As an officer at University Analytics, he designed cash management models, databases, and software packages that are still used by most major U.S. banks in consulting with their corporate clients. Having sold his interest in University Analytics, Dr. Vander Weide now concentrates on strategic and financial consulting, academic research, and executive education.

PUBLICATIONS
JAMES H. VANDER WEIDE

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Principles for Lifetime Portfolio Selection: Lessons from Portfolio Theory, *Handbook of Portfolio Construction: Contemporary Applications of Markowitz Techniques*, John B. Guerard, (Ed.), Springer, forthcoming March 2009.

Managing Corporate Liquidity: an Introduction to Working Capital Management, John Wiley and Sons, 1984 (with S. Maier).

**SUMMARY EXPERT TESTIMONY
JAMES H. VANDER WEIDE**

SPONSOR	JURISDICTION	DATE	DOCKET NO.
Kentucky-American Water Company	Kentucky	Oct-08	2008-00427
Atmos Energy	Tennessee	Oct-08	0800197
Dorsey & Whitney LLP-Williams v. Gannon	Montana 2nd Judicial Dist. Ct. Silver Bow County	Apr-08	DV-02-201
Atmos Energy	Georgia	Mar-08	27163-U
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Jan-08	
Trans Québec & Maritimes Pipeline Inc.	National Energy Board (Canada)	Dec-07	
Xcel Energy	North Dakota	Dec-07	PU-07-776
Verizon Southwest	Texas	Nov-07	34723
Empire District Electric Company	Missouri	Oct-07	ER-2008-0093
North Carolina Rate Bureau (workers compensation)	North Carolina Dept. of Insurance	Sep-07	
Verizon North Inc. Contel of the South Inc.	Michigan	Aug-07	Case No. U-15210
Georgia Power Company	Georgia	Jun-07	25060-U
Duke Energy Carolinas	North Carolina	May-07	E-7 Sub 828 et al
MidAmerican Energy Company	Iowa	May-07	SPU-06-5 et al
Morrison & Foerster LLP-JDS Uniphase Securities Litigation	U.S. District Court Northern District California	Feb-07	C-02-1486-CW
TransCanada Pipelines Ltd.	National Energy Board (Canada)	Feb-07	
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	Dec-06	
San Diego Gas & Electric	FERC	Nov-06	ER07-284-000
North Carolina Rate Bureau (workers compensation)	North Carolina Dept. of Insurance	Aug-06	
Union Electric Company d/b/a AmerenUE	Missouri	Jun-06	ER-2007-0002
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	May-06	
North Carolina Rate Bureau (dwelling fire)	North Carolina Dept. of Insurance	Mar-06	
Empire District Electric Company	Missouri	Feb-06	ER-2006-0315
PacifiCorp Power & Light Company	Washington	Jan-06	UE-050684
Verizon Maine	Maine	Dec-05	2005-155
Winston & Strawn LLP-Cisco Systems Securities Litigation	U.S. District Court Northern District California	Nov-05	C-01-20418-JW
Dominion Virginia Power	Virginia	Nov-05	PUE-2004-00048
Bryan Cave LLP--Omniplex Comms. v. Lucent Technologies	U.S. District Court Eastern District Missouri	Sep-05	04CV00477 ERW
North Carolina Rate Bureau (workers comp)	North Carolina Dept. of Insurance	Sep-05	
Empire District Electric Company	Kansas	Sep-05	05-EPDE-980-RTS
Verizon Southwest	Texas	Jul-05	29315
PG&E Company	FERC	Jul-05	ER-05-1284
Dominion Hope	West Virginia	Jun-05	05-034-G42T
Empire District Electric Company	Missouri	Jun-05	EO-2005-0263
Verizon New England	U.S. District Court New Hampshire	May-05	04-CV-65-PB
San Diego Gas & Electric	California	May-05	05-05-012
Progress Energy	Florida	May-05	50078
Verizon Vermont	Vermont	Feb-05	6959
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	Feb-05	
Verizon Florida	Florida	Jan-05	050059-TL
Verizon Illinois	Illinois	Jan-05	00-0812
Dominion Resources	North Carolina	Sep-04	E-22 Sub 412
Tennessee-American Water Company	Tennessee	Aug-04	04-00288
Valor Telecommunications of Texas, LP.	New Mexico	Jul-04	3495 Phase C
Alcoa Power Generating Inc.	North Carolina Property Tax Commission	Jul-04	02 PTC 162 and 02 PTC 709
PG&E Company	California	May-04	04-05-21
Verizon Northwest	Washington	Apr-04	UT-040788

SPONSOR	JURISDICTION	DATE	DOCKET NO.
Verizon Northwest	Washington	Apr-04	UT-040788
Kentucky-American Water Company	Kentucky	Apr-04	2004-00103
MidAmerican Energy	South Dakota	Apr-04	NG4-001
Empire District Electric Company	Missouri	Apr-04	ER-2004-0570
Interstate Power and Light Company	Iowa	Mar-04	RPU-04-01
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Feb-04	
Northern Natural Gas Company	FERC	Feb-04	RP04-155-000
Verizon New Jersey	New Jersey	Jan-04	TO00060356
Verizon	FCC	Jan-04	03-173, FCC 03-224
Verizon	FCC	Dec-03	03-173, FCC 03-224
Verizon California Inc.	California	Nov-03	R93-04-003,193-04-002
Phillips County Telephone Company	Colorado	Nov-03	03S-315T
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	Oct-03	
PG&E Company	FERC	Oct-03	ER04-109-000
Allstate Insurance Company	Texas Department of Insurance	Sep-03	2568
Verizon Northwest Inc.	Washington	Jul-03	UT-023003
Empire District Electric Company	Oklahoma	Jul-03	Case No. PUD 200300121
Verizon Virginia Inc.	FCC	Apr-03	CC-00218,00249,00251
North Carolina Rate Bureau (dwelling fire)	North Carolina Dept. of Insurance	Apr-03	
Northern Natural Gas Company	FERC	Apr-03	RP03-398-000
MidAmerican Energy	Iowa	Apr-03	RPU-03-1, WRU-03-25-156
PG&E Company	FERC	Mar-03	ER03666000
Verizon Florida Inc.	Florida	Feb-03	981834-TP/990321-TP
Verizon North	Indiana	Feb-03	42259
San Diego Gas & Electric	FERC	Feb-03	ER03-601000
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Jan-03	
Gulf Insurance Company	Superior Court, North Carolina	Jan-03	2000-CVS-3558
PG&E Company	FERC	Jan-03	ER03409000
Verizon New England Inc. New Hampshire	New Hampshire	Dec-02	DT 02-110
Verizon Northwest	Washington	Dec-02	UT 020406
PG&E Company	California	Dec-02	
MidAmerican Energy	Iowa	Nov-02	RPU-02-3, 02-8
MidAmerican Energy	Iowa	Nov-02	RPU-02-10
Verizon Michigan	US District Court Eastern District of Michigan	Sep-02	Civil Action No. 00-73208
North Carolina Rate Bureau (workers comp)	North Carolina Dept. of Insurance	Sep-02	
Verizon New England Inc. New Hampshire	New Hampshire	Aug-02	DT 02-110
Interstate Power Company	Iowa Board of Tax Review	Jul-02	832
PG&E Company	California	May-02	A 02-05-022 et al
Verizon New England Inc. Massachusetts	FCC	May-02	EB 02 MD 006
Verizon New England Inc. Rhode Island	Rhode Island	May-02	Docket No. 2681
Neumedia, Inc.	US Bankruptcy Court Southern District W. Virginia	Apr-02	Case No. 01-20873
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	Mar-02	
MidAmerican Energy Company	Iowa	Mar-02	RPU 02 2
North Carolina Natural Gas Company	North Carolina	Feb-02	G21 Sub 424
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Jan-02	
Verizon Pennsylvania	Pennsylvania	Dec-01	R-00016683
Verizon Florida	Florida	Nov-01	99064B-TP
PG&E Company	FERC	Nov-01	ER0166000
Verizon Delaware	Delaware	Oct-01	96-324 Phase II
Florida Power Corporation	Florida	Sep-01	000824-EL
North Carolina Rate Bureau (workers comp)	North Carolina Dept. of Insurance	Sep-01	
Verizon Washington DC	District of Columbia	Jul-01	962
Verizon Virginia	FCC	Jul-01	CC-00218,00249,00251
Sherburne County Rural Telephone Company	Minnesota	Jul-01	P427/CI-00-712

SPONSOR	JURISDICTION	DATE	DOCKET NO.
Verizon New Jersey	New Jersey	Jun-01	TO01020095
Verizon Maryland	Maryland	May-01	8879
Verizon Massachusetts	Massachusetts	May-01	DTE 01-20
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Apr-01	
PG&E Company	FERC	Mar-01	ER011639000
Maupin Taylor & Ellis P.A.	National Association of Securities Dealers	Jan-01	99-05099
USTA	FCC	Oct-00	RM 10011
Verizon New York	New York	Oct-00	98-C-1357
Verizon New Jersey	New Jersey	Oct-00	TO00060356
PG&E Company	FERC	Oct-00	ER0166000
Verizon New Jersey	New Jersey	Sep-00	TO99120934
North Carolina Rate Bureau (workers comp)	North Carolina Dept. of Insurance	Sep-00	
PG&E Company	California	Aug-00	00-05-018
Verizon New York	New York	Jul-00	98-C-1357
PG&E Company	California	May-00	00-05-013
PG&E Company	FERC	Mar-00	ER00-66-000
PG&E Company	FERC	Mar-00	ER99-4323-000
Bell Atlantic	New York	Feb-00	98-C-1357
USTA	FCC	Jan-00	94-1, 96-262
MidAmerican Energy	Iowa	Nov-99	SPU-99-32
PG&E Company	California	Nov-99	99-11-003
PG&E Company	FERC	Nov-99	ER973255,981261,981685
North Carolina Rate Bureau (workers comp)	North Carolina Dept. of Insurance	Sep-99	
MidAmerican Energy	Illinois	Sep-99	99-0534
PG&E Company	FERC	Sep-99	ER99-4323-000
MidAmerican Energy	FERC	Jul-99	ER99-3887
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	Jun-99	
Bell Atlantic	Vermont	May-99	6167
Nevada Power Company	FERC	May-99	
Bell Atlantic, GTE, US West	FCC	Apr-99	CC98-166
Nevada Power Company	Nevada	Apr-99	
Bell Atlantic, GTE, US West	FCC	Mar-99	CC98-166
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Mar-99	
PG&E Company	FERC	Mar-99	ER99-2326-000
MidAmerican Energy	Illinois	Mar-99	099-0310
PG&E Company	FERC	Feb-99	ER99-2358,2087,2351
MidAmerican Energy	US District Court, District of Nebraska	Feb-99	8:97 CV 346
Bell Atlantic, GTE, US West	FCC	Jan-99	CC98-166
The Southern Company	FERC	Jan-99	ER98-1096
Deutsche Telekom	Germany	Nov-98	
Telefonica	Spain	Nov-98	
Cincinnati Bell Telephone Company	Ohio	Oct-98	96899TPALT
MidAmerican Energy	Iowa	Sep-98	RPU 98-5
MidAmerican Energy	South Dakota	Sep-98	NG98-011
MidAmerican Energy	Iowa	Sep-98	SPU 98-8
GTE Florida Incorporated	Florida	Aug-98	980696-TP
GTE North and South	Illinois	Jun-98	960503
GTE Midwest Incorporated	Missouri	Jun-98	TO98329
GTE North and South	Illinois	May-98	960503
MidAmerican Energy	Iowa Board of Tax Review	May-98	835
San Diego Gas & Electric	California	May-98	98-05-024
GTE Midwest Incorporated	Nebraska	Apr-98	C1416
Carolina Telephone	North Carolina	Mar-98	P100Sub133d
GTE Southwest	Texas	Feb-98	18515

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North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Feb-98	P100sub133d
Public Service Electric & Gas	New Jersey	Feb-98	PUC734897N,-734797N,BPUEO97070461,-07070462
GTE North	Minnesota	Dec-97	P999/M97909
GTE Northwest	Oregon	Dec-97	UM874
The Southern Company	FERC	Dec-97	ER981096000
GTE North	Pennsylvania	Nov-97	A310125F0002
Bell Atlantic	Rhode Island	Nov-97	2681
GTE North	Indiana	Oct-97	40618
GTE North	Minnesota	Oct-97	P442,407/5321/CI961541
GTE Southwest	New Mexico	Oct-97	96310TC,96344TC
GTE Midwest Incorporated	Iowa	Sep-97	RPU-96-7
North Carolina Rate Bureau (workers)	North Carolina Dept. of Insurance	Sep-97	
GTE Hawaiian Telephone	Hawaii	Aug-97	7702
The Stentor Companies	Canadian Radio-television and Telecommunications Commission	Jul-97	CRTC97-11
New England Telephone	Vermont	Jul-97	5713
Bell-Atlantic-New Jersey	New Jersey	Jun-97	TX95120631
Nevada Bell	Nevada	May-97	96-9035
New England Telephone	Maine	Apr-97	96-781
GTE North, Inc.	Michigan	Apr-97	U11281
Bell Atlantic-Virginia	Virginia	Apr-97	970005
Cincinnati Bell Telephone	Ohio	Feb-97	96899TPALT
Bell Atlantic - Pennsylvania	Pennsylvania	Feb-97	A310203,213,236,258F002
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Feb-97	
Bell Atlantic-Washington, D.C.	District of Columbia	Jan-97	962
Pacific Bell, Sprint, US West	FCC	Jan-97	CC 96-45
United States Telephone Association	FCC	Jan-97	CC 96-262
Bell Atlantic-Maryland	Maryland	Jan-97	8731
Bell Atlantic-West Virginia	West Virginia	Jan-97	961516, 1561, 1009TPC,961533TT
Poe, Hoof, & Reinhardt	Durham Cnty Superior Court Kountis vs. Circle K	Jan-97	95CVS04754
Bell Atlantic-Delaware	Delaware	Dec-96	96324
Bell Atlantic-New Jersey	New Jersey	Nov-96	TX95120631
Carolina Power & Light Company	FERC	Nov-96	OA96-198-000
New England Telephone	Massachusetts	Oct-96	DPU 96-73/74,-75, -80/81, -83, -94
New England Telephone	New Hampshire	Oct-96	96-252
Bell Atlantic-Virginia	Virginia	Oct-96	960044
Citizens Utilities	Illinois	Sep-96	96-0200, 96-0240
Union Telephone Company	New Hampshire	Sep-96	95-311
Bell Atlantic-New Jersey	New Jersey	Sep-96	TO-96070519
New York Telephone	New York	Sep-96	95-C-0657, 94-C-0095,91-C-1174
North Carolina Rate Bureau (workers comp)	North Carolina Dept. of Insurance	Sep-96	
MidAmerican Energy Company	Illinois	Sep-96	96-0274
MidAmerican Energy Company	Iowa	Sep-96	RPU96-8
United States Telephone Association	FCC	Mar-96	AAD-96.28
United States Telephone Association	FCC	Mar-96	CC 94-1 PhaseIV
Bell Atlantic - Maryland	Maryland	Mar-96	8715
Nevada Bell	Nevada	Mar-96	96-3002
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Mar-96	
Carolina Tel. and Telegraph Co, Central Tel Co	North Carolina	Feb-96	P7 sub 825, P10 sub 479
Oklahoma Rural Telephone Coalition	Oklahoma	Oct-95	PUD950000119
BellSouth	Tennessee	Oct-95	95-02614
Wake County, North Carolina	US District Court, Eastern Dist. NC	Oct-95	594CV643H2
Bell Atlantic - District of Columbia	District of Columbia	Sep-95	814 Phase IV
South Central Bell Telephone Company	Tennessee	Aug-95	95-02614

SPONSOR	JURISDICTION	DATE	DOCKET NO.
GTE South	Virginia	Jun-95	95-0019
Roseville Telephone Company	California	May-95	A.95-05-030
Bell Atlantic - New Jersey	New Jersey	May-95	TX94090388
Cincinnati Bell Telephone Company	Ohio	May-95	941695TPACE
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	May-95	727
Northern Illinois Gas	Illinois	May-95	95-0219
South Central Bell Telephone Company	Kentucky	Apr-95	94-121
Midwest Gas	South Dakota	Mar-95	
Virginia Natural Gas, Inc.	Virginia	Mar-95	PUE940054
Hope Gas, Inc.	West Virginia	Mar-95	95-0003G42T
The Peoples Natural Gas Company	Pennsylvania	Feb-95	R-943252
and Coke Co., North Shore Gas, Iowa-Illinois Gas	Illinois	Jan-95	94-0403
and Electric, Central Illinois Public Service,	Illinois	Jan-95	94-0403
Northern Illinois Gas, The Peoples Gas, Light	Illinois	Jan-95	94-0403
United Cities Gas, and Interstate Power	Illinois	Jan-95	94-0403
Cincinnati Bell Telephone Company	Kentucky	Oct-94	94-355
Midwest Gas	Nebraska	Oct-94	
Midwest Power	Iowa	Sep-94	RPU-94-4
Bell Atlantic	FCC	Aug-94	CS 94-28, MM 93-215
Midwest Gas	Iowa	Jul-94	RPU-94-3
Bell Atlantic	FCC	Jun-94	CC 94-1
Nevada Power Company	Nevada	Jun-94	93-11045
Cincinnati Bell Telephone Company	Ohio	Mar-94	93-551-TP-CSS
Cincinnati Bell Telephone Company	Ohio	Mar-94	93-432-TP-ALT
GTE South/Contel	Virginia	Feb-94	PUC9300036
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Feb-94	689
Bell of Pennsylvania	Pennsylvania	Jan-94	P930715
GTE South	South Carolina	Jan-94	93-504-C
United Telephone-Southeast	Tennessee	Jan-94	93-04818
C&P of VA, GTE South, Contel, United Tel. SE	Virginia	Sep-93	PUC920029
Bell Atlantic, NYNEX, Pacific Companies	FCC	Aug-93	MM 93-215
C&P, Centel, Contel, GTE, & United	Virginia	Aug-93	PUC920029
Chesapeake & Potomac Tel Virginia	Virginia	Aug-93	93-00-
GTE North	Illinois	Jul-93	93-0301
Midwest Power	Iowa	Jul-93	INU-93-1
Midwest Power	South Dakota	Jul-93	EL93-016
Chesapeake & Potomac Tel. Co. DC	District of Columbia	Jun-93	926
Cincinnati Bell	Ohio	Jun-93	93432TPALT
North Carolina Rate Bureau (dwelling fire)	North Carolina Dept. of Insurance	Jun-93	671
North Carolina Rate Bureau (homeowners)	North Carolina Dept. of Insurance	Jun-93	670
Pacific Bell Telephone Company	California	Mar-93	92-05-004
Minnesota Independent Equal Access Corp.	Minnesota	Mar-93	P3007/GR931
South Central Bell Telephone Company	Tennessee	Feb-93	92-13527
South Central Bell Telephone Company	Kentucky	Dec-92	92-523
Southern New England Telephone Company	Connecticut	Nov-92	92-09-19
Chesapeake & Potomac Tel. Co.CDC	District of Columbia	Nov-92	814
Diamond State Telephone Company	Delaware	Sep-92	PSC 92-47
New Jersey Bell Telephone Company	New Jersey	Sep-92	TO-92030958
Allstate Insurance Company	New Jersey Dept. of Insurance	Sep-92	INS 06174-92
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Aug-92	650
North Carolina Rate Bureau (workers' comp)	North Carolina Dept. of Insurance	Aug-92	647
Midwest Gas Company	Minnesota	Aug-92	G010/GR92710
Pennsylvania-American Water Company	Pennsylvania	Jul-92	R-922428
Central Telephone Co. of Florida	Florida	Jun-92	920310-TL
C&P of VA, GTE South, Contel, United Tel. SE	Virginia	Jun-92	PUC920029

SPONSOR	JURISDICTION	DATE	DOCKET NO.
Chesapeake & Potomac Tel. Co. Maryland	Maryland	May-92	8462
Pacific Bell Telephone Company	California	Apr-92	92-05-004
Iowa Power Inc.	Iowa	Mar-92	RPU-92-2
Contel of Texas	Texas	Feb-92	10646
Southern Bell Telephone Company	Florida	Jan-92	880069-TL
Nevada Power Company	Nevada	Jan-92	92-1067
GTE South	Georgia	Dec-91	4003-U
GTE South	Georgia	Dec-91	4110-U
Allstate Insurance Company (property)	Texas Dept. of Insurance	Dec-91	1846
IPS Electric	Iowa	Oct-91	RPU-91-6
GTE South	Tennessee	Aug-91	91-05738
North Carolina Rate Bureau (workers' comp)	North Carolina Dept. of Insurance	Aug-91	609
Midwest Gas Company	Iowa	Jul-91	RPU-91-5
Pennsylvania-American Water Company	Pennsylvania	Jun-91	R-911909
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Jun-91	606
Allstate Insurance Company	California Dept. of Insurance	May-91	RCD-2
Nevada Power Company	Nevada	May-91	91-5055
Kentucky Power Company	Kentucky	Apr-91	91-066
Chesapeake & Potomac Tel. Co.CD.C.	District of Columbia	Feb-91	850
Allstate Insurance Company	New Jersey Dept. of Insurance	Jan-91	INS-9536-90
GTE South	South Carolina	Nov-90	90-698-C
Southern Bell Telephone Company	Florida	Oct-90	880069-TL
GTE South	West Virginia	Aug-90	90-522-T-42T
North Carolina Rate Bureau (workers' comp)	North Carolina Dept. of Insurance	Aug-90	R90-08-
The Travelers Indemnity Company	Pennsylvania Dept. of Insurance	Aug-90	R-90-06-23
Chesapeake & Potomac Tel. Co.-Maryland	Maryland	Jul-90	8274
Allstate Insurance Company	Pennsylvania Dept. of Insurance	Jul-90	R90-07-01
Central Tel. Co. of Florida	Florida	Jun-90	89-1246-TL
Citizens Telephone Company	North Carolina	Jun-90	P-12, SUB 89
North Carolina Rate Bureau (auto)	North Carolina Dept. of Insurance	Jun-90	568
Iowa Resources, Inc. and Midwest Energy	Iowa	Jun-90	SPU-90-5
Contel of Illinois	Illinois	May-90	90-0128
Southern New England Tel. Co.	Connecticut	Apr-90	89-12-05
Bell Atlantic	FCC	Apr-90	89-624 II
Pennsylvania-American Water Company	Pennsylvania	Mar-90	R-901652
Bell Atlantic	FCC	Feb-90	89-624
GTE South	Tennessee	Jan-90	
Allstate Insurance Company	California Dept. of Insurance	Jan-90	REB-1002
Bell Atlantic	FCC	Nov-89	87-463 II
Allstate Insurance Company	California Dept. of Insurance	Sep-89	REB-1006
Pacific Bell	California	Mar-89	87-11-0033
Iowa Power & Light	Iowa	Dec-88	RPU-88-10
Pacific Bell	California	Oct-88	88-05-009
Southern Bell	Florida	Apr-88	880069TL
Carolina Independent Telcos.	North Carolina	Apr-88	P-100, Sub 81
United States Telephone Association	U. S. Congress	Apr-88	
Carolina Power & Light	South Carolina	Mar-88	88-11-E
New Jersey Bell Telephone Co.	New Jersey	Feb-88	87050398
Carolina Power & Light	FERC	Jan-88	ER-88-224-000
Carolina Power & Light	North Carolina	Dec-87	E-2, Sub 537
Bell Atlantic	FCC	Nov-87	87-463
Diamond State Telephone Co.	Delaware	Jul-87	86-20
Central Telephone Co. of Nevada	Nevada	Jun-87	87-1249
ALLTEL	Florida	Apr-87	870076-PU
Southern Bell	Florida	Apr-87	870076-PU

SPONSOR	JURISDICTION	DATE	DOCKET NO.
Carolina Power & Light	North Carolina	Apr-87	E-2, Sub 526
So. New England Telephone Co.	Connecticut	Mar-87	87-01-02
Northern Illinois Gas Co.	Illinois	Mar-87	87-0032
Bell of Pennsylvania	Pennsylvania	Feb-87	860923
Carolina Power & Light	FERC	Jan-87	ER-87-240-000
Bell South	NTIA	Dec-86	61091-619
Heins Telephone Company	North Carolina	Oct-86	P-26, Sub 93
Public Service Co. of NC	North Carolina	Jul-86	G-5, Sub 207
Bell Atlantic	FCC	Feb-86	84-800 III
BellSouth	FCC	Feb-86	84-800 III
ALLTEL Carolina, Inc	North Carolina	Feb-86	P-118, Sub 39
ALLTEL Georgia, Inc.	Georgia	Jan-86	3567-U
ALLTEL Ohio	Ohio	Jan-86	86-60-TP-AIR
Western Reserve Telephone Co.	Ohio	Jan-86	85-1973-TP-AIR
New England Telephone & Telegraph	Maine	Dec-85	
ALLTEL-Florida	Florida	Oct-85	850064-TL
Iowa Southern Utilities	Iowa	Oct-85	RPU-85-11
Bell Atlantic	FCC	Sep-85	84-800 II
Pacific Telesis	FCC	Sep-85	84-800 II
Pacific Bell	California	Apr-85	85-01-034
United Telephone Co. of Missouri	Missouri	Apr-85	TR-85-179
South Carolina Generating Co.	FERC	Apr-85	85-204
South Central Bell	Kentucky	Mar-85	9160
New England Telephone & Telegraph	Vermont	Mar-85	5001
Chesapeake & Potomac Telephone Co.	West Virginia	Mar-85	84-747
Chesapeake & Potomac Telephone Co.	Maryland	Jan-85	7851
Central Telephone Co. of Ohio	Ohio	Dec-84	84-1431-TP-AIR
Ohio Bell	Ohio	Dec-84	84-1435-TP-AIR
Carolina Power & Light Co.	FERC	Dec-84	ER85-184000
BellSouth	FCC	Nov-84	84-800 I
Pacific Telesis	FCC	Nov-84	84-800 I
New Jersey Bell	New Jersey	Aug-84	848-856
Southern Bell	South Carolina	Aug-84	84-308-C
Pacific Power & Light Co.	Montana	Jul-84	84.73.8
Carolina Power & Light Co.	South Carolina	Jun-84	84-122-E
Southern Bell	Georgia	Mar-84	3465-U
Carolina Power & Light Co.	North Carolina	Feb-84	E-2, Sub 481
Southern Bell	North Carolina	Jan-84	P-55, Sub 834
South Carolina Electric & Gas	South Carolina	Nov-83	83-307-E
Empire Telephone Co.	Georgia	Oct-83	3343-U
Southern Bell	Georgia	Aug-83	3393-U
Carolina Power & Light Co.	FERC	Aug-83	ER83-765-000
General Telephone Co. of the SW	Arkansas	Jul-83	83-147-U
Heins Telephone Co.	North Carolina	Jul-83	No.26 Sub 88
General Telephone Co. of the NW	Washington	Jul-83	U-82-45
Leeds Telephone Co.	Alabama	Apr-83	18578
General Telephone Co. of California	California	Apr-83	83-07-02
North Carolina Natural Gas	North Carolina	Apr-83	G21 Sub 235
Carolina Power & Light	South Carolina	Apr-83	82-328-E
Eastern Illinois Telephone Co.	Illinois	Feb-83	83-0072
Carolina Power & Light	North Carolina	Feb-83	E-2 Sub 461
New Jersey Bell	New Jersey	Dec-82	8211-1030
Southern Bell	Florida	Nov-82	820294-TP
United Telephone of Missouri	Missouri	Nov-82	TR-83-135
Central Telephone Co. of NC	North Carolina	Nov-82	P-10 Sub 415

SPONSOR	JURISDICTION	DATE	DOCKET NO.
Concord Telephone Company	North Carolina	Nov-82	P-16 Sub 146
Carolina Telephone & Telegraph	North Carolina	Aug-82	P-7, Sub 670
Central Telephone Co. of Ohio	Ohio	Jul-82	82-636-TP-AIR
Southern Bell	South Carolina	Jul-82	82-294-C
General Telephone Co. of the SW	Arkansas	Jun-82	82-232-U
General Telephone Co. of Illinois	Illinois	Jun-82	82-0458
General Telephone Co. of the SW	Oklahoma	Jun-82	27482
Empire Telephone Co.	Georgia	May-82	3355-U
Mid-Georgia Telephone Co.	Georgia	May-82	3354-U
General Telephone Co. of the SW	Texas	Apr-82	4300
General Telephone Co. of the SE	Alabama	Jan-82	18199
Carolina Power & Light Co.	South Carolina	Jan-82	81-163-E
Elmore-Coosa Telephone Co.	Alabama	Nov-81	18215
General Telephone Co. of the SE	North Carolina	Sep-81	P-19, Sub 182
United Telephone Co. of Ohio	Ohio	Sep-81	81-627-TP-AIR
General Telephone Co. of the SE	South Carolina	Sep-81	81-121-C
Carolina Telephone & Telegraph	North Carolina	Aug-81	P-7, Sub 652
Southern Bell	North Carolina	Aug-81	P-55, Sub 794
Woodbury Telephone Co.	Connecticut	Jul-81	810504
Central Telephone Co. of Virginia	Virginia	Jun-81	810030
United Telephone Co. of Missouri	Missouri	May-81	TR-81-302
General Telephone Co. of the SE	Virginia	Apr-81	810003
New England Telephone	Vermont	Mar-81	4546
Carolina Telephone & Telegraph	North Carolina	Aug-80	P-7, Sub 652
Southern Bell	North Carolina	Aug-80	P-55, Sub 784
General Telephone Co. of the SW	Arkansas	Jun-80	U-3138
General Telephone Co. of the SE	Alabama	May-80	17850
Southern Bell	North Carolina	Oct-79	P-55, Sub 777
Southern Bell	Georgia	Mar-79	3144-U
General Telephone Co. of the SE	Virginia	Mar-76	810038
General Telephone Co. of the SW	Arkansas	Feb-76	U-2693, U-2724
General Telephone Co. of the SE	Alabama	Sep-75	17058
General Telephone Co. of the SE	South Carolina	Jun-75	D-18269

EXHIBIT 12
APPENDIX 2
ESTIMATING THE EXPECTED RISK PREMIUM
ON UTILITY STOCKS USING THE DCF MODEL

The DCF model is based on the assumption that investors value an asset on the basis of the future cash flows they expect to receive from owning the asset. Thus, investors value an investment in a bond because they expect to receive a sequence of semi-annual coupon payments over the life of the bond and a terminal payment equal to the bond's face value at the time the bond matures. Likewise, investors value an investment in a firm's stock because they expect to receive a sequence of dividend payments and, perhaps, expect to sell the stock at a higher price sometime in the future.

A second fundamental principle of the DCF method is that investors value a dollar received in the future less than a dollar received today. A future dollar is valued less than a current dollar because investors could invest a current dollar in an interest earning account and increase their wealth. This principle is called the time value of money.

Applying the two fundamental DCF principles noted above to an investment in a bond leads to the conclusion that investors value their investment in the bond on the basis of the present value of the bond's future cash flows. Thus, the price of the bond should be equal to:

EQUATION 1

$$P_B = \frac{C}{(1+i)} + \frac{C}{(1+i)^2} + \dots + \frac{C+F}{(1+i)^n}$$

where:

- P_B = Bond price;
- C = Cash value of the coupon payment (assumed for notational convenience to occur annually rather than semi-annually);
- F = Face value of the bond;

- i = The rate of interest the investor could earn by investing his money in an alternative bond of equal risk; and
- n = The number of periods before the bond matures.

Applying these same principles to an investment in a firm's stock suggests that the price of the stock should be equal to:

EQUATION 2

$$P_s = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \dots + \frac{D_n + P_n}{(1+k)^n}$$

where:

- P_s = Current price of the firm's stock;
- $D_1, D_2 \dots D_n$ = Expected annual dividend per share on the firm's stock;
- P_n = Price per share of stock at the time the investor expects to sell the stock; and
- k = Return the investor expects to earn on alternative investments of the same risk, i.e., the investor's required rate of return.

Equation (2) is frequently called the annual discounted cash flow model of stock valuation. Assuming that dividends grow at a constant annual rate, g , this equation can be solved for k , the cost of equity. The resulting cost of equity equation is $k = D_1/P_s + g$, where k is the cost of equity, D_1 is the expected next period annual dividend, P_s is the current price of the stock, and g is the constant annual growth rate in earnings, dividends, and book value per share. The term D_1/P_s is called the dividend yield component of the annual DCF model, and the term g is called the growth component of the annual DCF model.

The annual DCF model is only a correct expression for the present value of future dividends if dividends are paid annually at the end of each year. Since most industrial and utility firms pay dividends quarterly, the annual DCF model produces downwardly biased estimates of the cost of equity. Investors can expect to earn a higher annual

effective return on an investment in a firm that pays quarterly dividends than in one which pays the same amount of dollar dividends once at the end of each year.

The Dividend Component

The quarterly DCF model requires an estimate of the expected dividends for the next four quarters. I estimated the expected dividends for the next four quarters by multiplying the actual dividends for the last four quarters by the factor, $(1 + \text{the growth rate, } g)$.

The Growth Component

To estimate the growth component of the DCF model, I used the analysts' estimates of future earnings per share (EPS) growth reported by I/B/E/S Thomson Financial. As part of their research, financial analysts working at Wall Street firms periodically estimate EPS growth for each firm they follow. The EPS forecasts for each firm are then published. Investors who are contemplating purchasing or selling shares in individual companies review the forecasts. These estimates represent five-year forecasts of EPS growth. I/B/E/S is a firm that reports analysts' EPS growth forecasts for a broad group of companies. The forecasts are expressed in terms of a mean forecast and a standard deviation of forecast for each firm. Investors use the mean forecast as a consensus estimate of future firm performance. The I/B/E/S growth rates: (1) are widely circulated in the financial community, (2) include the projections of reputable financial analysts who develop estimates of future EPS growth, (3) are reported on a timely basis to investors, and (4) are widely used by institutional and other investors.

I relied on analysts' projections of future EPS growth because there is considerable empirical evidence that investors use analysts' forecasts to estimate future earnings growth. To test whether investors use analysts' growth forecasts to estimate future dividend and earnings growth, I prepared a study in conjunction with Willard T. Carleton, Karl Eller Professor of Finance at the University of Arizona, on why analysts' forecasts are the best estimate of investors' expectation of future long-term growth. This study is described in a paper entitled "Investor Growth Expectations and Stock Prices: the Analysts versus Historical Growth Extrapolation," published in the Spring 1988 edition of *The Journal of Portfolio Management*.

In our paper, we describe how we first performed a correlation analysis to identify the historically-oriented growth rates which best described a firm's stock price. Then

we did a regression study comparing the historical growth rates with the consensus analysts' forecasts. In every case, the regression equations containing the average of analysts' forecasts statistically outperformed the regression equations containing the historical growth estimates. These results are consistent with those found by Cragg and Malkiel, the early major research in this area (John G. Cragg and Burton G. Malkiel, *Expectations and the Structure of Share Prices*, University of Chicago Press, 1982). These results are also consistent with the hypothesis that investors use analysts' forecasts, rather than historically-oriented growth calculations, in making stock buy and sell decisions. They provide overwhelming evidence that the analysts' forecasts of future growth are superior to historically-oriented growth measures in predicting a firm's stock price.

My study has been updated to include more recent data. Researchers at State Street Financial Advisors updated my study using data through year-end 2003. Their results continue to confirm that analysts' growth forecasts are superior to historically-oriented growth measures in predicting a firm's stock price.

The Price Component

To measure the price component of the DCF model, I used a simple average of the monthly high and low stock prices for each firm over a three-month period. These high and low stock prices were obtained from Thomson Financial. I used the three-month average stock price in applying the DCF method because stock prices fluctuate daily, while financial analysts' forecasts for a given company are generally changed less frequently, often on a quarterly basis. Thus, to match the stock price with an earnings forecast, it is appropriate to average stock prices over a three-month period.

**EXHIBIT 13
APPENDIX 3
THE SENSITIVITY OF THE FORWARD-LOOKING
REQUIRED EQUITY RISK PREMIUM ON UTILITY STOCKS
TO CHANGES IN INTEREST RATES**

My estimate of the required equity risk premium on utility stocks is based on studies of the discounted cash flow (“DCF”) expected return on comparable groups of utilities in each month of my study period compared to the interest rate on long-term government bonds. Specifically, for each month in my study period, I calculate the risk premium using the equation

$$RP_{COMP} = DCF_{COMP} - I_B$$

where:

- RP_{COMP} = the required risk premium on an equity investment in the comparable companies,
- DCF_{COMP} = average DCF expected rate of return on a portfolio of comparable companies; and
- I_B = the yield to maturity on an investment in long-term U.S. Treasury bonds.

Electric Company Ex Ante Risk Premium Analysis. For my electric company ex ante risk premium analysis, I began with the Moody’s group of 24 electric companies shown in Table 1. I used the Moody’s group of electric companies because they are a widely followed group of electric utilities, and use of this constant group greatly simplified the data collection task required to estimate the ex ante risk premium over the months of my study. Simplifying the data collection task was desirable because the ex ante risk premium approach requires that the DCF model be estimated for every company in every month of the study period. Exhibit 5 displays the average DCF expected return on an investment in the portfolio of electric companies and the yield to maturity on long-term Treasury bonds in each month of the study.

Previous studies have shown that the ex ante risk premium tends to vary inversely with the level of interest rates, that is, the risk premium tends to increase when interest rates decline, and decrease when interest rates go up. To test whether my studies also indicate that the ex ante risk premium varies inversely with the level of interest rates, I performed a

regression analysis of the relationship between the ex ante risk premium and the yield to maturity on long-term Treasury bonds, using the equation,

$$RP_{COMP} = a + (b \times I_B) + e$$

where:

- RP_{COMP} = risk premium on comparable company group;
- I_B = yield to maturity on long-term U.S. Treasury bonds;
- e = a random residual; and
- a, b = coefficients estimated by the regression procedure.

Regression analysis assumes that the statistical residuals from the regression equation are random. My examination of the residuals revealed that there is a significant probability that the residuals are serially correlated (non-zero serial correlation indicates that the residual in one time period tends to be correlated with the residual in the previous time period).

Therefore, I made adjustments to my data to correct for the possibility of serial correlation in the residuals.

The common procedure for dealing with serial correlation in the residuals is to estimate the regression coefficients in two steps. First, a multiple regression analysis is used to estimate the serial correlation coefficient, r . Second, the estimated serial correlation coefficient is used to transform the original variables into new variables whose serial correlation is approximately zero. The regression coefficients are then re-estimated using the transformed variables as inputs in the regression equation. Based on my regression analysis of the statistical relationship between the yield to maturity on long-term Treasury bonds and the required risk premium, my estimate of the ex ante risk premium on an investment in my proxy electric company group as compared to an investment in long-term Treasury bonds is given by the equation:

$$RP_{COMP} = \begin{matrix} 10.67 \\ (10.49) \end{matrix} - \begin{matrix} 0.867 \times I_B \\ (-4.98)^{[8]} \end{matrix} \quad R^2 = 18.48 \text{ percent}$$

This equation suggests that the ex ante risk premium on electric utility stocks increases by more than 80 basis points when the interest rate on long-term Treasury bonds declines by 100 basis points. Equivalently, this regression equation suggests that the cost of equity for electric utilities declines by less than 20 basis points when the interest rate on long-term Treasury bonds declines by 100 basis points. These data demonstrate that the GCOC

[8] The t-statistics are shown in parentheses.

term Treasury bonds declines by 100 basis points. These data demonstrate that the GCOC ROE Formula, which assumes that the cost of equity declines by 75 basis points when the yield to maturity on long Canada bonds declines by 100 basis points, is no longer appropriate for estimating the cost of equity.

Using the 4.30 percent forecasted yield to maturity on long-term Canada bonds for 2009, the regression equation produces an ex ante risk premium equal to 7.03 percent ($0.1117 - .9636 \times 4.30 = 7.03$).

As described above, my ex ante risk premium regression analysis indicates that the cost of equity for utilities is significantly less sensitive to interest rate changes than the GCOC ROE Formula implies. Rather than declining by 75 basis points when the yield to maturity on long-term government bonds declines by 100 basis points, my analysis indicates that the cost of equity declines by less than 50 basis points when interest rates decline by 100 basis points. To test whether my conclusion is robust to changes in the cost of equity measurement period, I re-estimated my regression equations using quarterly cost of equity and interest data rather than monthly data. My regression analysis using quarterly data strongly supports my conclusion that the cost of equity for utilities is significantly less sensitive to interest rate changes than the GCOC ROE Formula suggests. For example, my regression analysis for electric and natural gas utilities using data for one month of each quarter, indicates that the cost of equity declines by less than 50 basis points when interest rates decline by 100 basis points.

TABLE 1
MOODY'S ELECTRIC COMPANIES

American Electric Power
Constellation Energy
Progress Energy
CH Energy Group
Cinergy Corp.
Consolidated Edison Inc.
DPL Inc.
DTE Energy Co.
Dominion Resources Inc.
Duke Energy Corp.
Energy East Corp.
FirstEnergy Corp.
Reliant Energy Inc.
IDACORP. Inc.
IPALCO Enterprises Inc.
NiSource Inc.
OGE Energy Corp.
Exelon Corp.
PPL Corp.
Potomac Electric Power Co.
Public Service Enterprise Group
Southern Company
Teco Energy Inc.
Xcel Energy Inc.

Source of data: *Mergent Public Utility Manual*, August 2002. Of these 24 companies, I did not include three companies in my ex ante risk premium DCF analysis because there was insufficient data to perform a DCF analysis for most of my study period. Specifically, IPALCO merged with a company that is not in the electric utility industry; Reliant divested its electric utility operations; and CH Energy does not have any I/B/E/S analysts' estimates of long-term growth. In addition, Cinergy completed its merger with Duke Energy in 2006.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

68. On November 21, 2008, American Water Capital Corp. (AWCC) filed with the Securities and Exchange Commission a Form 424-B, a prospectus, for a \$75 Million offering of unsecured notes with a coupon rate of 10%, to be underwritten by Edward Jones. Please respond to the following questions regarding that debt issuance.
- a. Please describe in detail the normal procedure for determining the need to issue long-term debt capital at American Water Capital Corporation, from the assessment of the need for additional debt capital, through contacting the underwriters, and finally issuing the debt.
 - b. Please indicate the personnel responsible for the decisions regarding the issuance of new debt securities at each point in the process identified in “a” above. Please also identify the ultimate decision-maker regarding the issuance of this particular debt and provide a complete copy of the final report he or she reviewed regarding the propriety of issuing this debt.
 - c. Please indicate if the standard process, outlined in response to “a” above, was followed with regard to the issuance of the \$75 Million 10% coupon debt. If not, please explain how that process was different and why.
 - d. Please provide the cost benefit analysis prepared to analyze the economics of this debt issuance. If none was prepared, please explain why.
 - e. Please provide any and all internal AWCC correspondence or memoranda regarding the issuance of the \$75 Million 10% debt, including the determination of the amount, the timing of the issue and the coupon rate.
 - f. Please provide all correspondence between AWCC and Edward Jones or any other underwriters or bankers involved in the issuance of this debt issue regarding, especially, the determination of the coupon rate.
 - g. At page 30 of the prospectus (Form 424-B), the Company notes that the proceeds of the debt issuance will be used “to fund the repayment of short-term debt with overnight maturity and an average interest rate of 3.0%.”
 - i. Please explain why it is economically reasonable to issue long-term 10% debt to re-finance short-term 3% debt. Please provide support for your response.
 - ii. At the time the new debt was issued, what was the size of AWCC’s revolving credit facility? Please provide supporting documentation.
 - iii. At the time the new debt was issued, what portion of the revolving credit facility had been drawn down and how much of that facility was still available? Please provide supporting documentation.
 - h. In concurrent rate case proceedings in other jurisdictions, have American Water Works representatives made reference to this debt issue in written or oral testimony? If so, please provide copies of any and all such references.

Response:

The Company notes that KAWC did not participate in the \$75.0 million LT financing consummated by AWCC on November 21, 2008, therefore the Company objects to this question on the grounds that much of the information requested is not relevant to this proceeding. Notwithstanding the general objection the Company provides the following responses to the multiple parts of the question.

- a. Each year, the subsidiaries of American Water Works Company, Inc. (“AWW”) put together their annual capital and operating business plans for the following year. These plans, which include forecasted cash flows from operations, investments and financings, are reviewed and approved by the regulated subsidiaries’ Boards of Directors and then aggregated at the corporate level.

The following narrative describes the processes at AWCC related to Planning, Capital Markets, Closing and Debt Maintenance.

Planning

1. Draft annual business plan financial statements and capitalization plans are generated at each AWW subsidiary and are provided to American Water Works Service Company, Inc. (“AWWSC”) Treasury & Risk Management Department (“TRMD”).
2. The TRMD summarizes the financing requirements of the AWW subsidiaries and prepares a consolidated capitalization plan which is submitted to AWCC.
3. The TRMD evaluates all available financing options including availability of CAP allocation in the case of State Tax-Exempt Debt Financings, appetite of investors for private or public placement of debt instruments, and general economic conditions.
4. The TRMD evaluates all subsidiary financing requirements to ensure the proposed financing activities by AWCC are not prohibited by indenture covenants. All assumptions and calculations are reviewed by the Assistant Treasurer of American Water Works Company, Inc.
5. The CFO of AWW reviews and approves the AWCC financing plan.
6. Consolidated AWCC financing proposals are then submitted for approval by the AWW Board of Directors. (Note: Approval is needed by the AWW’s Board of Directors – The Board approved \$215M of total financing which includes the \$75M offering. Please see the attached Resolution & Signature pages marked as Attachment 1. For the electronic version, refer to KAW_R_AGDR2#68_Attachment1_020909.pdf.

Capital Markets

7. The TRMD executes all approved AWCC financing transactions.
8. The TRMD will:
 - a. Identify legal counsel, trustees, underwriters,
 - b. Negotiate terms,

- c. Engage bond insurers, if appropriate, and
 - d. Secure/confirm credit ratings.
9. The TRMD forms a pricing committee, comprised of individuals designated in the Financing Policy, for all transactions in excess of \$10 Million. (Note: a Pricing Committee including the Company's Chairman, CEO and CFO was formed for the \$75M debt issuance.)

Closing

- 10. Subsequent to pricing and allocation of securities, the TRMD will prepare and finalize all loan documentation with purchasers, and execute documents for closing.
 - 11. All loan agreements are reviewed by the American Water Works Service Company, Inc. Law Department (the "Law Department") prior to execution, in compliance with the American Water Contract Administration Policy.
 - 12. All Loan agreements are reviewed by TRMD prior to execution.
 - 13. On a previously appointed date(s), all fees will be paid via wire transfer, and debt allocations will be reflected on the appropriate borrowing subsidiary's books.
 - 14. All inter-company loan agreements are prepared by TRMD for execution by the appropriate borrowing AWW subsidiary.
- b. The approval process for the issuance of debt begins with the subsidiary President and other officers who include the projected permanent financing in the business plan which is approved by the subsidiary Board of Directors. After discussion with the subsidiary officers, the ultimate decision for AWCC regarding the issuance of the debt is the AWK Board and the Pricing Committee as described the response to part (a) above.
- c. Yes, although due to market disruption, transaction updates were given to AWW's Board of Directors. Please see attached presentations dated 11/07/08 & 11/18/08, marked as Attachment 2. For the electronic version, refer to KAW_R_AGDR2#68_Attachment2_020909.pdf.
- d. Please see attached Attachment 3. For the electronic version, refer to KAW_R_AGDR2#68_Attachment3_020909.pdf.
- e. Please see attached Attachment 3. For the electronic version, refer to KAW_R_AGDR2#68_Attachment3_020909.pdf.
- f. Please see attached Attachment 3. For the electronic version, refer to KAW_R_AGDR2#68_Attachment3_020909.pdf.
- g. i. AWCC had maximum short-term borrowing limits of \$810M and \$334.8 million outstanding at the time of the transaction. However, due to significant financial market disruption, the ability of the banks to meet their obligation to lend was uncertain. Some of the banks providing lending commitments have subsequently received federal funds to shore up their financial condition. Additionally, the AWW subsidiaries' business plans included significant capital expenditures in

excess of cash generated from operations. Immediately prior to the offering, the Company forecasted significant cash outflows (see page 7 of Attachment 2) during the month of December 2008. Since AWCC's short term debt balance was relatively high, coupled with the uncertainty of access to ST debt in the financial markets at the time, and circumstances related to mortgage indenture requirements of the participating subsidiaries, it was determined that a small long term borrowing was the prudent course of action. Since market conditions were not optimal, AWCC and the participating subsidiaries divided the authorized debt issuance into two offerings, with the first offering used to address subsidiaries with the most pressing need for LT debt, while at the same time protecting the Company from a rapid increase or decrease in rates. This offering avoided ratings downgrades and the bad market publicity which can result if a company does not prudently minimize its reliance on short-term debt and uses up short-term borrowing capacity. Therefore, AWCC plans to continue to access the capital markets on a regular basis to meet the most pressing needs of its subsidiaries to minimize the risk associated with the somewhat unstable capital markets at the present time. The proceeds of the \$75.0 million LT debt issued by AWCC was in turn lent at similar terms and conditions to CA-Am (\$35M), TX-Am (\$3M), WV-Am (\$37M) to ensure they met their financing needs.

- ii. At that time, the total available credit line was \$800 million, plus an additional \$10 million from AWCC's working cash line, or \$810 million. However, it has been AWCC's policy to access the commercial paper markets for ST debt to the extent possible and only use the revolving credit for back-up and support for the commercial paper market program. Please see Attachment 4.
- iii. As of November 26, 2008, total outstanding short-term borrowings were \$334.8 million, comprised of \$103.6 million of CP, \$222.7 million from our revolving credit facility and the remaining \$8.5 million from our working cash line. Please see Attachments 4 and 5. For the electronic versions, refer to the following:
[KAW_R_AGDR2#68_Attachment4_020909.pdf](#)
[KAW_R_AGDR2#68_Attachment5_020909.pdf](#).
- h. To the knowledge of KAWC, no representative of AWW has appeared before a regulatory commission regarding the \$75.0 million LT debt issued by AWCC. Mr. Miller in his capacity as Manager of Rates for the SE Region of AWWSC and V.P & Treasurer of West Virginia - American Water Company ("WVAWC") appeared before the WV PSC regarding the issuance of \$37.0 million of the LT Debt obtained by AWCC on the behalf of WVAWC. The testimony of Mr. Miller is available on the WV PSC website, www.psc.state.wv.us.

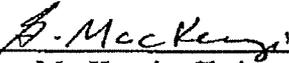
For the electronic version of this document, refer to [KAW_R_AGDR2#68_020909.pdf](#).

**UNANIMOUS WRITTEN CONSENT OF
THE BOARD OF DIRECTORS OF
AMERICAN WATER WORKS COMPANY, INC.**

November 7, 2008

The undersigned, being all the members of the Board of Directors (the "Board") of American Water Works Company, Inc., a Delaware corporation (the "Company"), hereby take the actions and adopt the resolutions attached hereto as Exhibit A by written consent pursuant to Section 141(f) of the General Corporation Law of the State of Delaware, and consent that this document be filed with the minutes of the Corporation, and declare that the actions and resolutions have the same force and effect as if taken and adopted at a duly constituted meeting of the Board, with an effective date as of the date first above written.

This action by written consent may be executed in any number of counterparts, each of which will be deemed to be an original, and all of which taken together will constitute one and the same instrument, notwithstanding that all directors have not signed the same counterpart, and facsimile or electronic image scan transmissions of the signatures provided for below may be relied upon, and will have the same force and effect, as the originals of such signatures.



George MacKenzie, Chairman

Julia L. Johnson

Donald L. Correll

William J. Marrazzo

Dr. Manfred Döss

Dr. Rolf Pohlig

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Andreas G. Zetzsche

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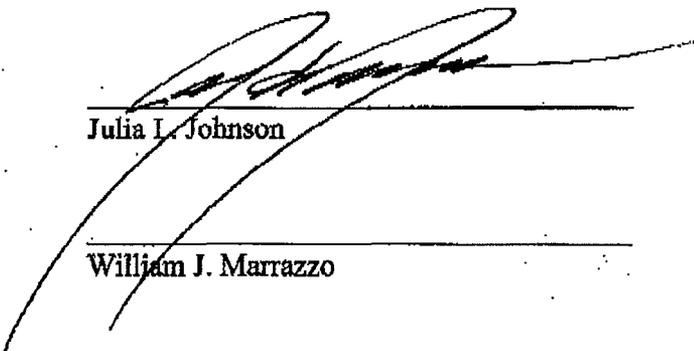
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November 7, 2008

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November 7, 2008

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This action by written consent may be executed in any number of counterparts, each of which will be deemed to be an original, and all of which taken together will constitute one and the same instrument, notwithstanding that all directors have not signed the same counterpart, and facsimile or electronic image scan transmissions of the signatures provided for below may be relied upon, and will have the same force and effect, as the originals of such signatures.

George MacKenzie, Chairman

Julia L. Johnson

Donald L. Correll

William J. Marrazzo

Dr. Manfred Döss

Dr. Rolf Pohlig

Martha Clark Goss

Andreas G. Zetsche

Richard R. Grigg

**UNANIMOUS WRITTEN CONSENT OF
THE BOARD OF DIRECTORS OF
AMERICAN WATER WORKS COMPANY, INC.**

November 7, 2008

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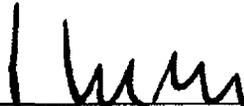
George MacKenzie, Chairman

Julia L. Johnson

Donald L. Correll

William J. Marrazzo

Dr. Manfred Döss


Dr. Rolf Pohlig

Martha Clark Goss

Andreas G. Zetzsche

Richard R. Grigg

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THE BOARD OF DIRECTORS OF
AMERICAN WATER WORKS COMPANY, INC.**

November 7, 2008

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George MacKenzie, Chairman

Julia L. Johnson

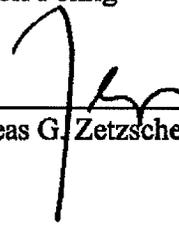
Donald L. Correll

William J. Marrazzo

Dr. Manfred Döss

Dr. Rolf Pohlig

Martha Clark Goss



Andreas G. Zetsche

Richard R. Grigg

EXHIBIT A
RESOLUTIONS TO BE ADOPTED BY
THE BOARD OF DIRECTORS OF
AMERICAN WATER WORKS COMPANY, INC.
FOR PUBLIC OFFERING OF DEBT BY AMERICAN WATER CAPITAL CORP.

November 7, 2008

BACKGROUND

WHEREAS, the Board at a duly called meeting held on Thursday, September 25, 2008, authorized and declared it advisable and in the best interests of the Company that its wholly-owned subsidiary, American Water Capital Corp., issue and sell up to \$215 million of debt securities through a tax-exempt transaction or public offering with final rates and terms to be determined by a pricing committee consisting of Donald Correll, Ellen Wolf and George MacKenzie;

WHEREAS, the Board deems it advisable and in the best interest of the Company, and with the recommendation of management, that each of its wholly owned subsidiaries, American Water Capital Corp., a Delaware Corporation ("AWWC"), and Pennsylvania-American Water Company offer and sell up to \$215 million principal amount of debt securities in the aggregate between them, with American Water Capital Corp. offering and selling up to that aggregate principal amount its debt securities (the "Notes") in one or more public offerings (each, an "Offering") and one or more tax-exempt offerings in each case with the benefit of a support agreement from the Company, and the balance of such amount being offered and sold by Pennsylvania-American Water Company in one or more tax-exempt or other offerings of the kinds it has customarily done, in each case in such amounts and at such rates as the Pricing Committee hereinafter named may determine;

WHEREAS, in connection with the consummation of the Offerings, it is contemplated, necessary or advantageous for the Company to execute and cause to be filed one or more registration statements (as defined below) and to execute certain certificates, instruments and other documents (collectively and including all exhibits and attachments thereto, the "Offering Documents");

WHEREAS, the Offerings are proposed to be made through one or more underwriters including, without limitation, Edward D. Jones & Co., L.P. (collectively, the "Underwriters"); and

WHEREAS, the Board of the Company has determined that the consummation of the Offerings and the Company's execution and delivery of the Offering Documents will benefit, directly or indirectly, the Company,

NOW, THEREFORE, BE IT:

AUTHORIZED OFFICERS

RESOLVED, that each of Donald L. Correll, Ellen C. Wolf and George W. Patrick (each an "Authorized Officer" and collectively the "Authorized Officers") is hereby authorized and directed to take all steps necessary or appropriate to cause the Offerings to be consummated, including taking any and all actions as are set forth herein other than those specifically reserved in these resolutions for the Pricing Committee named below.

PUBLIC-OFFERING OF DEBT SECURITIES

RESOLVED, that the Authorized Officers be, and each of them hereby individually is, authorized and directed, in the name of and on behalf of the Company to prepare, execute and file with the Securities and Exchange Commission ("SEC"), one or more registration statements (the "Registration Statements") under the Securities Act pursuant to which AWCC shall offer up to \$215,000,000 in aggregate principal amount of debt securities in one or more issuances and offerings with the benefit of a support agreement from the Company and thereafter prepare, execute and cause to be filed any amendments thereto (including any post-effective amendments or abbreviated additional registration statements), any amended prospectus or prospectuses, any prospectus supplement or supplements, or amendments or supplements to any of the foregoing, with all exhibits thereto, and to do all other things and to execute, personally or by attorney, any and all other documents necessary or advisable in connection therewith and to use all reasonable best efforts to obtain and maintain the effectiveness of such Registration Statements;

RESOLVED, that each officer and director of the Company who may be required to execute any Registration Statement (whether on behalf of the Company or as an officer or director thereof) be, and each hereby individually is, authorized to execute each Registration Statement and to execute a power of attorney appointing any Authorized Officer(s) as true and lawful attorney and agent to execute in his or her name, place and stead (in any such capacity) each Registration Statement and any and all amendments thereto, and any and all documents in connection therewith, and to file the same with the SEC (together with such other documents as an Authorized Officer may deem necessary or appropriate); further, said attorney and agent are to have authority to do and perform in the name and on behalf of each of the said officer and director or both, as the case may be, every act whatsoever necessary or advisable to be done in the premises, as fully and for all intents and purposes as any such officer or director might or could do in person;

RESOLVED, that the Authorized Officers be, and each of them hereby individually is, authorized to request acceleration of the effective date of a Registration Statement and the Company so as to cause such Registration Statement to become effective on such date as such Authorized Officer may desire;

UNDERWRITING AGREEMENTS

RESOLVED, that each Authorized Officer is authorized and directed to negotiate and approve the form, terms and provisions of one or more underwriting agreements with the Underwriters (or any representatives of the Underwriters on behalf of the Underwriters) relating

to any Offering (the "Underwriting Agreements"), with such changes and additions thereto and to the exhibits and other documents related thereto as the Authorized Officer(s) executing such agreement shall approve, and to execute and deliver such Underwriting Agreements on behalf of the Company;

PRICING COMMITTEE

RESOLVED, that each of George MacKenzie, Donald L. Correll, and Ellen C. Wolf is appointed to the Pricing Committee (the "Pricing Committee"); and that the Pricing Committee has the authority to negotiate with the Underwriters to determine the final terms of the Notes to be sold pursuant to the Underwriting Agreements including the aggregate principal amount of each offering and the underwriting discounts and commissions with respect thereto;

AGENT FOR SERVICE OF PROCESS

RESOLVED, that Donald L. Correll, President and Chief Executive Officer of the Company, is hereby appointed and designated as agent for service of process for the Company to receive notices and communications from the SEC with respect to any Registration Statement and to exercise the powers conferred upon such person as such agent by the Securities Act and the rules and regulations of the SEC thereunder;

BLUE SKY

RESOLVED, that the Authorized Officers be, and each of them hereby individually is, authorized and directed to take any and all actions that they may deem necessary, appropriate or advisable in order to effect the qualification (or exemption from registration or qualification) of the Notes for issuance, offer, sale and trade under the securities or blue sky laws of the several states of the United States of America or of any other jurisdictions, and in connection with such exemptions or qualifications, to execute, acknowledge, verify, deliver, file and publish all such applications, reports, resolutions, requests for exemptions and other documents and to take such other actions, including the payment of fees, and any Authorized Officer may need necessary or advisable in order to obtain and maintain any such exemption or qualification;

NEW YORK STOCK EXCHANGE

RESOLVED, that the Authorized Officers be, and each of them hereby individually is, authorized and directed to take any and all actions that they may deem necessary, appropriate or advisable in order to effect the listing and trading of the Notes on the New York Stock Exchange (the "NYSE"), including, without limitation, the preparation, execution and filing of all necessary applications, documents, forms and agreements with the NYSE, the payment of filing, listing or application fees, the preparation of the relevant certificates and the appearance of such Authorized Officer(s) before officials of the NYSE;

RESOLVED, that the Authorized Officers be, and each of them hereby individually is, authorized and directed to negotiate the form, terms and provisions of and to execute, deliver and perform any and all agreements, amendments or agreements, applications, certificates, instruments, consents, acknowledgements and other documents contemplated by or

related to the listing and trading of the Notes on the NYSE and to take such other actions as such Authorized Officer(s) may deem necessary or appropriate to carry out the foregoing resolutions;

FORM 8-A

RESOLVED, that the Authorized Officers be, and each of them hereby individually is, authorized and directed to prepare, execute and file with the SEC a Registration Statement on Form 8-A under the Securities Exchange Act of 1934 containing such information and together with such exhibits, amendments or supplements as such officer may deem necessary or appropriate and to take such actions in furtherance thereof as such officer may deem necessary or advisable to carry out the purpose and intent of the foregoing resolution;

OTHER DEBT ISSUANCES

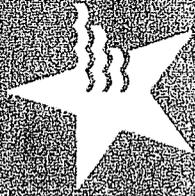
RESOLVED, that any portion of the \$215 million aggregate principal amount of debt securities not publicly offered and sold by AWCC pursuant to the foregoing resolutions, and that AWCC by action of its board of directors declares from time to time may not be so publicly offered and sold, may be offered and sold by AWCC from time to time in one or more tax-exempt offerings with the benefit of its support agreement with the Company, and further, that any portion of the \$215 million aggregate principal amount of debt securities not offered and sold by AWCC in public offerings or in tax-free offerings pursuant to the foregoing resolutions and that AWCC by action of its board of directors declares from time to time may not be so offered and sold, may from time to time be offered and sold by the Company's subsidiary Pennsylvania-American Water Company, in one or more tax-free offerings.

RESOLVED, that the aggregate amounts and terms of debt securities to be sold from time to time by AWCC and Pennsylvania-American Water Company pursuant to the immediately preceding resolution shall be determined by the Pricing Committee named above.

ALL FURTHER ACTION

RESOLVED, that each Authorized Officer is authorized and directed to negotiate, make, execute, perform, acknowledge, verify, issue and deliver all such agreements, amendments to agreements, applications, certificates, instruments, consents, acknowledgments, waivers, filings, financing statements and other documents; to do or cause to be done all such acts and things; and to make all such payments and remittances as such Authorized Officer may deem necessary or appropriate in order to effectuate the full intent and purposes of any or all of the preceding resolutions, such opinion of such Authorized Officer to be conclusively evidenced by the taking of such action by such Authorized Officer; and

RESOLVED, that any and all actions heretofore taken by any Authorized Officer (and any person acting on behalf of or under the direction of such Authorized Officer) in connection with any transaction or objective authorized or approved in any or all of the foregoing resolutions are hereby approved, ratified and confirmed in all respects; and any and all actions hereafter taken by any Authorized Officer in furtherance of any transaction or objective authorized or approved in any or all of the foregoing resolutions are hereby authorized, approved, ratified and confirmed in all respects.



AMERICAN WATER

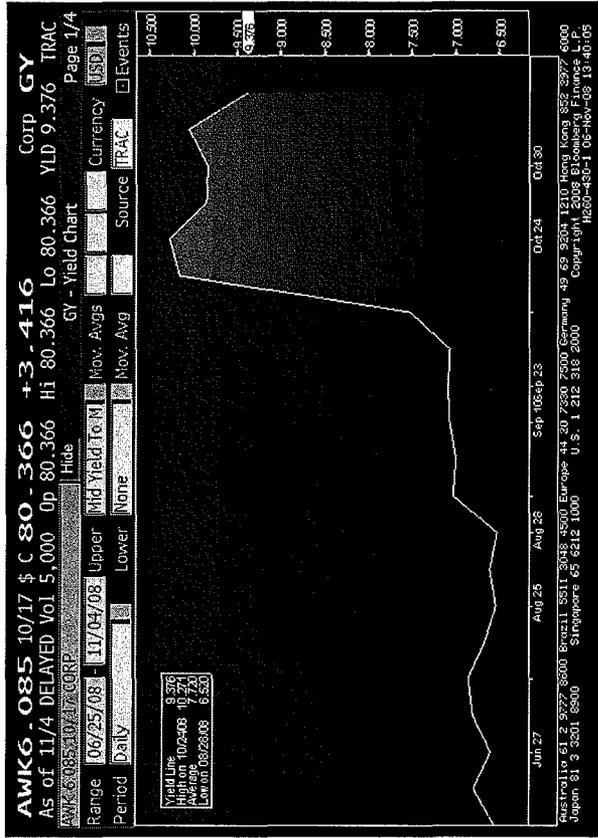
Market Update

Board Meeting
James Kalinovich
November 6, 2008

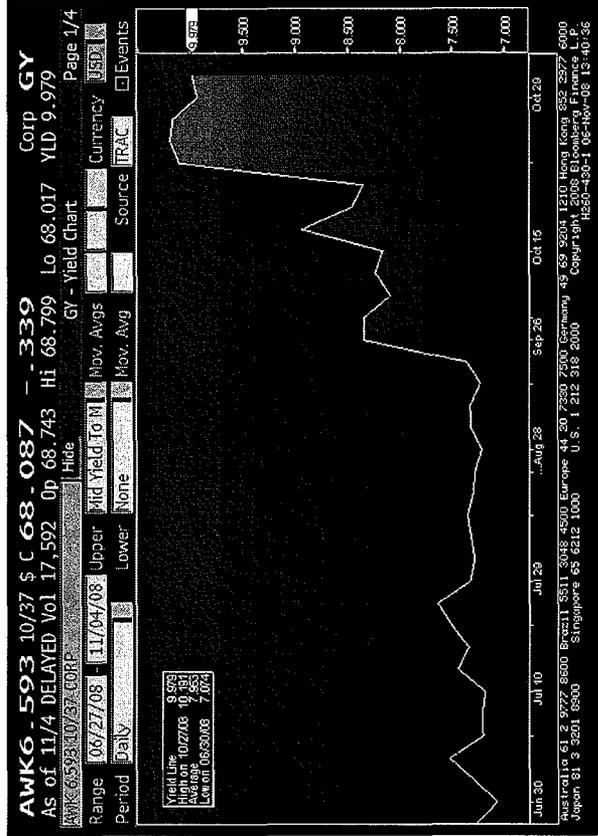
PRESENTATION REVISED 11-7-08



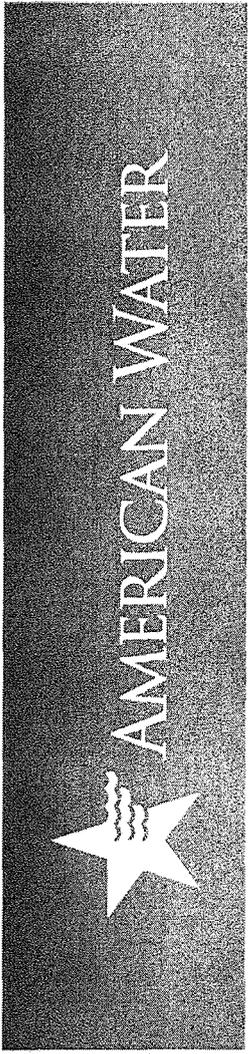
AWCC debt trading levels – November 6th



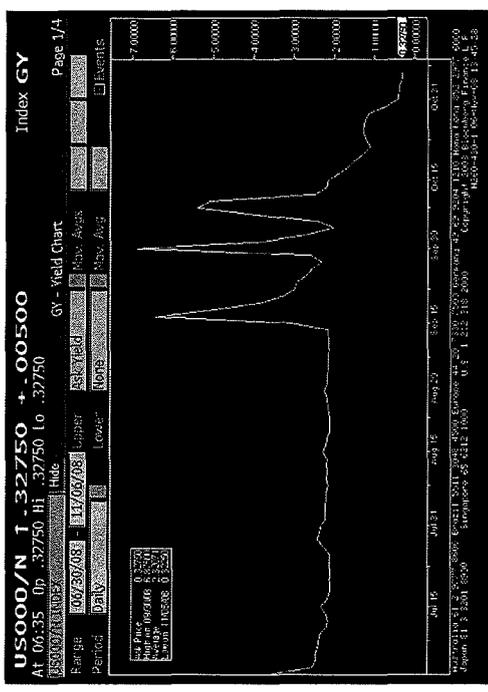
30 Year



10 Year

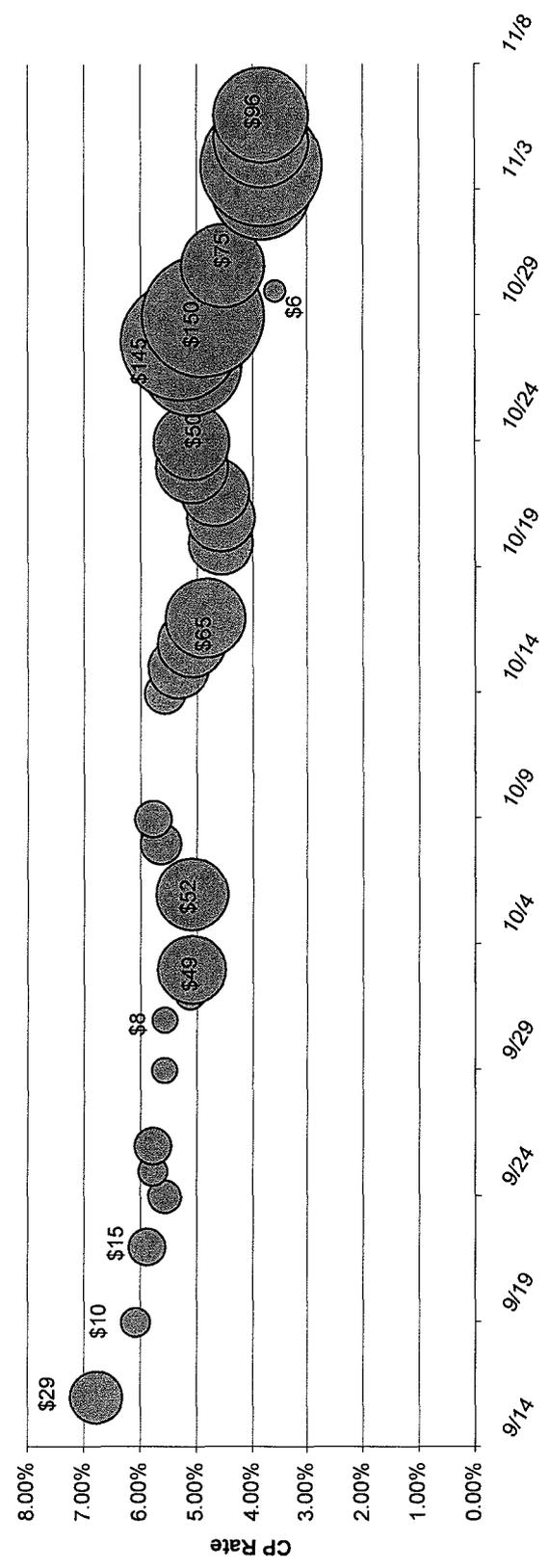


Overnight LIBOR



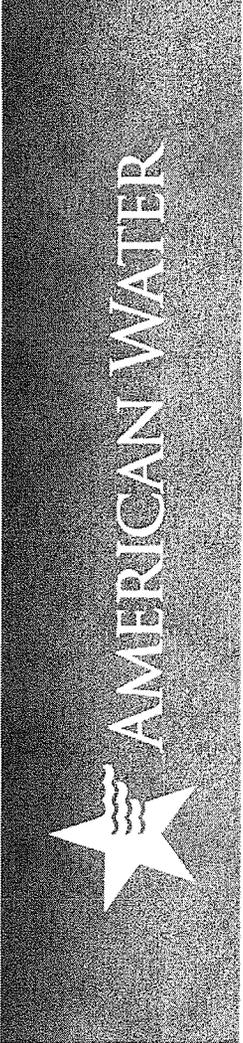
New Issue bond pricing – November 6th

	30 Year	10 Year
Benchmark Treasury yield*	4.20%	3.75%
Credit Spread	680 bps	680 bps
Coupon	11.00%	10.75%
Issuance Fee	0.30%	0.30%
All-in-Yield	11.30%	11.05%



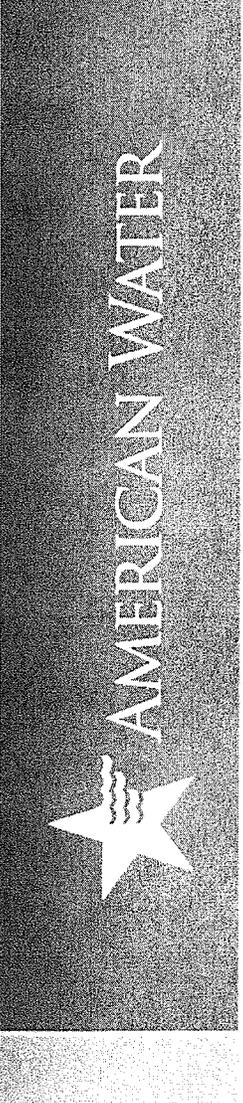
CP issued since 9-15-08

www.amwater.com



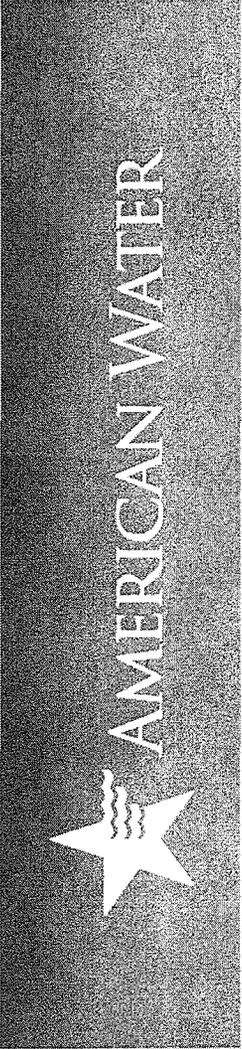
Retail Debt Offering

Securities Offered	AWCC Senior Unsecured Notes
Offering	<p>Three offerings:</p> <ul style="list-style-type: none"> ◦ Manage market volatility through shortened marketing period * Initial offering launch November 17th with immediate follow on possible December with likely delay until early 2009
Amount	\$[50], [40], [35] Maximum \$125M
Rate	[10.50]%
Documentation	<ul style="list-style-type: none"> ◦ S-1 filed with SEC today ◦ Standardized AWCC indenture
Significant Terms & Conditions	<ul style="list-style-type: none"> ◦ Estate feature – Bondholder’s estate can put note back to company upon death of bondholder (minimum \$25,000) ◦ Callable in 5 years at par * High selling concession ◦ All other covenants same as outstanding \$1.5 Billion notes



Tax exempt Debt Offering

Securities Offered	PA American 1st Mortgage Bonds issued by Chester County Industrial Development Authority
Offering Date	Planned offering in December subject to regulatory approval
Amount	\$80M
Rate	[7.50]% - Assuming A-/A3 rating at PA American
Documentation	<ul style="list-style-type: none"> * Loan agreement between PA American and Chester County Industrial Development Authority * Secured through PA American Indenture of Mortgage dated May 1, 1968 * Public offering by Chester County PA is exempt from SEC registration
Significant Terms & Conditions	<ul style="list-style-type: none"> * 1st lien on PA American assets * Interest accrued by holders is exempt from federal tax * Callable in 5 years at par



Original Plan – Q4 2008

Sources	Uses
NJ Tax-exempt notes	Term out former NJ Auction rate Debt
PA PennVest loans	Refinance 6 7/8% NJ Tax-exempt notes
PA Tax-exempt notes	Refinance 6.00% NJ Tax-exempt notes
IN Tax-exempt notes	Refinance 5.95% NJ Tax-exempt notes
Public Bonds – Edward Jones	General Corporate Purposes
Total Sources	Total Uses
\$290.0	\$145.0
5.0	65.0
80.0	45.0
5.0	35.0
<u>125.0</u>	<u>215.0</u>
\$505.0	\$505.0

Revised Plan – Q4 2008

Sources	Uses
PA Tax-exempt notes	General Corporate Purposes
Public Bonds – Edward Jones	
Public Bonds – Edward Jones	
Total Sources	Total Uses
80.0	<u>180.0</u>
50.0	
<u>50.0</u>	
\$180.0	\$180.0



Short-term Debt

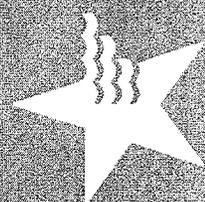
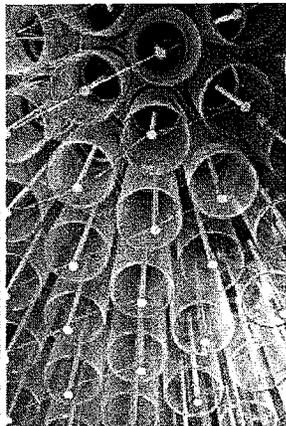
Monthly Activity	10-31-08 (actual)	11-31-08 (forecast)	12-31-08 (forecast)
Beginning Balance	\$243	\$301	\$361
+ Net operating Activity	10	40	27
+ Debt service and dividends	48	20	134
- LT debt issuance	<u>0</u>	<u>0</u>	<u>(130)</u>
Ending Balance	301	361	392
CP Balance	75	0	0
Revolver Balance	<u>226</u>	<u>361</u>	<u>392</u>
Total St Borrowing	301	361	392



Credit Facilities

Institution	Commitment through September 15, 2012	Commitment through September 15, 2013
JP Morgan	\$115	\$0
Citibank NA	115	115
Citizens Bank	80	80
Credit Suisse	80	80
William Street (Goldman)	80	80
Merrill Lynch (merging with BofA)	80	80
Morgan Stanley	80	80
UBS	80	80
National City (merging with PNC)	50	50
PNC	40	40
Bank of NY Mellon – Proposed Addition	40	0
Total	840	685

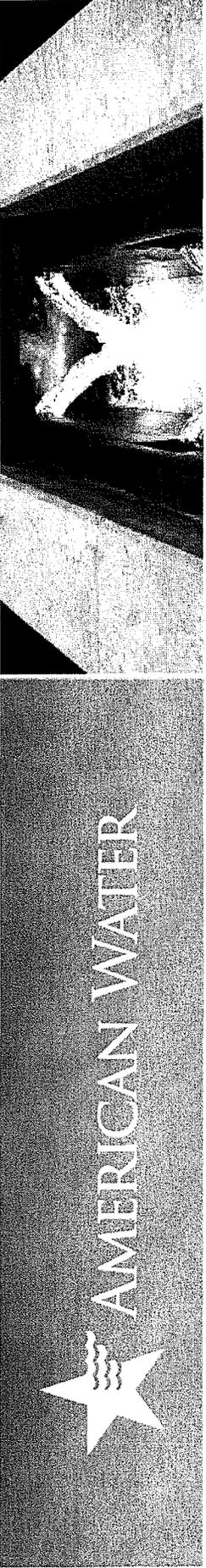
- PNC provide a supplemental \$10 million 364 day credit line terminating 12-31-08
- Propose we add BNY Mellon at same terms for 2b.p fee
- Interviewing candidates fro new administrative agent



AMERICAN WATER

Edward Jones Offering Update

James Kalinovich
November 18, 2008



Retail Debt Offering – Initial Marketing

Securities Offered	AWCC Senior Unsecured Notes
Offering	* Initial offering launch November 18 th with final pricing planned November 21 st
Amount	\$50 million
Rate	Initial marketing yield 10.00%
Documentation	* S-1 filed with SEC * Standardized AWCC indenture
Significant Terms & Conditions	* Estate feature – Bondholder’s estate can put note back to company upon death of bondholder (minimum \$25,000) * Callable in 5 years at par * High selling concession * All other covenants same as outstanding \$1.5 Billion notes

Final pricing planned for November 21st

American Water Capital Corp. Taxable Pricing Update – 11/18/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 42 offerings since 2000 raising \$3.1 billion.
- Five year par call.
- In today's market, the rate would be 10.0%.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.18%)	582 bps	615 bps	
Reoffer Yield	10.00%	10.33%	
PV Underwriting Fee	0.57%	0.10%	
All-in Cost	10.57%	10.43%	14 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	10.07%	10.43%	36 bps

Pricing as of 11/14/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$50 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 36 bps.



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 11/18/08

Recent Taxable Utility Offerings (September-November 2008)

<u>Date</u>	<u>Issuer</u>	<u>Size (\$m)</u>	<u>Yield / Maturity</u>	<u>Rating</u>	<u>Spread</u>	<u>Market</u>
11/17/08	SEMPRA Energy	\$250.0	8.90% due 11/15/13	BBB+/Baa1	+670	Institutional
11/17/08	SEMPRA Energy	\$500.0	9.80% due 02/15/19	BBB+/Baa1	+619	Institutional
11/14/08	Southwn Pub Serv	\$250.0	8.75% due 12/01/18	BBB+/Baa1	+515	Institutional
11/13/08	Pacific Gas & Elec	\$400.0	6.25% due 12/01/13	BBB+/A3 (Notes)	+410	Institutional
11/13/08	Pacific Gas & Elec	\$800.0	8.25% due 10/15/18	BBB+/A3 (Notes)	+456	Institutional
11/12/08	Duke Energy	\$500.0	7.00% due 11/15/18	A/A2 (Mortgage)	+340	Institutional
11/12/08	Duke Energy	\$400.0	5.75% due 11/15/13	A/A2 (Mortgage)	+345	Institutional
11/12/08	Georgia Power	\$400.0	6.00% due 11/01/13	A/A2 (Notes)	+360	Institutional
11/12/08	Georgia Power	\$100.0	8.20% due 11/01/48	A/A2 (Notes)	+403	Institutional
11/06/08	Atlantic City Elec	\$250.0	7.75% due 11/15/18	A-/A3 (Mortgage)	+ 412	Institutional
11/03/08	VA Electric & Power	\$700.0	8.875% due 11/15/38	A-/Baa1 (Notes)	+ 456	Institutional
10/26/08	Natl. Rural Fin Corp	\$1,000.0	10.375% due 11/01/18	A+/A1 (Collateral Trust)	+ 680	Institutional
10/20/08	Illinois Power	\$400.0	10.00% due 11/15/18	BBB/Baa3 (Notes)	+ 609	Institutional
10/16/08	Pacific Gas & Elec	\$600.0	8.50% due 10/15/18	BBB+/A3 (Notes)	+ 456	Institutional
10/15/08	Ohio Edison	\$275.0	8.50% due 10/15/38	BBB+/Baa1 (Mortgage)	+ 427	Institutional
10/14/08	PPL Electric	\$400.0	7.15% due 11/30/13	A-/A3 (Mortgage)	+ 413	Institutional
10/07/08	Southern Cal Ed	\$500.0	5.86% due 03/15/14	A / A2 (Mortgage)	+ 340	Institutional
10/07/08	Detroit Edison	\$250.0	6.46% due 10/01/13	A-/A3 (Mortgage)	+ 400	Institutional
10/01/08	Interstate P&L	\$250.0	7.375% due 10/01/18	BBB+/A3 (Notes)	+ 358	Institutional
10/01/08	Wisconsin P&L	\$250.0	7.75% due 10/01/38	A-/A2 (Notes)	+ 350	Institutional
09/25/08	PECO Energy	\$300.0	5.64% due 10/15/13	A-/A2 (Mortgage)	+ 263	Institutional
09/25/08	South Carolina E&G	\$300.0	6.54% due 11/01/18	A-/A2 (Mortgage)	+ 265	Institutional
09/24/08	UGI Utilities	\$108.0	6.375% due 09/30/13	A/A3 (Notes)	+ 346	Institutional
09/18/08	Laclede Gas Co.	\$80.0	6.35% due 10/15/38	A/A3 (Mortgage)	+ 225	Retail
09/04/08	Oklahoma G&E	\$250.0	6.40% due 09/01/18	BBB+/A2 (Notes)	+ 275	Institutional



Edward Jones

American Water Capital Corp.

Taxable Pricing Update – 11/13/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 42 offerings since 2000 raising \$3.1 billion.
- Five year par call.
- In today's market, the rate would be in the 9.875% to 10.0% range.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.17%)	570 bps	610 bps	
Reoffer Yield	9.88%	10.27%	
PV Underwriting Fee	0.56%	0.10%	
All-in Cost	10.43%	10.37%	-6 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	9.93%	10.37%	44 bps

Pricing as of 11/12/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$50 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 45 bps.



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 11/13/08

Recent Taxable Utility Offerings (September-November 2008)

Date	Issuer	Size (\$m)	Yield / Maturity	Rating	Spread	Market
11/13/08	Pacific Gas & Elec.	\$400.0	6.25% due 12/01/13	BBB+/A3 (Notes)	+410	Institutional
11/13/08	Pacific Gas & Elec.	\$800.0	8.25% due 10/15/18	BBB+/A3 (Notes)	+456	Institutional
11/12/08	Duke Energy	\$500.0	7.00% due 11/15/18	A/A2 (Mortgage)	+340	Institutional
11/12/08	Duke Energy	\$400.0	5.75% due 11/15/13	A/A2 (Mortgage)	+345	Institutional
11/12/08	Georgia Power	\$400.0	6.00% due 11/01/13	A/A2 (Notes)	+360	Institutional
11/12/08	Georgia Power	\$100.0	8.20% due 11/01/48	A/A2 (Notes)	+403	Institutional
11/06/08	Atlantic City Elec.	\$250.0	7.75% due 11/15/18	A-/A3 (Mortgage)	+ 412	Institutional
11/03/08	VA Electric & Power	\$700.0	8.875% due 11/15/38	A-/Baa1 (Notes)	+ 456	Institutional
10/26/08	Natl. Rural Fin Corp.	\$1,000.0	10.375% due 11/01/18	A+/A1 (Collateral Trust)	+ 680	Institutional
10/20/08	Illinois Power	\$400.0	10.00% due 11/15/18	BBB/Baa3 (Notes)	+ 609	Institutional
10/16/08	Pacific Gas & Elec.	\$600.0	8.50% due 10/15/18	BBB+/A3 (Notes)	+ 456	Institutional
10/15/08	Ohio Edison	\$275.0	8.50% due 10/15/38	BBB+/Baa1 (Mortgage)	+ 427	Institutional
10/14/08	PPL Electric	\$400.0	7.15% due 11/30/13	A-/A3 (Mortgage)	+ 413	Institutional
10/07/08	Southern Cal Ed	\$500.0	5.86% due 03/15/14	A / A2 (Mortgage)	+ 340	Institutional
10/07/08	Detroit Edison	\$250.0	6.46% due 10/01/13	A-/A3 (Mortgage)	+ 400	Institutional
10/01/08	Interstate P&L	\$250.0	7.375% due 10/01/18	BBB+/A3 (Notes)	+ 358	Institutional
10/01/08	Wisconsin P&L	\$250.0	7.75% due 10/01/38	A-/A2 (Notes)	+ 350	Institutional
09/25/08	PECO Energy	\$300.0	5.64% due 10/15/13	A-/A2 (Mortgage)	+ 263	Institutional
09/25/08	South Carolina E&G	\$300.0	6.54% due 11/01/18	A-/A2 (Mortgage)	+ 265	Institutional
09/24/08	UGI Utilities	\$108.0	6.375% due 09/30/13	A/A3 (Notes)	+ 346	Institutional
09/18/08	Laclede Gas Co.	\$80.0	6.35% due 10/15/38	A/A3 (Mortgage)	+ 225	Retail
09/04/08	Oklahoma G&E	\$250.0	6.40% due 09/01/18	BBB+/A2 (Notes)	+ 275	Institutional

Edward Jones Taxable Debt Offerings (2003 - 2008)

ISSUER	DATE	ISSUE SIZE (\$)	STRUCTURE	ROLE	RATING
Laclede Gas Company	09/18/08	80,000,000	30 n/c 5	Lead	A3/A
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	31 n/c 5	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	31 n/c 5	Sole	Aaa/AAA
Alabama Power Company	10/11/07	200,000,000	30 n/c 5	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	33 n/c 5	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	34 n/c 5	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	30 n/c 5	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	15 n/c 3	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	30 n/c 5	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	30 n/c 5	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	30 n/c 5	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	20 n/c 4	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	25 n/c 5	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	25 n/c 5	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	30 n/c 5	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	30 n/c 5	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	20 n/c 4	Sole	NR



Edward Jones

American Water Capital Corp.

Taxable Pricing Update – 11/07/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 42 offerings since 2000 raising \$3.1 billion.
- Five year par call.
- In today's market, the rate would be in the 9.875% to 10.0% range.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.18%)	570 bps	610 bps	
Reoffer Yield	9.88%	10.28%	
PV Underwriting Fee	0.56%	0.10%	
All-in Cost	10.43%	10.38%	-5 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	9.93%	10.38%	45 bps

Pricing as of 11/05/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$50 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 45 bps.

American Water Capital Corp. Taxable Pricing Update – 11/07/08

Recent Taxable Utility Offerings (September/October 2008)

Date	Issuer	Size (\$m)	Yield / Maturity	Rating	Spread	Market
11/06/08	Atlantic City Elec.	\$250.0	7.75% due 11/15/18	A-/A3 (Mortgage)	+ 412	Institutional
11/03/08	VA Electric & Power	\$700.0	8.875% due 11/15/38	A-/Baa1 (Notes)	+ 456	Institutional
10/26/08	Natl. Rural Fin Corp.	\$1,000.0	10.375% due 11/01/18	A+/A1 (Collateral Trust)	+ 680	Institutional
10/20/08	Illinois Power	\$400.0	10.00% due 11/15/18	BBB/Baa3 (Notes)	+ 609	Institutional
10/16/08	Pacific Gas & Elec.	\$600.0	8.50% due 10/15/18	BBB+/A3 (Notes)	+ 456	Institutional
10/15/08	Ohio Edison	\$275.0	8.50% due 10/15/38	BBB+/Baa1 (Mortgage)	+ 427	Institutional
10/14/08	PPL Electric	\$400.0	7.15% due 11/30/13	A-/A3 (Mortgage)	+ 413	Institutional
10/07/08	Southern Cal Ed	\$500.0	5.86% due 03/15/14	A / A2 (Mortgage)	+ 340	Institutional
10/07/08	Detroit Edison	\$250.0	6.46% due 10/01/13	A-/A3 (Mortgage)	+ 400	Institutional
10/01/08	Interstate P&L	\$250.0	7.375% due 10/01/18	BBB+/A3 (Notes)	+ 358	Institutional
10/01/08	Wisconsin P&L	\$250.0	7.75% due 10/01/38	A-/A2 (Notes)	+ 350	Institutional
09/25/08	PECO Energy	\$300.0	5.64% due 10/15/13	A-/A2 (Mortgage)	+ 263	Institutional
09/25/08	South Carolina E&G	\$300.0	6.54% due 11/01/18	A-/A2 (Mortgage)	+ 265	Institutional
09/24/08	UGI Utilities	\$108.0	6.375% due 09/30/13	A/A3 (Notes)	+ 346	Institutional
09/18/08	Laclede Gas Co.	\$80.0	6.35% due 10/15/38	A/A3 (Mortgage)	+ 225	Retail
09/04/08	Oklahoma G&E	\$250.0	6.40% due 09/01/18	BBB+/A2 (Notes)	+ 275	Institutional

Edward Jones Taxable Debt Offerings (2003 - 2008)

ISSUER	DATE	ISSUE SIZE (\$)	STRUCTURE	ROLE	RATING
Laclede Gas Company	09/18/08	80,000,000	30 n/c 5	Lead	A3/A
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	31 n/c 5	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	31 n/c 5	Sole	Aaa/AAA
Alabama Power Company	10/11/07	200,000,000	30 n/c 5	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	33 n/c 5	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	34 n/c 5	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	30 n/c 5	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	15 n/c 3	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	30 n/c 5	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	30 n/c 5	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	30 n/c 5	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	20 n/c 4	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	25 n/c 5	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	25 n/c 5	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	30 n/c 5	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	30 n/c 5	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	20 n/c 4	Sole	NR



Edward Jones

American Water Capital Corp.

Taxable Pricing Update – 10/31/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 42 offerings since 2000 raising \$3.1 billion.
- Five year par call.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.24%)	576 bps	610 bps	
Reoffer Yield	10.00%	10.34%	
PV Underwriting Fee	0.57%	0.10%	
All-in Cost	10.57%	10.44%	-13 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	10.07%	10.44%	37 bps

Pricing as of 10/31/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$50 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 37 bps.

American Water Capital Corp. Taxable Pricing Update – 10/31/08

Recent Taxable Utility Offerings (September/October 2008)

Date	Issuer	Size (\$m)	Yield / Maturity	Rating	Spread	Market
10/20/08	Illinois Power	\$400.0	10.00% due 11/15/18	BBB/Baa3 (Notes)	+ 609	Institutional
10/16/08	Pacific Gas & Elec.	\$600.0	8.50% due 10/15/18	BBB+/A3 (Notes)	+ 456	Institutional
10/15/08	Ohio Edison	\$275.0	8.50% due 10/15/38	BBB+/Baa1 (Mortgage)	+ 427	Institutional
10/14/08	PPL Electric	\$400.0	7.15% due 11/30/13	A-/A3 (Mortgage)	+ 413	Institutional
10/07/08	Southern Cal Ed	\$500.0	5.86% due 03/15/14	A / A2 (Mortgage)	+ 340	Institutional
10/07/08	Detroit Edison	\$250.0	6.46% due 10/01/13	A-/A3 (Mortgage)	+ 400	Institutional
10/01/08	Interstate P&L	\$250.0	7.375% due 10/01/18	BBB+/A3 (Notes)	+ 358	Institutional
10/01/08	Wisconsin P&L	\$250.0	7.75% due 10/01/38	A-/A2 (Notes)	+ 350	Institutional
09/25/08	PECO Energy	\$300.0	5.64% due 10/15/13	A-/A2 (Mortgage)	+ 263	Institutional
09/25/08	South Carolina E&G	\$300.0	6.54% due 11/01/18	A-/A2 (Mortgage)	+ 265	Institutional
09/24/08	UGI Utilities	\$108.0	6.375% due 09/30/13	A/A3 (Notes)	+ 346	Institutional
09/18/08	Laclede Gas Co.	\$80.0	6.35% due 10/15/38	A/A3 (Mortgage)	+ 225	Retail
09/04/08	Oklahoma G&E	\$250.0	6.40% due 09/01/18	BBB+/A2 (Notes)	+ 275	Institutional

Edward Jones Taxable Debt Offerings (2003 - 2008)

ISSUER	DATE	ISSUE SIZE (\$)	STRUCTURE	ROLE	RATING
Laclede Gas Company	09/18/08	80,000,000	30 n/c 5	Lead	A3/A
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	31 n/c 5	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	31 n/c 5	Sole	Aaa/AAA
Alabama Power Company	10/11/07	200,000,000	30 n/c 5	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	33 n/c 5	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	34 n/c 5	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	30 n/c 5	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	15 n/c 3	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	30 n/c 5	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	30 n/c 5	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	30 n/c 5	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	20 n/c 4	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	25 n/c 5	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	25 n/c 5	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	30 n/c 5	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	30 n/c 5	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	20 n/c 4	Sole	NR



Edward Jones

American Water Capital Corp.

Taxable Pricing Update – 10/23/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 42 offerings since 2000 raising \$3.1 billion.
- Five year par call.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.02%)	498 bps	545 bps	
Reoffer Yield	9.00%	9.47%	
PV Underwriting Fee	0.50%	0.09%	
All-in Cost	9.50%	9.56%	6 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	9.00%	9.56%	56 bps

Pricing as of 10/23/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$75 to \$100 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 56 bps.



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 10/23/08

Recent Taxable Utility Offerings (September/October 2008)

Date	Issuer	Size (\$m)	Yield / Maturity	Rating	Spread	Market
10/20/08	Illinois Power	\$400.0	10.00% due 11/15/18	BBB/Baa3 (Notes)	+ 609	Institutional
10/16/08	Pacific Gas & Elec.	\$600.0	8.50% due 10/15/18	BBB+/A3 (Notes)	+ 456	Institutional
10/15/08	Ohio Edison	\$275.0	8.50% due 10/15/38	BBB+/Baa1 (Mortgage)	+ 427	Institutional
10/14/08	PPL Electric	\$400.0	7.15% due 11/30/13	A-/A3 (Mortgage)	+ 413	Institutional
10/07/08	Southern Cal Ed	\$500.0	5.86% due 03/15/14	A / A2 (Mortgage)	+ 340	Institutional
10/07/08	Detroit Edison	\$250.0	6.46% due 10/01/13	A-/A3 (Mortgage)	+ 400	Institutional
10/01/08	Interstate P&L	\$250.0	7.375% due 10/01/18	BBB+/A3 (Notes)	+ 358	Institutional
10/01/08	Wisconsin P&L	\$250.0	7.75% due 10/01/38	A-/A2 (Notes)	+ 350	Institutional
09/25/08	PECO Energy	\$300.0	5.64% due 10/15/13	A-/A2 (Mortgage)	+ 263	Institutional
09/25/08	South Carolina E&G	\$300.0	6.54% due 11/01/18	A-/A2 (Mortgage)	+ 265	Institutional
09/24/08	UGI Utilities	\$108.0	6.375% due 09/30/13	A/A3 (Notes)	+ 346	Institutional
09/18/08	Laclede Gas Co.	\$80.0	6.35% due 10/15/38	A/A3 (Mortgage)	+ 225	Retail
09/04/08	Oklahoma G&E	\$250.0	6.40% due 09/01/18	BBB+/A2 (Notes)	+ 275	Institutional

Edward Jones Taxable Debt Offerings (2003 - 2008)

ISSUER	DATE	ISSUE SIZE (\$)	STRUCTURE	ROLE	RATING
Laclede Gas Company	09/18/08	80,000,000	30 n/c 5	Lead	A3/A
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	31 n/c 5	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	31 n/c 5	Sole	Aaa/AAA
Alabama Power Company	10/11/07	200,000,000	30 n/c 5	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	33 n/c 5	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	34 n/c 5	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	30 n/c 5	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	15 n/c 3	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	30 n/c 5	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	30 n/c 5	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	30 n/c 5	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	30 n/c 5	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	20 n/c 4	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	25 n/c 5	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	25 n/c 5	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	30 n/c 5	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	30 n/c 5	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	20 n/c 4	Sole	NR



Edward Jones

American Water Capital Corp.

Taxable Pricing Update – 10/16/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 41 offerings since 2000 raising \$3.0 billion.
- Five year par call.
- In today's market, we would be in 8.375% to 8.50% range.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.21%)	429 bps	455 bps	
Reoffer Yield	8.50%	8.76%	
PV Underwriting Fee	0.46%	0.08%	
All-in Cost	8.96%	8.84%	-12 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	8.46%	8.84%	38 bps

Pricing as of 10/16/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$125 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 38 bps.



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 10/16/08

Edward Jones Taxable Utility Offerings (2002-2008)

ISSUER	OFFERING DATE	ISSUE SIZE (\$)	EDWARD JONES ROLE	RATING
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	Sole	A2/A
Alabama Power Company	10/11/07	200,000,000	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	Sole	NR
Empire District Electric	12/18/02	50,000,000	Co-Mgr	BBB-/Baa2
Savannah Electric	11/04/02	55,000,000	Lead	AAA/Aaa
Ottertail Corporation	09/23/02	40,000,000	Co-Mgr	AAA/Aaa
Ottertail Corporation	09/23/02	25,000,000	Co-Mgr	A+/A2
National Fuel Gas Company	09/12/02	97,700,000	Co-Mgr	A3/BBB+
Cleco Power LLC	05/06/02	50,000,000	Lead	AAA/Aaa
Duke Energy	04/11/02	250,000,000	Co-Mgr	AAA/Aaa
Cleco Power LLC	01/30/02	25,000,000	Sole	AAA/Aaa



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 09/12/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 41 offerings since 2000 raising \$3.0 billion.
- Five year par call.
- In today's market, we would be in the 7.15% to 7.25% range.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.20%)	300 bps	325 bps	
Reoffer Yield	7.20%	7.45%	
PV Underwriting Fee	0.38%	0.07%	
All-in Cost	7.58%	7.52%	-6 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	7.08%	7.52%	44 bps

Pricing as of 09/15/08 is based on the T30 (4.38% due 02/15/38)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$125 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 44 bps.



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 09/12/08

Edward Jones Utility Offerings (2002-2008)

ISSUER	OFFERING DATE	ISSUE SIZE (\$)	EDWARD JONES ROLE	RATING
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	Sole	A2/A
Alabama Power Company	10/11/07	200,000,000	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	Sole	NR
Empire District Electric	12/18/02	50,000,000	Co-Mgr	BBB-/Baa2
Savannah Electric	11/04/02	55,000,000	Lead	AAA/Aaa
Ottertail Corporation	09/23/02	40,000,000	Co-Mgr	AAA/Aaa
Ottertail Corporation	09/23/02	25,000,000	Co-Mgr	A+/A2
National Fuel Gas Company	09/12/02	97,700,000	Co-Mgr	A3/BBB+
Cleco Power LLC	05/06/02	50,000,000	Lead	AAA/Aaa
Duke Energy	04/11/02	250,000,000	Co-Mgr	AAA/Aaa
Cleco Power LLC	01/30/02	25,000,000	Sole	AAA/Aaa

Edward Jones Weekly Retail Note Program Results (2006 & 2007)

	2007 Sales #	2007 Rank	2006 Sales #	2006 Rank
Freddie Mac	\$570.8mm	1	593.0mm	1
Bank of America	\$526.9mm	1	465.2mm	1
CIT	\$190.8mm	1	405.1mm	1
Prudential	\$489.8mm	1	354.6mm	1
GE	\$687.8mm	1	320.5mm	1
Principal Life	\$249.3mm	1	173.2mm	1
Bank of New York	\$180.9mm	1	180.0mm	1
Fannie Mae	\$180.7mm	3	169.0mm	3
Toyota	\$155.6mm	2	165.0mm	2
Caterpillar	\$297.8mm	1	143.0mm	1
JP Morgan	\$641.0mm	1	160.3mm	1



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 09/04/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 41 offerings since 2000 raising \$3.0 billion.
- Five year par call.
- In today's market, we would be in the 7.10% to 7.20% range.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.33%)	282 bps	310 bps	
Reoffer Yield	7.15%	7.43%	
PV Underwriting Fee	0.38%	0.07%	
All-in Cost	7.53%	7.50%	-3 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	7.03%	7.50%	47 bps

Pricing as of 09/03/08 is based on the T30 (4.75% due 02/15/37)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$125 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 47 bps.



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 09/04/08

Edward Jones Utility Offerings (2002-2008)

ISSUER	OFFERING DATE	ISSUE SIZE (\$)	EDWARD JONES ROLE	RATING
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	Sole	A2/A
Alabama Power Company	10/11/07	200,000,000	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	Sole	NR
Empire District Electric	12/18/02	50,000,000	Co-Mgr	BBB-/Baa2
Savannah Electric	11/04/02	55,000,000	Lead	AAA/Aaa
Ottertail Corporation	09/23/02	40,000,000	Co-Mgr	AAA/Aaa
Ottertail Corporation	09/23/02	25,000,000	Co-Mgr	A+/A2
National Fuel Gas Company	09/12/02	97,700,000	Co-Mgr	A3/BBB+
Cleco Power LLC	05/06/02	50,000,000	Lead	AAA/Aaa
Duke Energy	04/11/02	250,000,000	Co-Mgr	AAA/Aaa
Cleco Power LLC	01/30/02	25,000,000	Sole	AAA/Aaa

Edward Jones Weekly Retail Note Program Results (2006 & 2007)

	2007 Sales #	2007 Rank	2006 Sales #	2006 Rank
Freddie Mac	\$570.8mm	1	593.0mm	1
Bank of America	\$526.9mm	1	465.2mm	1
CIT	\$190.8mm	1	405.1mm	1
Prudential	\$489.8mm	1	354.6mm	1
GE	\$687.8mm	1	320.5mm	1
Principal Life	\$249.3mm	1	173.2mm	1
Bank of New York	\$180.9mm	1	180.0mm	1
Fannie Mae	\$180.7mm	3	169.0mm	3
Toyota	\$155.6mm	2	165.0mm	2
Caterpillar	\$297.8mm	1	143.0mm	1
JP Morgan	\$641.0mm	1	160.3mm	1



Edward Jones

American Water Capital Corp. Taxable Pricing Update – 08/22/08

Monthly Notes

- Retail feature includes monthly interest.
- Proven reliability with utilities: 41 offerings since 2000 raising \$3.0 billion.
- Five year par call.
- In today's market, we would be in the 7.00% to 7.10% range.

Comparison of Pricing and Terms

American Water Capital Corp.	Edward Jones Note	Institutional Bullet	Savings
Structure	30 n/c 5	30-yr	
Payments / Year	12	2	
Rating	BBB+/Baa2	BBB+/Baa2	
Reoffer Spread (T30 = 4.45%)	255 bps	285 bps	
Reoffer Yield	7.00%	7.30%	
PV Underwriting Fee	0.37%	0.07%	
All-in Cost	7.37%	7.37%	0 bps
Value of Call Option	0.50%	n/a	
Option-Adjusted Cost	6.87%	7.37%	50 bps

Pricing as of 08/20/08 is based on the T30 (4.75% due 02/15/37)

Assumptions

- Edward Jones' upfront fee is 3.15% (\$31.50/\$1000) of the par amount.
- Edward Jones will lead manage the offering and/or work with your selected underwriting group.
- Our pricing is based on a demand of \$125 million and assumes a Senior Unsecured Note offering.
- Our pricing assumes a rating of Baa2/BBB+ (Stable).
- The bonds include an estate feature limited annually to \$25,000 per holder and to 2.0% of the original principal amount in the aggregate.
- On an option-adjusted basis, Monthly Notes would save approximately 50 bps.

American Water Capital Corp. Taxable Pricing Update – 08/22/08

Edward Jones Utility Offerings (2002-2008)

ISSUER	OFFERING DATE	ISSUE SIZE (\$)	EDWARD JONES ROLE	RATING
Vectren Utility Holdings, Inc.	03/05/08	125,000,000	Sole	Baa1/A-
Georgia Power Company	11/29/07	100,000,000	Sole	A2/A
Alabama Power Company	10/11/07	200,000,000	Sole	Aaa/AAA
Georgia Power Company	08/24/07	250,000,000	Sole	Aaa/AAA
Georgia Power Company	12/08/06	150,000,000	Sole	Aaa/AAA
Vectren Utility Holdings, Inc.	10/13/06	100,000,000	Sole	Aaa/AAA
Piedmont Natural Gas	09/15/06	200,000,000	Lead	Aaa/AAA
Delta Natural Gas Company, Inc.	04/03/06	40,000,000	Sole	AAA
Alabama Power Company	01/14/06	100,000,000	Sole	Aaa/AAA
Consumers Energy	04/07/05	150,000,000	Lead	Aaa/AAA
Cascade Natural Gas	01/20/05	30,000,000	Sole	Aaa/AAA
Alabama Gas Corporation	01/11/05	40,000,000	Sole	A1/A-
Entergy New Orleans	08/17/04	35,000,000	Co-Mgr	AAA
Entergy New Orleans	08/10/04	40,000,000	Co-Mgr	AAA
Savannah Electric	12/11/03	35,000,000	Lead	Aaa/AAA
Gulf Power Company	03/21/03	65,000,000	Lead	Aaa/AAA
Georgia Power Company	02/21/03	150,000,000	Lead	AAA/Aaa
Delta Natural Gas Company, Inc.	02/11/03	20,000,000	Sole	NR
Empire District Electric	12/18/02	50,000,000	Co-Mgr	BBB-/Baa2
Savannah Electric	11/04/02	55,000,000	Lead	AAA/Aaa
Ottertail Corporation	09/23/02	40,000,000	Co-Mgr	AAA/Aaa
Ottertail Corporation	09/23/02	25,000,000	Co-Mgr	A+/A2
National Fuel Gas Company	09/12/02	97,700,000	Co-Mgr	A3/BBB+
Cleco Power LLC	05/06/02	50,000,000	Lead	AAA/Aaa
Duke Energy	04/11/02	250,000,000	Co-Mgr	AAA/Aaa
Cleco Power LLC	01/30/02	25,000,000	Sole	AAA/Aaa

Edward Jones Weekly Retail Note Program Results (2006 & 2007)

	2007 Sales #	2007 Rank	2006 Sales #	2006 Rank
Freddie Mac	\$570.8mm	1	593.0mm	1
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Prudential	\$489.8mm	1	354.6mm	1
GE	\$687.8mm	1	320.5mm	1
Principal Life	\$249.3mm	1	173.2mm	1
Bank of New York	\$180.9mm	1	180.0mm	1
Fannie Mae	\$180.7mm	3	169.0mm	3
Toyota	\$155.6mm	2	165.0mm	2
Caterpillar	\$297.8mm	1	143.0mm	1
JP Morgan	\$641.0mm	1	160.3mm	1



<Thomas.Connor@rbsgc.com

To <Mahaveer.Jain@amwater.com>

>

cc

11/21/2008 03:33 PM

bcc

Subject RE: AWK Pricing

Mahaveer,

I think our market would price a 10-year issuance at roughly 633 bps over Treasuries.

I'm joking - a little - because I see that's where you priced a small deal early today. But honestly, I see your 2017 bond has been trading in the high 500s - low 600s area so would have thought we would price a new private placement deal at roughly +625-650 over. If you have interest in additional funds we may be able to tap more from our existing investors without much work on your part. Please let me know.

TC

Thomas M. Connor

RBS Global Banking & Markets

Office: +1 203 618 6636

From: Connor, Thomas, RBSGC

Sent: Friday, November 21, 2008 10:24 AM

To: 'Mahaveer.Jain@amwater.com'

Subject: RE: AWK Pricing

Mahaveer,

I will research this and revert asap.

TC

Thomas M. Connor

RBS Global Banking & Markets

Office: +1 203 618 6636

From: Mahaveer.Jain@amwater.com [mailto:Mahaveer.Jain@amwater.com]

Sent: Friday, November 21, 2008 9:28 AM

To: Connor, Thomas, RBSGC

Subject: AWK Pricing

Tom,

Can you provide me a pricing for private placement debt and public issuance (30 years)

Thanks

Phone: (856) 346-8247

Cell: (856) 938-8390

Fax : (856) 566-4004

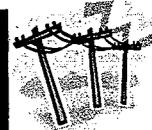
email : mahaveer.jain@amwater.com

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*



THE POWERLINE



Debt Capital Markets Update for the Week Ending November 21st, 2008

New Issue Market

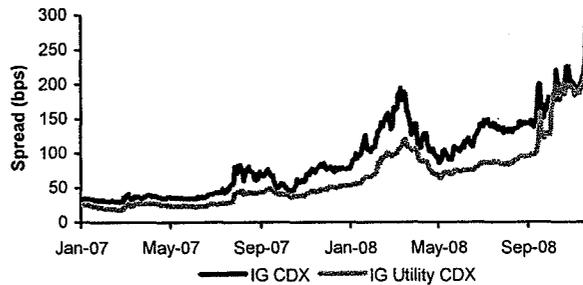
- The new issue market was active early in the week, but slowed considerably on Thursday and Friday as concerns about the global economic outlook caused equities and credit to weaken significantly. 11 deals priced for a total of \$7.8 billion of new issuance
- Non-financial issuance included
 - British Sky Broadcasting (Baa2/BBB) priced \$600 million of 10 year notes at +587.5/10yr UST for a coupon of 9.5%
 - Cellco Partnership / Verizon Wireless (A2/A) priced \$1.25 billion of 5 year notes at +537.5/5yr UST for a coupon of 7.375% and \$2.25 billion of 10 year notes at +512.5/10yr UST for a coupon of 8.5%
- Selected Transactions
 - Delmarva Power & Light (Baa1/A-), a subsidiary of Pepco Holdings, issued \$250 million of 5 year First Mortgage Bonds at +420/5yr UST for a coupon of 6.4%
 - Sempra Energy (Baa1/BBB+) priced \$250 million of 5 year notes at +670/5yr UST for a coupon of 8.9% and \$500 million of 10 year notes at +619.7/10yr UST for a coupon of 9.8%
 - Southern California Gas (A1/A+), a subsidiary of Sempra Energy, priced \$250 million of 5 year First Mortgage Bonds at +332/5yr UST for a coupon of 5.5%
 - Westar Energy (Baa2/BBB), priced \$300 million of 10 year First Mortgage Bonds at +521.3/10yr UST for a coupon of 8.625%
- The past week saw a reversal in the performance of recent new issuances. As equity and credit markets deteriorated, bond prices fell and spreads widened

Economic Update

- Industrial production increased by 1.3% in October, rebounding from the low levels caused by hurricanes in September. However, this increase follows a 3.7% revised decline (from -2.8%) for September, showing that deterioration has occurred underneath distortions caused by the hurricanes. Also, the industrial utilization rate has slumped by over 2 percentage points in the last two months - the largest two month decline since the 1981-82 recession. Thus, the industrial sector is contracting at a rate consistent with a fairly severe recession
- The homebuilder's index fell 9 points, a 5 point drop month over month. This month's weakness focused on lower numbers for present sales and buyer traffic. Present sales slumped to 8pts from 14pts and traffic to 7pts from 11pts. Both of these declines point to weak home sales data to come for new and existing homes
- Initial jobless claims surged to 542,000 from 514,000 last week. Large increases in both initial and continuing jobless claims point in the direction of the poor economic performance in October persisting into November. The pace of labor market decline is actually accelerating, and the labor market is clearly in recession mode
- Treasuries rallied as weakening credit and equity markets strengthened the flight to quality phenomenon. The 2yr tightened by 7bps to 1.17%, the 5yr strengthened by 31bps to 2.03%, the 10yr tightened by 54bps to 3.20%, and the 30yr tightened by 52bps to 3.70%

	Release Date	Market Consensus	GS		
Existing Home Sales (Oct)	11/24	-3.1%	-5.0%		
Real GDP - Provisional (Q3)	11/25	-0.5%	-0.3%		
Durable Goods Orders (Oct)	11/26	-3.0%	-2.0%		
	3mL	2yr UST	5yr UST	10yr UST	30yr UST
This Week %	2.16	1.17	2.03	3.20	3.70
Last Week %	2.24	1.24	2.34	3.74	4.22

Secondary Market Update



- Credit traded wider last week
 - Credit gapped wider on Monday as equities were focused on auto-makers and Citigroup. Congressional talks on a bailout for the autos seemed headed for a stalemate, and Citigroup announced that it was cutting 52,000 employees, approximately 15% of its workforce. The IG CDX index finished 9bps wider at 215bps, and the HVOL index was 10bps wider at 485bps
 - On Wednesday and Thursday equity and credit significantly weakened as the Dow dropped to its lowest level since March 2003, the S&P Index fell to an 11 year low, and the IG CDX index hit an all time high. Many factors caused the sell off - construction starts on housing and new building permits dropped to the lowest level in almost 50 years, and agency spreads blew out as the CMBX AAA tranche fell to 53pts, reflecting a 32pt drop since the beginning of November. All this and more concern about Citigroup on Thursday caused the IG index to close at an all time high of 283bps, and the HVOL index closed 50bps wider at 600bps
 - Equity and credit markets improved on Friday as the FDIC approved the final proposal of the Temporary Loan Guarantee Program, and the market also reacted positively to news that president-elect Obama will appoint Timothy Geithner as the new Treasury secretary. The IG CDX index closed 15bps tighter at 269bps, and the HVOL index tightened by 25bps to 575bps
- Last week, the IG CDX widened by 64bps to 269bps, and the Utility CDX also widened by 40bps to 234bps
 - First Energy was wider by 25bps, Dominion Resources was wider by 30bps, and American Electric Power and Duke Energy were wider by 25bps and 30bps, respectively

Temporary Liquidity Guarantee Program (TLGP) Update

- On Friday the US Federal Deposit Insurance Corporation voted to strengthen the guarantee on bank bonds, clearing the way for financial institutions to access credit markets with the backing of the US government
 - The FDIC will guarantee senior unsecured bank debt of participating institutions - all payments of interest and principal will be taken over by the guarantor in the event of the underlying issuer defaulting
 - This guarantee will be strong enough to put bonds issued under this program on par with other government or government backed securities. Issuance under the TLGP will be rated Aaa/AAA/AAA - the same as the US government
 - The guarantee applies to all designated senior unsecured issuances made prior to June 30, 2009 and covers the period from the date of issuance through June 30, 2012, except for issues with a maturity of less than one month
- The FDIC also replaced a flat 75 basis point fee on each debt issue with a tiered pricing system that charges different amounts depending on the maturity of the bond issued
 - The original flat fee reduced cost savings on shorter term debt
- Goldman Sachs announced on Friday that it would offer debt securities under the new FDIC guarantee program on Monday, pending confirmation from the rating agencies
 - The debt will carry a maturity of no later than June 30, 2012 and will price early next week

Comparison of Yields

	Edward Jones	Institutional Bullet	AWK 30 yr 6.55% notes
Structure	30 Years	30 Years	30 Years
Rating	BBB+/Baa2	BBB+/Baa2	BBB+/Baa2
US 30 Yr Treasury	4.18%	4.18%	4.18%
Spread	5.27%	5.71%	5.59%
New issue Premium	0.55%	0.55%	0.50%
Yield	10.00%	10.44%	10.27%
Issuance Fees and Costs	4.00%	0.35%	0.00%
All -in -cost	10.57%	10.43%	10.27%
Call Option Cost *	0.50%	0.00%	0.00%
Option Adjusted Cost	10.07%	10.43%	10.27%

* A Call option could cost between 0.5% - 1%.
For our comparion we are assuming 0.5% as the cost

<HELP> for explanation, <MENU> for similar functions.

Govt **HP**

BGN/NY/CLOSE/MID/YTW

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US TREASURY N/B T 4 ½ 05/15/38 112-31 /113-00 (3.77 /77) BGN @10:16
 Source **BGN** HI 118-18+ ON 11/20/08
 Range **8/ 7/08** to **11/24/08** Period **D** Daily AVE 104-09+
 Market **M** Mid/Last LOW 98-08+ ON 8/11/08

DATE	PRICE	YIELD	DATE	PRICE	YIELD	DATE	PRICE	YIELD
F			F 11/ 7	103-24+	4.274	F 10/17	102-29+	4.324
T			T 11/ 6	105-02	4.199	T 10/16	104-02	4.257
W			W 11/ 5	105-15	4.176	W 10/15	105-06	4.192
T			T 11/ 4	105-05+	4.193	T 10/14	103-23	4.277
M 11/24	112-31+	3.767	M 11/ 3	102-30	4.323	M 10/13	106-05	4.137
F 11/21	114-12+	3.694	F 10/31	102-06	4.367	F 10/10	106-05	4.137
T 11/20	H118-18+	3.486	T 10/30	102-25+	4.331	T 10/ 9	106-24+	4.103
W 11/19	110-11	3.906	W 10/29	104-12+	4.238	W 10/ 8	107-23+	4.049
T 11/18	106-17+	4.115	T 10/28	105-06	4.192	T 10/ 7	108-02	4.031
M 11/17	105-05+	4.193	M 10/27	107-25	4.046	M 10/ 6	109-04	3.973
F 11/14	104-17+	4.229	F 10/24	107-11+	4.070	F 10/ 3	107-01	4.088
T 11/13	102-11+	4.357	T 10/23	107-22+	4.051	T 10/ 2	105-28+	4.152
W 11/12	105-18+	4.170	W 10/22	107-19+	4.056	W 10/ 1	104-25	4.216
T 11/11	105-05+	4.193	T 10/21	104-24	4.217	T 9/30	103-04	4.312
M 11/10	105-05+	4.193	M 10/20	104-02+	4.256	M 9/29	106-18+	4.114

<HELP> for explanation, <MENU> for similar functions.

Corp **HP**

TRAC/CLOSE/TRADE/YTM

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AMERICAN WATER AWK 6.593 10/37 69.500/69.500

(9.78/9.78) TRAC

Range 6/27/08 to 11/19/08

Source **TRAC**
Period **D** Daily
Market **I** Trade

HI 94.074 ON 6/30/08
AVE 84.656
LOW 66.673 ON 10/27/08

DATE	Price	YIELD	DATE	Price	YIELD	DATE	Price	YIELD
F 11/19	69.500	9.775	F 10/31			F 10/10	83.322	8.093
T 11/18			T 10/30			T 10/ 9	80.975	8.344
M 11/17			W 10/29	68.426	9.929	W 10/ 8		
F 11/14	70.901	9.579	T 10/28	66.863	10.162	T 10/ 7		
T 11/13			M 10/27	L66.673	10.191	M 10/ 6		
W 11/12			F 10/24			F 10/ 3		
T 11/11			T 10/23	67.233	10.106	T 10/ 2		
M 11/10			W 10/22	80.839	8.359	W 10/ 1		
F 11/ 7			T 10/21	79.892	8.464	T 9/30		
T 11/ 6			M 10/20	75.859	8.936	M 9/29		
W 11/ 5			F 10/17			F 9/26	80.973	8.343
T 11/ 4	68.087	9.979	T 10/16			T 9/25		
M 11/ 3			W 10/15	82.675	8.161	W 9/24		
			T 10/14	81.962	8.237	T 9/23		
			M 10/13			M 9/22		

EXECUTION COPY

U.S. \$800,000,000

CREDIT AGREEMENT

dated as of September 15, 2006

among

AMERICAN WATER CAPITAL CORP.,
as Borrower

THE LENDERS IDENTIFIED HEREIN,
as Lenders

and

JPMORGAN CHASE BANK, N.A.,
as Administrative Agent and LC Issuing Bank

J.P. MORGAN SECURITIES INC.,
Co-Lead Arranger

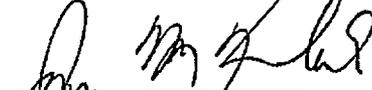
CITIGROUP GLOBAL MARKETS INC.,
Co-Lead Arranger

CITIBANK, N.A.,
Syndication Agent

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

BORROWER:

AMERICAN WATER CAPITAL CORP.

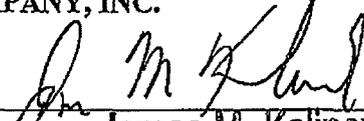
By: 
Name: _____
Title: **James M. Kalinovich**
Treasurer

Address for Notices:
1025 Laurel Oak Road
Voorhees, NJ 08043
Attention: Treasurer
Telecopy number: 856.566.4004

PARENT:

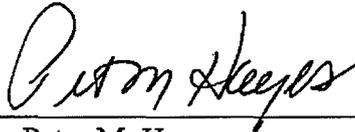
Acknowledged and agreed solely as to
Section 9.01 of the Credit Agreement.

**AMERICAN WATER WORKS
COMPANY, INC.**

By 
Name: **James M. Kalinovich**
Title: **Treasurer**

Address for Notices:
1025 Laurel Oak Road
Voorhees, NJ 08043
Attention: Treasurer
Telecopy number: 856.566.4004

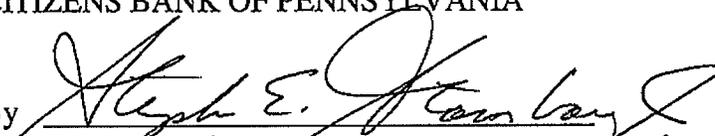
JPMORGAN CHASE BANK, N.A.
as Administrative Agent, as an LC Issuing Bank, and as
a Lender

By 
Name: Peter M. Hayes
Title: Vice President

CITIBANK, N.A.
as Syndication Agent and as a Lender

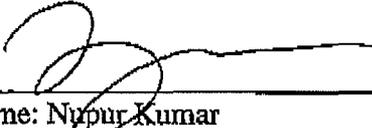
By *Amit Vasani*
Name: Amit Vasani
Title: Vice President

CITIZENS BANK OF PENNSYLVANIA

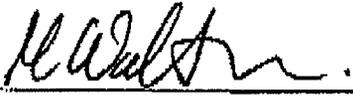
By 
Name: Stephen E. Stambaugh
Title: Senior Vice President

CREDIT SUISSE, Cayman Islands Branch

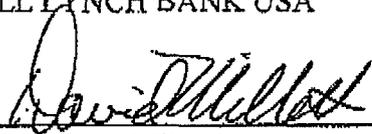
By 
Name: Sarah Wu
Title: Director

By 
Name: Nupur Kumar
Title: Associate

WILLIAM STREET COMMITMENT
CORPORATION (Recourse only to assets of
William Street Commitment Corporation)

By 
Name: Mark Walton
Title: Assistant Vice President

MERRILL LYNCH BANK USA

By 

Name: David Millett

Title: Vice President

AMERICAN WATER CAPITAL CORP. CREDIT AGREEMENT

MORGAN STANLEY BANK

By

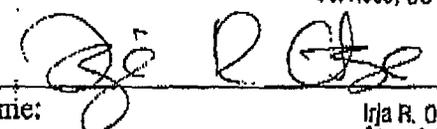


Name:
Title:

Daniel Twenge
Authorized Signatory
Morgan Stanley Bank

UBS LOAN FINANCE LLC

By 
Name: Richard L. Tarrow
Title: Director
Banking Products
Services, US

By 
Name: Irja R. Otsa
Title: Associate Director
Banking Products
Services, US

CoBank, ACB

By 
Name: David Dornbirer
Title: Vice President

PNC BANK, NATIONAL ASSOCIATION

By Meredith Jermann
Name: Meredith Jermann
Title: Vice President

AMERICAN WATER CAPITAL CORP. CREDIT AGREEMENT

Borrowings as of November 26, 2008	
(\$ in millions)	
Commercial Paper Outstanding	\$ 103.6
Revolving Credit Facility	\$ 222.7
Working Cash Line (PNC)	\$ 8.5
Total Outstanding short-term borrowings	\$ 334.8

Working Cash® Sweep Report



As of Date: November 26, 2008

11/28/2008 04:56:19 AM

PNC, NEW JERSEY	031207607	USD
AWCC Credit Line	8013583379WCL	

Beginning Balance	(\$8,648,627.58)
Cash Contribution	\$112,040.40
Cash Withdrawal	\$0.00
Investment Income	\$0.00
Interest Expense	\$0.00
Ending Balance	(\$8,536,587.18)
Credit Line Available	\$1,463,412.82
Investment Balance	\$0.00
Total Available Liquidity	\$1,463,412.82
Credit Line Borrowed	✓ \$8,536,587.18

[Credit Line Description]

\$10,000,000.00 DAILY 30 DAY LIBOR 1.686% AS OF 11-25-08

Investment Description

BRLF TempFund Dollar Shares 2.064% AS OF 11-26-08

Sum of Credit Line	
Date	Total
9/17/2008	87,500,000.00
9/18/2008	10,000,000.00
9/19/2008	0.00
9/20/2008	0.00
9/21/2008	0.00
9/22/2008	5,000,000.00
9/23/2008	12,000,000.00
9/24/2008	0.00
9/25/2008	15,000,000.00
9/26/2008	0.00
9/27/2008	0.00
9/28/2008	0.00
9/29/2008	22,000,000.00
9/30/2008	15,000,000.00
10/1/2008	6,700,000.00
10/2/2008	-8,500,000.00
10/3/2008	-5,000,000.00
10/4/2008	0.00
10/5/2008	0.00
10/6/2008	35,000,000.00
10/7/2008	50,000,000.00
10/8/2008	0.00
10/9/2008	-5,000,000.00
10/10/2008	24,000,000.00
10/11/2008	0.00
10/12/2008	0.00
10/13/2008	0.00
10/14/2008	5,000,000.00
10/15/2008	20,000,000.00
10/16/2008	-5,000,000.00
10/17/2008	-13,000,000.00
10/18/2008	0.00
10/19/2008	0.00
10/20/2008	20,000,000.00
10/21/2008	-11,000,000.00
10/22/2008	-7,500,000.00
10/23/2008	-8,000,000.00
10/24/2008	2,000,000.00
10/25/2008	0.00
10/26/2008	0.00
10/27/2008	-47,000,000.00
10/28/2008	-50,000,000.00
10/29/2008	0.00
10/30/2008	115,000,000.00
10/31/2008	-78,000,000.00
11/1/2008	0.00
11/2/2008	0.00
11/3/2008	0.00
11/4/2008	-59,000,000.00
11/5/2008	70,000,000.00
11/6/2008	-10,000,000.00
11/7/2008	13,000,000.00

11/8/2008	0.00
11/9/2008	0.00
11/10/2008	43,000,000.00
11/11/2008	0.00
11/12/2008	-39,500,000.00
11/13/2008	-26,500,000.00
11/14/2008	0.00
11/15/2008	0.00
11/16/2008	0.00
11/17/2008	48,000,000.00
11/18/2008	-48,000,000.00
11/19/2008	7,000,000.00
11/20/2008	0.00
11/21/2008	118,000,000.00
11/22/2008	0.00
11/23/2008	0.00
11/24/2008	-63,500,000.00
11/25/2008	-4,000,000.00
11/26/2008	-32,000,000.00
Grand Total	222,700,000.00



Outstanding Report Detail
Issuer / Program / Issue Date Sort
 Report Period as of 11/26/2008

er: 500661 AMERICAN WATER CAPITAL 4(2)
 ram: 500661 AMERICAN WATER CAPITAL 4(2)

Maturity Dt	CUSIP	Order #	Inst	F/V	I/D	Rate	Term	Yield	Par Amt	Int/Disc Amt	Mgt/Comm Amt	Value at Maturity	CCY
As of Date: 11/26/2008													
'01/2008	03040LM14	00511	CP	F	D	3.550000	5	3.551751	43,600,000.00	21,497.22	0.00	43,600,000.00	USD
'01/2008	03040LM14	00616	CP	F	D	3.900000	5	3.902114	10,000,000.00	5,416.67	0.00	10,000,000.00	USD
'01/2008	03040LM14	00617	CP	F	D	3.900000	5	3.902114	50,000,000.00	27,083.33	0.00	50,000,000.00	USD
Is for: 11/26/2008													
Is for: 500661 AMERICAN WATER CAPITAL 4(2)													
Is for: 500661 AMERICAN WATER CAPITAL 4(2)													
id Totals													
103,600,000.00													
53,997.22													
0.00													
103,600,000.00													
53,997.22													
0.00													
103,600,000.00													
53,997.22													
0.00													

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S SECOND REQUEST FOR INFORMATION

Witness: Michael A. Miller

69. With regard to OAG 1-128(c), please provide a consolidating balance sheet for American Water Works (an accounting balance sheet in which all of the holding company's subsidiaries are displayed with their actual capital structure and consolidated into the parent company). If the information does not exist, please indicate through a comprehensive narrative how the holding company prepares a consolidated balance sheet and include in the narrative the actual consolidation process as applied to the information pertaining to the Kentucky American Water Company for the most recent year available. If Kentucky American Water believes that any of the information sought through OAG 1-128(c) or this supplemental request falls within the definition of confidential information, please affirmatively state this fact.

Response:

The Company objects to this data request on the grounds that it seeks information that is not relevant to the rate case, is overly burdensome, is not public information and may impair the competitive advantage of non-regulated subsidiaries if disclosed. Notwithstanding the objections, the Company provides the following description of the audit and consolidation process.

Attached is a copy of the (consolidated) 2007 audited financial statements of American Water Works, Company, Inc. ("Parent"). The financial results of Kentucky American Water, its Parent, as well as other American Water subsidiaries are audited annually by PriceWaterhouseCoopers ("PWC"). As part of the audit process, PWC examines affiliated transactions and the process for eliminating from the consolidated balance sheet any amounts that are related to the affiliated transactions in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). PWC made no note in its 2007 audit report of any departures from GAAP related to the affiliated transactions.

Some of the affiliated balances that are eliminated in the consolidation process include, but are not limited to: the operating subsidiary debt issued from American Water Capital Corporation ("AWCC") and the related investment on the balance sheet of AWCC, the equity of the operating subsidiaries and the related investment on the balance sheet of the Parent, and numerous transactions related to inter-company water sales, purchased water, accounts receivables and accounts payable.

For the electronic version, refer to KAW_R_AGDR2#69_020909.pdf.

**American Water Works Company, Inc.
and Subsidiary Companies**

**(formerly Thames Water Aqua US Holdings, Inc.
and Subsidiary Companies)**

(a wholly owned subsidiary of RWE Aktiengesellschaft)

Consolidated Financial Statements

**As of December 31, 2007 and 2006
and for the Years Ended December 31, 2007, 2006 and 2005**

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Notes to Consolidated Financial Statements	8 - 37



PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
2001 Market Street
Philadelphia, PA 19103-7042
Telephone (267) 330 3000
Facsimile (267) 330 3300

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholder of
American Water Works Company, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in common stockholder's equity and comprehensive income (loss) and of consolidated cash flows present fairly, in all material respects, the financial position of American Water Works Company, Inc. and Subsidiary Companies (formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies) at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for its defined benefit pension and other postretirement benefit plans effective December 31, 2006.

PricewaterhouseCoopers LLP

February 28, 2008

American Water Works Company, Inc. and Subsidiary Companies
(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)
Consolidated Balance Sheets
(In thousands, except per share data)

	ASSETS	
	December 31,	
	2007	2006
Property, plant and equipment		
Utility plant - at original cost, net of accumulated depreciation	\$ 9,199,909	\$ 8,605,341
Nonutility property, net of accumulated depreciation	118,052	115,216
Total property, plant and equipment	<u>9,317,961</u>	<u>8,720,557</u>
Current assets		
Cash and cash equivalents	13,481	29,754
Restricted funds	3,258	2,100
Utility customer accounts receivable	147,640	153,583
Allowance for uncollectible accounts	(20,923)	(23,061)
Unbilled utility revenues	134,326	123,180
Non-regulated trade and other receivables, net	66,540	54,463
Taxes receivable, including federal income	23,111	-
Materials and supplies	27,458	23,012
Assets of discontinued operations	-	12,834
Other	35,463	36,576
Total current assets	<u>430,354</u>	<u>412,441</u>
Regulatory and other long-term assets		
Regulatory assets	628,039	587,157
Restricted funds	10,252	17,239
Goodwill	2,456,952	2,962,493
Other	90,514	83,172
Total regulatory and other long-term assets	<u>3,185,757</u>	<u>3,650,061</u>
TOTAL ASSETS	<u>\$ 12,934,072</u>	<u>\$ 12,783,059</u>

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies
(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)
Consolidated Balance Sheets
(In thousands, except per share data)

CAPITALIZATION AND LIABILITIES

	December 31,	
	2007	2006
Capitalization		
Common stockholder's equity	\$ 4,542,046	\$ 3,817,397
Preferred stock without mandatory redemption requirements	4,568	4,568
Long-term debt		
Long-term debt	4,674,837	3,096,404
Redeemable preferred stock at redemption value	24,296	1,774,475
Total capitalization	<u>9,245,747</u>	<u>8,692,844</u>
Current liabilities		
Short-term debt	220,514	719,745
Current portion of long-term debt	96,455	287,383
Accounts payable	168,886	140,691
Taxes accrued, including federal income	56,002	28,115
Interest accrued	50,867	34,775
Liabilities of discontinued operations	-	2,478
Other	181,765	150,475
Total current liabilities	<u>774,489</u>	<u>1,363,662</u>
Regulatory and other long-term liabilities		
Advances for construction	655,375	615,671
Deferred income taxes	638,918	583,403
Deferred investment tax credits	35,361	36,533
Regulatory liability-cost of removal	192,650	166,867
Accrued pension expense	290,722	314,577
Accrued postretirement benefit expense	158,552	144,904
Other	123,871	110,354
Total regulatory and other long-term liabilities	<u>2,095,449</u>	<u>1,972,309</u>
Contributions in aid of construction	818,387	754,244
Commitments and contingencies	-	-
TOTAL CAPITALIZATION AND LIABILITIES	<u><u>\$ 12,934,072</u></u>	<u><u>\$ 12,783,059</u></u>

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies
(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)
Consolidated Statements of Operations
(In thousands, except per share data)

	Years Ended December 31,		
	2007	2006	2005
Operating revenues	\$ 2,214,215	\$ 2,093,067	\$ 2,136,746
Operating expenses			
Operation and maintenance	1,246,479	1,174,544	1,201,566
Depreciation and amortization	267,335	259,181	261,364
General taxes	183,253	185,065	183,324
Loss (gain) on sales of assets	(7,326)	79	(6,517)
Impairment charges	509,345	221,685	385,434
Total operating expenses, net	<u>2,199,086</u>	<u>1,840,554</u>	<u>2,025,171</u>
Operating income	<u>15,129</u>	<u>252,513</u>	<u>111,575</u>
Other income (deductions)			
Interest, net	(283,165)	(365,970)	(345,257)
Allowance for other funds used during construction	7,759	5,980	5,810
Allowance for borrowed funds used during construction	3,449	2,652	2,420
Amortization of debt expense	(4,867)	(5,062)	(4,367)
Preferred dividends of subsidiaries	(225)	(215)	(227)
Other, net	6,401	1,164	5,895
Total other income (deductions)	<u>(270,648)</u>	<u>(361,451)</u>	<u>(335,726)</u>
Loss from continuing operations before income taxes	(255,519)	(108,938)	(224,151)
Provision for income taxes	86,756	46,912	50,979
Loss from continuing operations	<u>(342,275)</u>	<u>(155,850)</u>	<u>(275,130)</u>
Loss from discontinued operations, net of tax	(551)	(6,393)	(49,910)
Net loss	<u>\$ (342,826)</u>	<u>\$ (162,243)</u>	<u>\$ (325,040)</u>
Basic earnings per common share			
Loss from continuing operations	<u>\$ (2.14)</u>	<u>\$ (0.97)</u>	<u>\$ (1.72)</u>
Loss from discontinued operations, net of tax	<u>\$ (0.00)</u>	<u>\$ (0.04)</u>	<u>\$ (0.31)</u>
Net loss	<u>\$ (2.14)</u>	<u>\$ (1.01)</u>	<u>\$ (2.03)</u>
Diluted earnings per common share			
Loss from continuing operations	<u>\$ (2.14)</u>	<u>\$ (0.97)</u>	<u>\$ (1.72)</u>
Loss from discontinued operations, net of tax	<u>\$ (0.00)</u>	<u>\$ (0.04)</u>	<u>\$ (0.31)</u>
Net loss	<u>\$ (2.14)</u>	<u>\$ (1.01)</u>	<u>\$ (2.03)</u>
Average common shares outstanding during the period:			
Basic	<u>160,000</u>	<u>160,000</u>	<u>160,000</u>
Diluted	<u>160,000</u>	<u>160,000</u>	<u>160,000</u>

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies
(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)
Consolidated Statements of Cash Flows
(In thousands, except per share data)

	Years Ended December 31,		
	2007	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	\$ (342,826)	\$ (162,243)	\$ (325,040)
Adjustments			
Loss on sale of discontinued businesses	-	1,001	15,407
Depreciation and amortization	267,335	259,181	261,364
Impairment charges	509,345	227,802	420,370
Removal costs net of salvage	38,442	34,627	32,196
Provision for deferred income taxes	41,918	34,464	26,861
Amortization of deferred investment tax credits	(1,510)	(1,306)	(1,612)
Provision for losses on utility accounts receivable	17,553	26,706	27,485
Allowance for other funds used during construction	(7,759)	(5,980)	(5,810)
(Gain) loss on sale of assets	(7,326)	79	(6,517)
Gain on early extinguishment of debt	(13,113)	(3,739)	-
Other, net	(45,117)	9,734	29,383
Changes in assets and liabilities			
Receivables and unbilled utility revenues	(35,097)	3,094	4,589
Taxes receivable, including federal income	(23,111)	-	-
Other current assets	(1,171)	326	20,060
Accounts payable	6,860	7,214	23,100
Taxes accrued, including federal income	42,430	(56,970)	4,193
Interest accrued	16,092	(18,131)	4,564
Other current liabilities	10,767	(32,111)	(5,158)
Net cash provided by operating activities	<u>473,712</u>	<u>323,748</u>	<u>525,435</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Construction expenditures	(758,569)	(688,843)	(558,446)
Allowance for other funds used during construction	7,759	5,980	5,810
Acquisitions	(15,877)	(12,534)	(4,979)
Proceeds from sale of assets and securities	16,346	3,665	1,528
Proceeds from sale of discontinued operations	9,660	30,151	15,336
Removal costs from property, plant and equipment retirements	(9,852)	(20,446)	(17,928)
Receivable from affiliates	-	-	562
Net funds (restricted) released	5,829	(9,411)	27,952
Investment in equity investee	(1,874)	-	-
Net cash used in investing activities	<u>(746,578)</u>	<u>(691,438)</u>	<u>(530,165)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	3,869,109	582,498	494,322
Repayment of long-term debt	(2,350,725)	(637,479)	(66,039)
Net borrowings (repayments) under short-term debt agreements	(541,623)	345,682	(485,334)
Advances and contributions for construction, net of refunds	35,846	47,446	51,985
Change in cash overdraft position	42,198	-	-
Capital contributions	967,092	-	-
Debt issuance costs	(14,916)	(5,239)	(3,347)
Redemption of preferred stocks	(1,750,388)	(541)	(636)
Net cash provided by financing activities	<u>256,593</u>	<u>332,367</u>	<u>(9,049)</u>
Net decrease in cash and cash equivalents	(16,273)	(35,323)	(13,779)
Cash and cash equivalents at beginning of period	29,754	65,077	78,856
Cash and cash equivalents at end of period	<u>\$ 13,481</u>	<u>\$ 29,754</u>	<u>\$ 65,077</u>
Cash paid during the year for:			
Interest, net of capitalized amount	\$ 295,707	\$ 402,370	\$ 349,084
Income taxes, net of refunds	\$ 17,823	\$ 11,633	\$ 43,694
Non-cash investing activity			
Capital expenditures acquired on account but unpaid as of year-end	\$ 94,930	\$ 73,595	\$ 85,703
Non-cash financing activity			
Advances and contributions	\$ 101,226	\$ 72,892	\$ 85,818
Capital contribution (See Note 10)	\$ 100,000	\$ 1,194,454	\$ -

The accompanying notes are an integral part of these consolidated financial statements.

**American Water Works Company, Inc. and Subsidiary Companies
(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)
Consolidated Statements of Changes in Common Stockholder's Equity and Comprehensive Income (Loss)**
(In thousands, except per share data)

	Common Stock Shares	Par Value	Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Common Stockholder's Equity	Comprehensive Income (Loss)
Balance at December 31, 2004	160,000	\$ 1,600	\$ 3,376,401	\$ (249,009)	\$ 563	\$ 3,129,555	
Net loss	-	-	-	(325,040)	-	(325,040)	\$ (325,040)
Market value adjustments for investments, net of tax of \$125	-	-	-	-	(233)	(233)	(233)
Additional minimum pension liability, net of tax of \$302	-	-	-	-	(472)	(472)	(472)
Foreign currency translation	-	-	-	-	906	906	906
Dividends on preferred stock	-	-	-	-	-	-	-
Total comprehensive loss	-	-	-	-	-	-	\$ (324,839)
Balance at December 31, 2005	160,000	\$ 1,600	\$ 3,376,401	\$ (574,049)	\$ 764	\$ 2,804,716	
Net loss	-	-	-	(162,243)	-	(162,243)	\$ (162,243)
Equity investment by RWE	-	-	1,194,454	-	-	1,194,454	-
Market value adjustments for investments, net of tax of \$254	-	-	-	-	471	471	471
Additional minimum pension liability, net of tax of \$1,115	-	-	-	-	1,744	1,744	1,744
Recognition of employee benefit plan underfunded status	-	-	-	-	(21,919)	(21,919)	-
Foreign currency translation	-	-	-	-	174	174	174
Dividends on preferred stock	-	-	-	-	-	-	-
Total comprehensive loss	-	-	-	-	-	-	\$ (159,854)
Balance at December 31, 2006	160,000	\$ 1,600	\$ 4,570,855	\$ (736,292)	\$ (18,766)	\$ 3,817,397	
Net loss	-	-	-	(342,826)	-	(342,826)	\$ (342,826)
Equity investment by RWE	-	-	1,067,092	-	-	1,067,092	-
Change in employee benefit plan funded status	-	-	-	-	924	924	-
Pension plan amortized to periodic benefit cost: Prior service cost	-	-	-	-	36	36	36
Actuarial loss	-	-	-	-	72	72	72
Foreign currency translation	-	-	-	-	(649)	(649)	(649)
Total comprehensive loss	-	-	-	-	-	-	\$ (343,367)
Balance at December 31, 2007	160,000	\$ 1,600	\$ 5,637,947	\$ (1,079,118)	\$ (18,383)	\$ 4,542,046	

The accompanying notes are an integral part of these consolidated financial statements.

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Note 1: Organization and Operation

American Water Works Company, Inc. ("AWW") and its subsidiaries (collectively referred to herein as the "Company"), formerly Thames Water Aqua US Holdings, Inc. ("TWAUSHI") and a wholly owned subsidiary of RWE Aktiengesellschaft ("RWE"), is the holding company for regulated and non-regulated subsidiaries throughout the United States of America and Ontario, Canada. The regulated subsidiaries provide water and wastewater services and, as public utilities, function under rules and regulations prescribed by state regulators. These regulated subsidiaries have similar long-term economic characteristics and are operationally segregated into the 20 U.S. states in which the Company operates regulated utilities. The non-regulated subsidiaries include distinctive lines of business including Homeowner Services, which provides water and sewer line protection plans for homeowners, the Operations and Maintenance contracts group, which conducts operation and maintenance of water and wastewater facilities for municipalities and the U.S. Military, among others, and Carbon Regeneration, which sells granular activated carbon technologies to help remove contaminants and improve the quality of drinking water.

RWE has announced its intention to divest the Company through an initial public offering ("IPO"). These consolidated financial statements represent the consolidated results of the Company, formerly issued under the name of TWAUSHI. On September 28, 2007, TWAUSHI, formerly the parent company of AWW, merged with and into AWW (the "Merger"). The IPO required filing of a registration statement with the U.S. Securities and Exchange Commission, which was filed on August 27, 2007 and subsequently amended on October 11, 2007 and January 29, 2008.

Prior to the merger, AWW was a wholly-owned subsidiary of TWAUSHI. As a result of the Merger, TWAUSHI, at the time an indirect wholly-owned subsidiary of RWE, was dissolved and AWW is the surviving entity. As the merger parties were each part of a group of entities under the common control of RWE, AWW recognized the transfer of the assets and liabilities of TWAUSHI at their respective carrying amounts as of the effective date of the Merger in accordance with Statement of Financial Accounting Standards No. 141, "Accounting for Business Combinations" ("SFAS 141"). In accordance with SFAS 141, as the merger parties were each part of a group of entities under common control of RWE, the Merger did not constitute a business combination and the method used by the Company to account for the merger was similar to the pooling method and was performed retroactively in these consolidated financial statements as if they had historically been a combined entity. Accordingly, the consolidated financial statements of AWW as of and at December 31, 2007, 2006 and 2005 include the accounts of TWAUSHI.

Note 2: Significant Accounting Policies

Principles of Consolidation

As a result of the Merger, the accompanying consolidated financial statements include the accounts of AWW and its subsidiaries, which include the accounts of the former TWAUSHI entity and its subsidiaries. The Company's results of operations are comprised of the combination of the formerly separate entities and their subsidiaries. Intercompany balances and transactions between subsidiaries have been eliminated. The Company uses the equity method to report its investments in two joint venture investments in each of which the Company holds a 50% voting interest and cannot exercise control over the operations and policies of the investments. Under the equity method, the Company records its interests as an investment and its percentage share of earnings as earnings or losses of investee.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The Company considers benefit plan assumptions, the carrying values of goodwill and other long-lived assets, including regulatory assets, revenue recognition and accounting for income taxes to be its critical accounting estimates. The Company's significant estimates that are particularly sensitive to

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change in the near term are amounts reported for pension and other postemployment benefits, contingency-related obligations and goodwill.

Regulation

The Company's regulated utilities are subject to regulation by the public utility commissions and the local governments of the states in which they operate (the "Regulators"). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). This statement sets forth the application of generally accepted accounting principles for those companies whose rates are established by or are subject to approval by an independent third-party regulator. Under SFAS 71, regulated utilities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in operations by a non-regulated company. These deferred regulatory assets and liabilities are then reflected in the statement of operations in the period in which the costs and credits are reflected in the rates charged for service.

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. The costs incurred to acquire and internally develop computer software for internal use are capitalized as a unit of property. The carrying value of these costs amounted to \$29,103 and \$44,652 at December 31, 2007 and 2006, respectively. The cost of repairs, maintenance, including planned major maintenance activities, and minor replacements of property is charged to maintenance expense as incurred.

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates, until the costs to retire those assets are incurred.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method.

Nonutility property consists primarily of buildings and equipment utilized by the Company for internal operations. This property is stated at cost, net of accumulated depreciation calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to forty years.

Cash and Cash Equivalents

Substantially all cash is invested in interest-bearing accounts. All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

The Company had book overdrafts for certain of its disbursement accounts of \$42,198 and \$0 at December 31, 2007 and 2006, respectively. A book overdraft represents transactions that have not cleared the bank accounts at the end of the period. The Company transfers cash on an as-needed basis to fund these items as they clear the bank. The balance of the book overdraft is reported as short-term debt and the change in the book overdraft balance is reported as cash flows from financing activities.

Restricted Funds

Restricted funds represent proceeds received from financings for the construction and capital improvement of utility facilities. The proceeds of these financings are held in escrow until the

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capital expenditures are incurred. Restricted funds expected to be released within 12 months subsequent to year-end are classified as current.

Utility Customer Accounts Receivable

Regulated utility customer accounts receivable represent amounts billed to water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators and generally, collateral is not required.

Allowance for Uncollectible Accounts

Allowances for uncollectible accounts are maintained for estimated probable losses resulting from the Company's inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes-off accounts when they become uncollectible. (See Note 5)

Non-regulated Trade and Other Receivables, Net

Non-regulated trade and other receivables, net consists of non-regulated trade accounts receivable and non-regulated unbilled revenues, net of a reserve for doubtful accounts and non-utility customer receivables of the regulated subsidiaries. In determining the reserve for uncollectible non-regulated accounts, the Company considers the length of time the trade accounts receivable are past due and the customer's current ability to pay their obligation. Unbilled receivables are accrued when service has been provided but has not been billed to customers. (See Note 6)

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Goodwill

The Company considers the carrying value of goodwill to be one of its critical accounting estimates. The Company believes the assumptions and other considerations used to value goodwill to be appropriate. However, if actual experience differs from the assumptions and considerations used in its analysis, the resulting change could have a material impact on the consolidated financial statements.

Goodwill is primarily associated with the acquisitions of American Water Works Company, Inc. in 2003 and E'town Corporation in 2001 (the "Acquisitions") and has been assigned to reporting units based on the fair values at the date of the Acquisitions. The regulated utility subsidiaries have been aggregated and deemed a single reporting unit as they have similar economic characteristics. In the non-regulated segment, the business is organized into seven reporting units for its non-regulated services. In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill is reviewed annually, or more frequently if changes in circumstances indicate the carrying value may not be recoverable. To test for impairment, the Company utilizes discounted estimated future cash flows, comparable public company analyses and all other available relevant fair value information to measure fair value for each reporting unit. This calculation is highly sensitive to the estimated future cash flows of each reporting unit, the discount rate assumed in these calculations, the market multiples of comparable companies and the estimated price per share of the Company's stock assumed in these calculations. Annual impairment reviews are performed in the fourth quarter of the calendar year, in conjunction with the timing of the completion of the Company's annual strategic business plan.

For each of the years ended December 31, 2007, 2006 and 2005, the Company determined that its goodwill, including goodwill of discontinued operations, was impaired and recorded impairments of \$509,345, \$227,802 and \$396,348 respectively. (See Note 8)

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Impairment of Long-Lived Assets

The Company considers the carrying value of long-lived assets to be one of its critical accounting estimates. The Company believes the assumptions and other considerations used to evaluate the carrying value of long-lived assets to be appropriate. However, if actual experience differs from the assumptions and considerations used in its estimates, the resulting change could have a material adverse impact on the consolidated financial statements.

Long-lived assets, other than goodwill, include land, buildings, equipment and long-term investments. Long-lived assets, other than investments and land, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market value of a long-lived asset, a significant adverse change in the manner the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, the Company estimates the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets and compares that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recorded.

The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the assets carrying value exceeds its fair value.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

The Company considered the results of the goodwill impairment analysis as indicators that the carrying value of long-lived assets may not be recoverable and performed impairment analyses for long-lived assets, other than investments, in accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment of Disposal of Long-Lived Assets" ("SFAS 144"). As a result of SFAS 144 impairment analyses, the Company recorded pretax charges of \$0, \$0, and \$24,022 for the years ended December 2007, 2006 and 2005, respectively. The non-regulated impairment in 2005 primarily resulted from lower than expected growth, slower development compared with original expectations, and a building with a carrying value that exceeded its fair value. These charges are included in impairment charges in the statements of operations. The carrying values as of December 31, 2007, 2006 and 2005 were determined to be appropriate.

The Company holds other investments including investments in privately held companies and investments in joint ventures accounted for using the equity method. The Company's investments in privately held companies and joint ventures are classified as other long-term assets.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which the Company invests, as well as volatility inherent in the external markets. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value. As a result of fair value analyses, the Company recorded pretax charges of \$0 for the year ended December 31, 2007, \$750 for the year ended December 31, 2006 and \$0 for the year ended December 31, 2005.

Advances and Contributions in Aid of Construction

Regulated utility subsidiaries may receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Advances which are no longer

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refundable are reclassified to contributions in aid of construction. Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such contributions generally serves as a rate base reduction since they represent non-investor supplied funds. Non-cash utility property has been received, primarily from developers, as advances or contributions of \$101,226, \$72,892, and \$85,818 for the years ended December 31, 2007, 2006 and 2005, respectively.

Generally, the Company depreciates utility plant funded by contributions and amortizes its contributions balance as a reduction to depreciation expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for the contributions. Certain of the Company's subsidiaries do not depreciate contributed property, based on regulatory guidelines. Amortization of contributions in aid of construction was \$20,720, \$16,697 and \$14,960 for the years ended December 31, 2007, 2006 and 2005, respectively.

Recognition of Revenues

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are provided and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period.

The Company has agreements with the United States Government to operate and maintain water and wastewater systems at various military bases pursuant to 50 year contracts ("military agreements"). The military agreements are subject to periodic price redetermination adjustments and modifications for changes in circumstance. Additionally, the Company has agreements ranging in length from one to 25 years with various municipalities to operate and maintain water and wastewater systems ("O&M agreements"). Revenue from these non-regulated operations is recognized as services are provided. (See Note 20)

Construction Contracts

In accordance with the American Institute of Certified Public Accountants' Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production Type Contracts," the Consolidated Statements of Operations include revenues and operation and maintenance expenses related to agreements for the design and construction of water and waste water treatment plants. Revenues from these construction projects are recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined. Under these agreements, revenues were \$32,141, \$56,069 and \$120,331 and operation and maintenance expenses were \$34,543, \$53,845 and \$117,814 as of December 31, 2007, 2006 and 2005, respectively.

Taxes

The parent company and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

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Investment tax credits have been deferred by the regulated utility subsidiaries and are being amortized to income over the average estimated service lives of the related assets.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

Allowance for Funds Used During Construction ("AFUDC")

AFUDC is a non-cash credit to income with a corresponding charge to utility plant which represents the cost of borrowed funds or a return on equity funds devoted to plant under construction. The regulated utility subsidiaries record AFUDC to the extent permitted by the Regulators.

Environmental Costs

Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$6,600, \$6,600 and \$5,557 at December 31, 2007, 2006 and 2005, respectively. (See Note 7) The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates.

New Accounting Standards

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards SFAS No. 160 ("SFAS 160"), "Noncontrolling Interests in Consolidated Financial Statements—An Amendment of ARB No. 51," which establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for the Company on January 1, 2009. The Company is currently evaluating the effect, if any, that the adoption of SFAS 160 will have on its results of operations, financial position and cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R) ("SFAS 141(R)", "Business Combinations," which will significantly change the accounting for business combinations. SFAS 141(R) is effective for the Company for business combinations finalized on or after January 1, 2009. The Company is currently evaluating the effect, if any, that the adoption of SFAS 141(R) will have on its results of operations, financial position and cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115" ("SFAS 159"). This standard permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This standard will be effective for the Company on January 1, 2008. The Company does not believe the standard will have a significant effect on its results of operations, financial position or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)," ("SFAS 158"). This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, actuarial gains and losses, prior service costs or credits, and transition obligations and assets that have not been recognized in net periodic benefit cost under previous accounting standards will be recognized as a regulatory asset for the portion of the underfunded liability that meets the recovery criteria prescribed in SFAS 71 and as accumulated other comprehensive income, net of tax effects, for that portion of the underfunded liability that does not meet SFAS 71 regulatory accounting criteria. The Company adopted the recognition and disclosure requirements of the statement as of the end of fiscal year 2006.

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In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position FAS 157-2 which allows a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company is currently evaluating the impact on its financial statements of adopting SFAS 157.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," ("FIN 48") an Interpretation of SFAS No. 109, "Accounting for Income Taxes." FIN 48 is intended to address inconsistencies among entities with the measurement and recognition in accounting for income tax deductions for financial statement purposes. Specifically, FIN 48 addresses the timing of the recognition of income tax benefits. FIN 48 requires the financial statement recognition of an income tax benefit when the Company determines that it is more-likely-than-not that the tax position will be sustained. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted as required on January 1, 2007 and it did not have a significant effect on the Company's results of operations, financial position or cash flows. The Company elected to recognize accrued interest and penalties related to tax positions as a component of income tax expense.

During 2006, the Emerging Issues Task Force of the FASB ratified EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)" ("EITF 06-3"). The Task Force reached a consensus that the scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and that the presentation of such taxes is an accounting policy that should be disclosed. The Company's accounting policy is to present these taxes on a net basis (excluded from revenues).

Note 3: Acquisitions

On November 1, 2007, the Company acquired all of the outstanding capital stock of S.J. Services, Inc. ("SJS"), for \$13,000 in cash, which included the assumption of long-term debt totaling \$3,541, and incurred acquisition costs of \$458. The acquisition was accounted for as a business combination and in accordance with SFAS 141. Accordingly, operating results of SJS from November 1, 2007 through December 31, 2007 are included in the Company's results of operations. The purchase price was allocated to the net tangible and intangible assets based upon their estimated fair values at the date of acquisition. The following table shows the purchase price allocation:

Property, plant and equipment	\$	15,614
Current assets		2,162
Other long term assets		917
Goodwill		4,727
<u>Total assets acquired</u>		<u>23,420</u>
Current liabilities		491
Long term debt (including current portion)		2,791
Deferred taxes		1,114
Contributions in aid of construction		5,566
<u>Total liabilities assumed</u>		<u>9,962</u>
Net assets acquired	\$	<u>13,458</u>

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In addition to SJS, during 2007, the Company closed on the acquisitions of eight other regulated water systems. These water systems were acquired for an aggregate purchase price of \$2,419.

As of December 31, 2007, the Company has entered into agreement with the City of Trenton, New Jersey to purchase the assets of the City's water system located in the four surrounding townships. The acquisition would add approximately thirty-nine thousand customers to the Company's customer base with a proposed purchase price of \$100,000. The proposed purchase has been approved by the Trenton City Council and is awaiting approval from the New Jersey Board of Public Utilities. Included in other current assets is a \$10,000 refundable deposit the Company made in December 2007 which is being held in an interest bearing escrow account as required by the bidding process.

Note 4: Utility Plant

The components of utility plant by category at December 31 are as follows:

	Range of Remaining Useful Lives	2007	2006
Water plant			
Land and other non-depreciable assets		\$ 144,909	\$ 141,092
Sources of supply	7 to 93 Years	488,477	464,328
Treatment and pumping facilities	2 to 90 Years	2,273,501	2,201,989
Transmission and distribution facilities	5 to 101 Years	5,462,209	5,141,382
Services, meters and fire hydrants	5 to 100 Years	2,027,746	1,889,105
General structures and equipment	3 to 70 Years	774,051	612,462
Wastewater plant	4 to 100 Years	506,049	451,251
Construction work in progress		299,917	276,405
		11,976,859	11,178,014
Less accumulated depreciation		2,776,950	2,572,673
		<u>\$ 9,199,909</u>	<u>\$ 8,605,341</u>

Utility plant depreciation expense amounted to \$263,737 in 2007, \$249,355 in 2006 and \$249,524 in 2005. Included in the 2005 amount is \$21,644 resulting from an information technology project that was abandoned.

Note 5: Allowance for Uncollectible Accounts

The following table summarizes the changes in the Company's allowances for uncollectible accounts:

	2007	2006	2005
Balance at January 1,	\$ (23,061)	\$ (15,051)	\$ (9,748)
Amounts charged to expense	(17,553)	(26,706)	(27,485)
Amounts written off	22,192	21,538	24,677
Recoveries of amounts written off	(2,501)	(2,842)	(2,495)
Balance at December 31,	<u>\$ (20,923)</u>	<u>\$ (23,061)</u>	<u>\$ (15,051)</u>

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Note 6: Non-regulated Trade and Other Receivables, Net

Components of the Company's non-regulated trade and other receivables, net are as follows:

	2007	2006
Non-regulated trade accounts receivable	\$ 28,028	\$ 23,365
Allowance for doubtful accounts - non-regulated trade accounts receivable	(5,567)	(8,663)
Non-regulated unbilled revenue	17,232	12,624
Other	26,847	27,137
	<u>\$ 66,540</u>	<u>\$ 54,463</u>

Note 7: Regulatory Assets

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Except for income taxes, regulatory assets are excluded from the Company's rate base and do not earn a return. The components of regulatory assets are as follows:

	2007	2006
Income taxes recoverable through rates	\$ 228,562	\$ 230,860
Debt and preferred stock expense	76,070	66,021
Deferred pension expense	102,130	106,622
Deferred other postretirement benefit expense	45,683	23,721
Deferred security costs	16,853	21,089
Deferred business services project expense	17,037	21,368
Deferred tank painting costs	18,502	16,537
Deferred rate case expense	11,854	6,675
Purchase premium recoverable through rates	60,869	61,079
Environmental remediation recoverable through rates	6,600	6,600
Coastal water project costs	15,739	-
Other	28,140	26,585
	<u>\$ 628,039</u>	<u>\$ 587,157</u>

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the regulatory authorities of full normalization for rate making purposes. Full normalization requires no flow through of tax benefits to customers. The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from date of issue; expenses of issues with sinking fund provisions are charged to operations as shares are retired.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain subsidiaries. These costs will be recovered in future service rates as contributions are made to the pension plan. The Company has regulatory assets of \$45,933 and \$44,813 at December 31, 2007 and 2006 which is the portion of the underfunded status that is probable of recovery through rates in future periods.

Postretirement benefit expense in excess of the amount recovered in rates through 1997 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service and will be fully recovered over a 20-year period ending in 2012 as authorized by the

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regulatory authorities. The Company has regulatory assets of \$40,012 and \$16,687 at December 31, 2007 and 2006 which is the portion of the underfunded status that is probable of recovery through rates in future periods.

The cost of additional security measures that were implemented to protect facilities after the terrorist attacks on September 11, 2001 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service by certain subsidiaries.

Business services project expenses consist of reengineering and start-up activities for consolidated customer and shared administrative service centers that began operations in 2001. These costs are recognized in the rates charged for water service by certain subsidiaries.

Tank painting costs are generally deferred and amortized to current operations on a straight-line basis over periods ranging from 5 to 15 years, as authorized by the regulatory authorities in their determination of rates charged for service.

Purchase premium recoverable through rates is the recovery of the acquisition premium related to an asset acquisition by the Company's California subsidiary during 2002. As authorized for recovery by the California regulator, these costs are being amortized to operations based on an agreed schedule of mortgage style amortization. The recovery period is from May 2004 through December 2041.

Environmental remediation recoverable through rates is the recovery of costs incurred by the Company's California subsidiary under a settlement agreement entered into with the National Oceanic and Atmospheric Administration to improve habitat conditions in the Carmel River Watershed.

Coastal water project costs include certain preliminary costs associated with studying alternative projects to help solve water supply shortages in Monterey, California. In 2007, in accordance with the instructions of the California regulator, the Company reclassified \$12,287 to Coastal water project costs that was included in construction work in progress at December 31, 2006. Coastal water project costs incurred through December 31, 2006 have been reviewed and approved for recovery. The Company believes it is probable that the costs incurred since the last rate review will also be recoverable.

Note 8: Goodwill

The Company reviews goodwill associated with its reporting units for impairment. The performance of the impairment test involves a two-step process. The first step of the impairment test involves comparing the fair value of a reporting unit with the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, a second step is performed to determine the amount of the impairment loss. The impairment loss is determined by comparing the implied fair value of goodwill with the carrying amount of goodwill. The Company believes that the estimates of fair value are reasonable. The Company may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in the valuation multiples of comparable water utilities, a decline in the market value of the Company's common stock and its value relative to the Company's book equity at the consummation of the IPO or a decline over a period of time of the Company's stock price following consummation of the IPO. A decline in the Company's forecasted results in the Company's business plan, such as changes in rate case results or capital investment budgets or changes in the Company's interest rates may also result in an incremental impairment charge. Further recognition of impairments of a significant portion of goodwill would negatively affect the Company's results of operations and total capitalization, the effect of which could be material and could make it more difficult for the Company to secure financing on attractive terms and maintain compliance with the Company's debt covenants.

For the years ended December 31, 2007, 2006 and 2005, the Company recorded impairment charges for goodwill, including discontinued operations, in the amount of \$509,345, \$227,802, and \$396,348, respectively.

During the third quarter of 2007, as a result of the Company's debt being placed on review for possible downgrades and the proposed sale of the Company in an IPO, management determined that it was appropriate to update its valuation analysis before the next scheduled annual test.

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Based on this assessment, the Company performed an interim impairment test and in the third quarter of 2007 the Company recorded an impairment charge to goodwill related to its Regulated Businesses in the amount of \$243,345. The impairment charge was not due to any one significant event but represents the result of a decline in the estimated fair value of the Regulated Businesses from November 30, 2006. The decline was primarily due to slightly lower long-term earnings than previously forecasted caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined that impairment had occurred based upon information regarding the Company's market value in connection with the IPO. Management determined that the indicative fair value of the Company based on estimates of the IPO price range was the best evidence of the Company's market value and incorporated this indicated market value into the Company's valuation methodology. Based on the results of the impairment test, an impairment of \$266,000 to the Company's carrying value was recognized.

The 2006 impairment charge was attributable to higher interest rates in the regulated business and a change in the potential net realizable value of an unregulated business.

The 2005 impairment charge was primarily attributable to a change in the Company's strategic business plan for the unregulated business and lower margins than previously forecasted in the regulated business.

The change in the Company's goodwill assets, as allocated between the reporting units is as follows:

Reporting Unit	Balance as of Dec. 31, 2004	Goodwill reclassified to assets of discontinued operations	2005 Impairment Losses	Balance as of Dec. 31, 2005	Goodwill from Acquisitions	2006 Impairment Losses	Balance as of Dec. 31, 2006	Goodwill from Acquisitions	2007 Impairment Losses	Balance as of Dec. 31, 2007
Regulated Operations & maintenance	\$ 3,387,071	\$ -	\$ (341,946)	\$ 3,045,125	\$ 2,606	\$ (214,922)	\$ 2,832,811	\$ 3,804	\$ (509,345)	\$ 2,327,270
Residuals	34,678	(21,016)	(7,951)	5,711	-	(5,711)	-	-	-	-
Underground	16,141	(16,141)	-	-	-	-	-	-	-	-
Carbon	3,138	-	(1,366)	1,752	-	-	1,752	-	-	1,752
Engineering	1,052	-	-	1,052	-	(1,052)	-	-	-	-
Homeowner services	121,800	-	-	121,800	-	-	121,800	-	-	121,800
Military	28,190	-	(22,060)	6,130	-	-	6,130	-	-	6,130
Total	\$ 3,592,070	\$ (37,157)	\$ (373,343)	\$ 3,181,570	\$ 2,608	\$ (221,686)	\$ 2,962,493	\$ 3,804	\$ (509,345)	\$ 2,456,952

Note 9: Preferred Stock Without Mandatory Redemption Requirements

Certain preferred stock agreements do not require annual sinking fund payments or redemption except at the option of the subsidiaries and are as follows:

Dividend Yield	Balance at December 31	
	2007	2006
4.50%	\$ 1,720	\$ 1,720
5.00%	1,968	1,968
5.50%	488	488
5.75%	392	392
	\$ 4,568	\$ 4,568

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Note 10: Long-Term Debt

The Company primarily incurs long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term at December 31 are:

	Rate	Maturity Date	2007	2006
Long-term debt of American Water Works Company, Inc.				
Mandatory redeemable preferred stock (a)			\$ -	\$ 1,750,000
Long-term debt of American Water Capital Corp.				
Private activity bonds and government funded debt				
Floating rate (b)	3.20%-5.05%	2018-2032	86,860	86,860
Senior notes				
Fixed rate	5.39%-6.87%	2011-2037	2,712,000	623,000
RWE notes (c)				
Fixed rate			-	465,300
Long-term debt of other subsidiaries				
Private activity bonds and government funded debt				
Fixed rate	0%-6.88%	2009-2038	942,941	949,240
Floating rate (d)	3.65%-4.90%	2015-2032	178,145	178,145
Mortgage bonds				
Fixed rate	6.31%-9.71%	2008-2034	731,340	832,876
Senior debt				
Fixed rate	5.60%-9.10%	2008-2025	45,473	146,000
Mandatory redeemable preferred stock	4.60%-9.75%	2013-2036	24,644	25,032
Notes payable and other (e)	5.76%-11.77%	2008-2026	3,442	5,703
Long-term debt			\$ 4,724,845	\$ 5,062,156
Unamortized debt discount, net (f)			70,743	96,106
Total long-term debt			\$ 4,795,588	\$ 5,158,262

- (a) Thames Water Investments Luxembourg ("TWILUX"), an affiliate and wholly owned subsidiary of RWE, was the holder of \$1,750,000 of the Company's 5.9% preferred stock, par value \$1, which was issued in connection with RWE's acquisition of American Water Works Company, Inc. One thousand seven hundred and fifty shares were authorized and outstanding at December 31, 2006.
- (b) Tax-exempt bonds which are remarketed as money market bonds for periods up to 270 days (1 to 127 days during 2007). These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption.
- (c) Debt funded by RWE. (See Note 19)
- (d) \$169,585 of the total represents tax-exempt bonds which are sold at auction rates that are reset every 7 to 35 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. The remaining \$8,560 represents tax-exempt bonds remarketed as money market bonds. See (b) above.
- (e) Includes capital lease obligations of \$1,982 and \$2,191 at December 31, 2007 and 2006, respectively. Lease payments of \$152, \$171, \$193, \$215, \$237 and \$1,014 will be made in 2008, 2009, 2010, 2011, 2012 and thereafter, respectively.
- (f) Includes fair value adjustments.

In 2007, the Company borrowed \$1,750,000 from RWE and used the proceeds to redeem \$1,750,000 of its 5.9% mandatory redeemable preferred stock.

Also during 2007, the Company issued senior notes in the principal amount of \$2,117,000 and received equity contributions from RWE in the amount of \$1,067,092. The Company used the proceeds from the senior notes and equity contributions to repay long-term and short-term RWE notes, repay outstanding commercial paper and for other corporate purposes amounting to \$2,011,530, \$624,446 and \$548,116, respectively.

A portion of the RWE notes that were redeemed in 2007 were obtained for the use of certain of the Company's regulated subsidiaries. These notes were redeemed early resulting in a difference of \$8,655 between the book value of the RWE notes and the cash consideration required to

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extinguish the notes. As agreed with the applicable Regulators, the difference on extinguishment was deferred as a regulatory liability by the Company's regulated subsidiaries and will be amortized to Interest, net over the remaining lives of the original RWE notes for periods ranging from 2014 to 2034.

The future sinking fund payments and maturities are as follows:

Year	Amount
2008	\$ 96,455
2009	55,799
2010	45,158
2011	35,043
2012	32,254
Thereafter	4,460,136

The following long-term debt was issued in 2007:

Company	Type	Interest Rate	Maturity	Amount
American Water Capital Corp.	RWE notes - variable rate	5.72%	2009	\$ 1,750,000
American Water Capital Corp.	Senior notes	5.39%-6.59%	2013-2037	2,117,000
Other subsidiaries	State financing authority loans and other	1.00%-1.62%	2013-2025	2,109
Total issuances				\$ 3,869,109

In 2007, the Company assumed \$3,347 of long-term debt consisting of senior notes and state financing authority loans with interest rates ranging from 0.00% to 9.10% and maturities ranging from 2008 to 2025 associated with the acquisition of SJS. This debt was recognized at fair value in the purchase accounting at \$2,791. (See Note 3)

The following debt and preferred stock with mandatory redemption requirements were retired through optional redemption or payment at maturity during 2007:

Company	Type	Interest Rate	Maturity	Amount
<u>Long-term debt</u>				
American Water Capital Corp.	Senior notes - fixed rate	6.87%	2011	\$ 28,000
American Water Capital Corp.	RWE notes - fixed rate	4.00%-6.05%	2007-2034	465,300
American Water Capital Corp.	RWE notes - variable rate	5.72%	2009	1,750,000
Other subsidiaries	Senior notes - fixed rate	7.25%-8.75%	2007-2028	101,531
Other subsidiaries		0%-10.06%	2007-2034	114,340
<u>Preferred stock with mandatory redemption requirements</u>				
American Water Works Company	RWE preferred stock - fixed rate	5.90%	2012	1,750,000
Other subsidiaries		4.60%-8.88%	2007-2019	388
Total retirements & redemptions				\$ 4,209,559

Gains from early extinguishment of debt included in Interest, net amounted to \$13,113, \$3,739 and \$0 in 2007, 2006 and 2005, respectively.

Interest, net includes interest income of approximately \$10,985, \$4,254 and \$3,300 at December 31, 2007, 2006 and 2005, respectively.

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Note 11: Short-Term Debt

The components of short-term debt at December 31 are as follows:

	2007	2006
RWE short-term notes	\$ -	\$ 398,230
Commercial paper, net of \$680 and \$1,395 discount at 12/31/07 and 12/31/06, respectively	169,267	321,339
Book overdraft	42,198	-
Other short-term debt	9,049	176
Total short-term debt	\$ 220,514	\$ 719,745

American Water Capital Corp. ("AWCC") had the following available capacity under its commercial paper program at December 31:

	2007	2006
Commercial paper program	\$ 700,000	\$ 700,000
Commercial paper program available capacity	530,053	377,266

On September 15, 2006, AWCC entered into an \$800,000 unsecured revolving credit facility syndicated among a group of ten banks. This revolving credit facility, which terminates on September 15, 2012, is principally used to support the commercial paper program at AWCC and to provide up to \$150,000 in letters of credit.

At December 31, AWCC had the following sub-limits and available capacity under the credit facility.

	2007	2006
Letter of credit sublimit	\$ 150,000	\$ 150,000
Letter of credit available capacity	60,659	85,986

The following table presents the short-term borrowing activity for AWCC for 2007 and 2006:

	2007	2006
Average borrowings	\$ 207,210	\$ 726,894
Maximum borrowings outstanding	720,964	2,222,500
Weighted average interest rates, computed on a daily basis	5.49%	5.30%
Weighted average interest rates, at December 31	5.62%	5.41%

Interest rates on advances under the credit facility are based on either prime or the London Interbank Offering Rate ("LIBOR") plus an applicable margin based upon credit ratings of the Company, as well as total outstanding amounts under the agreement at the time of the borrowing. The maximum LIBOR margin is 55 basis points.

The credit facility requires the Company to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00.

At December 31, 2007, the Company had \$96,211 of outstanding letters of credit, \$89,341 of which was issued under the revolving credit facility noted above.

AWCC has entered into a one year \$10,000 committed revolving line of credit with a financial institution. This line of credit will terminate on December 31, 2008 unless extended and is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on either the prime rate of the financial institution or the applicable LIBOR rate for the term selected plus 25 basis points.

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Note 12: General Taxes

Components of general tax expense from continuing operations for the years presented are as follows:

	2007	2006	2005
Gross receipts and franchise	\$ 71,360	\$ 71,629	\$ 69,237
Property and capital stock	75,172	75,132	77,535
Payroll	28,406	27,853	26,897
Other general	8,315	10,451	9,655
	<u>\$ 183,253</u>	<u>\$ 185,065</u>	<u>\$ 183,324</u>

Note 13: Income Taxes

Components of income tax expense from continuing operations for the years presented are as follows:

	2007	2006	2005
State income taxes			
Current	\$ 16,135	\$ 13,808	\$ 8,456
Deferred			
Current	2,079	(977)	590
Non-current	(11)	4,950	3,731
	<u>18,203</u>	<u>17,781</u>	<u>12,777</u>
Federal income taxes			
Current	30,213	-	17,274
Deferred			
Current	9,382	(15,213)	(7,431)
Non-current	30,468	45,704	29,971
Amortization of deferred investment tax credits	(1,510)	(1,360)	(1,612)
	<u>68,553</u>	<u>29,131</u>	<u>38,202</u>
	<u>\$ 86,756</u>	<u>\$ 46,912</u>	<u>\$ 50,979</u>

A reconciliation of income tax expense from continuing operations at the statutory federal income tax rate to actual income tax expense is as follows:

	2007	2006	2005
Income tax at statutory rate	\$ (89,432)	\$ (38,128)	\$ (78,453)
Increases (decreases) resulting from -			
State taxes, net of federal taxes	11,832	11,558	8,305
Change in valuation allowance	(4,727)	(3,870)	-
Flow through differences	2,780	2,363	2,655
Amortization of deferred investment tax credits	(1,510)	(1,360)	(1,612)
Subsidiary preferred dividends	799	707	745
Impairment charges	171,247	74,177	121,375
Other, net	(4,233)	1,465	(2,036)
Actual income tax expense	<u>\$ 86,756</u>	<u>\$ 46,912</u>	<u>\$ 50,979</u>

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The following table provides the components of the net deferred tax liability from continuing operations at December 31:

	2007	2006
Deferred tax assets:		
Advances and contributions	\$ 521,323	\$ 483,525
Deferred investment tax credits	13,495	13,936
Other postretirement benefits	71,124	63,155
Tax losses and credits	90,725	112,916
Pension benefits	119,523	130,897
Long-term debt	29,569	36,600
Capital loss not utilized	6,992	7,686
Other	82,000	82,327
	<u>934,751</u>	<u>931,042</u>
Valuation allowance	(29,021)	(37,746)
	<u>905,730</u>	<u>893,296</u>
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	1,370,241	1,297,602
Income taxes recoverable through rates	76,998	78,574
Security costs	6,980	8,861
Business services project expenses	2,158	4,248
Deferred other postretirement benefits	17,637	9,001
Deferred pension benefits	40,308	46,284
Other	30,326	32,129
	<u>1,544,648</u>	<u>1,476,699</u>
	<u>\$ (638,918)</u>	<u>\$ (583,403)</u>

At December 31, 2007 and 2006, the Company recorded federal net operating loss ("NOL") carryforwards of \$91,554 and \$175,266, respectively. The Company believes the federal NOL carryforwards are more likely than not to be recovered and require no valuation allowance. The federal NOL carryforwards will begin to expire in 2024. In addition, at December 31, 2007 and 2006, the Company recorded state NOL's of \$381,623 and \$358,556, respectively, the majority of which are offset by a valuation allowance because the Company does not believe these NOL's are more likely than not to be realized. The state NOL carryforwards will begin to expire in 2008.

At December 31, 2007 and 2006, the Company had Canadian NOL carryforwards of \$20,155 and \$21,930, respectively. The majority of these carryforwards are offset by a valuation allowance because the Company does not believe these NOL's are more likely than not to be realized. The Canadian NOL carryforwards will begin to expire in 2008.

At December 31, 2007 and 2006, the Company had capital loss carryforwards for federal income tax purposes of \$19,977 and \$21,960 respectively. The Company has recognized a full valuation allowance for the capital loss carryforwards because the Company does not believe these losses are more likely than not to be recovered.

The Company files income tax returns in the United States federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2001.

In December 2006, the Internal Revenue Service ("IRS") completed its examination of the 2003 and 2004 tax years. No material findings or adjustments were proposed and a Form 4549, Examination No Change Report was issued.

During the course of the audit, the Company filed refund claims of \$30,306. The majority of the refund claims are attributable to the carry back of NOL's generated in 2003. These claims procedurally require approval by the Joint Committee of Taxation ("JCT"). In March 2007, the IRS notified the Company that additional audit procedures were necessary to support the filing of the

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JCT report. The Company anticipates receipt of a significant portion of the refund by December 31, 2008 and has reclassified the amount expected to be received to current income tax receivable.

The Company has state income tax examinations in progress and does not expect material adjustments to result.

The Company adopted FIN 48 effective January 1, 2007. The adoption did not have any impact to the Company's opening balance of retained earnings in 2007 because the positions taken were adequately reserved. The Company's gross FIN 48 liability, excluding interest and penalties, for unrecognized tax benefits decreased during 2007 as follows:

	2007
Balance at January 1	\$ 2,202
Decreases relating to tax authority settlements	(36)
Decreases due to lapse of statute of limitations	(524)
Balance at December 31	<u>\$ 1,642</u>

The ending liability balance does not include interest and penalties of \$341, which is recorded as a component of income tax expense. The Company does not anticipate material changes to its unrecognized tax benefits within the next twelve months. If the Company sustains all of its positions an unrecognized tax benefit of \$1,396 would impact the Company's effective tax rate.

Note 14: Employee Benefits

Pension and Other Postretirement Benefits

The Company maintains noncontributory defined benefit pension plans covering eligible non-union employees of its regulated utility and shared services operations. Benefits under the plans are based on the employee's years of service and compensation. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan.

The Company's funding policy is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974. Pension plan assets are invested in a number of investments including equity and bond mutual funds, fixed income securities and guaranteed interest contracts with insurance companies.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain regulated subsidiaries pending future recovery in rates charged for utility services as contributions are made to the plans. (See Note 7)

The Company also has several unfunded noncontributory supplemental non-qualified pension plans that provide additional retirement benefits to certain employees.

The Company maintains postretirement benefit plans providing varying levels of medical and life insurance to eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002.

The Company's policy is to fund postretirement benefit costs accrued. Plan assets are invested in equity and bond mutual funds.

The obligations of the plans are dominated by obligations for active employees. Because the timing of expected benefit payments is so far in the future and the size of the plan assets are small relative to the Company's assets, the investment strategy is to allocate a large portion of assets to equities, which the Company believes will provide the highest return over the long-term period. The fixed income assets are invested in long duration debt securities in order to better match the duration of the plan liability.

The liabilities of the pension and other postretirement benefit plans were adjusted to their fair value at the time of the Acquisitions.

The Company periodically conducts an asset liability modeling study to ensure the investment

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strategy is aligned with the profile of the obligations. The long-term goals are to maximize the plan funded status and minimize contributions and pension expense, while taking into account the potential volatility risks on each of these items.

The asset allocation for the Company's U.S. pension plan at December 31, 2007 and 2006 by asset category, are as follows:

Asset category	Target	Percentage of Plan Assets	
	Allocation	At December 31,	
	2007	2007	2006
Equity securities	60%	60%	60%
Fixed income	40%	40%	40%
Total	100%	100%	100%

The investment policy guidelines of the pension plan require that the fixed income portfolio has an overall weighted average credit rating of AA or better by Standard & Poor's and the minimum credit quality for fixed income securities must be BBB- or better. Up to 20% of the portfolio may be invested in collateralized mortgage obligations backed by the United States Government.

The Company's other postretirement benefit plans are partially funded. The asset allocation for the Company's other postretirement benefit plans at December 31, 2007 and 2006, by asset category, are as follows:

Asset category	Target	Percentage of Plan Assets	
	Allocation	At December 31,	
	2007	2007	2006
Equity securities	60%	61%	60%
Fixed income	40%	39%	40%
Total	100%	100%	100%

The postretirement benefit plan assets are invested in a manner consistent with the pension plan investment policy.

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The following table provides a rollforward of the changes in the benefit obligation and plan assets for the most recent two years for all plans combined:

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Change in benefit obligation				
Benefit obligation at January 1	\$ 892,857	\$ 869,922	\$ 426,294	\$ 427,853
Service cost	25,611	24,308	12,683	11,613
Interest cost	53,288	49,622	25,383	24,348
Plan participants' contributions	-	-	1,682	1,038
Amendments	-	507	-	(144)
Actuarial (gain) loss	(23,284)	(18,042)	5,656	(18,882)
Curtailments	-	(1,692)	-	(238)
Settlements	-	(619)	-	-
Special termination benefits	93	373	-	-
Gross benefits paid	(31,571)	(28,577)	(21,300)	(20,694)
Federal subsidy	-	-	1,546	1,400
Other	-	(2,945)	-	-
Benefit obligation at December 31	\$ 916,994	\$ 892,857	\$ 451,944	\$ 426,294
Change in Plan Assets				
Fair value of plan assets at January 1	\$ 578,280	\$ 499,416	\$ 281,390	\$ 243,249
Actual return on plan assets	25,535	55,562	4,403	29,284
Employer contributions	54,028	53,654	27,217	27,837
Plan participants' contributions	-	-	1,682	1,038
Benefits paid	(31,571)	(30,352)	(21,300)	(20,018)
Fair value of plan assets at December 31	\$ 626,272	\$ 578,280	\$ 293,392	\$ 281,390
Funded status at December 31	\$ (290,722)	\$ (314,577)	\$ (158,552)	\$ (144,904)
Amounts recognized in the balance sheet consist of:				
Current liability	\$ (1,609)	\$ (1,609)	\$ (44)	\$ (32)
Noncurrent liability	(289,113)	(312,968)	(158,508)	(144,872)
Net amount recognized	\$ (290,722)	\$ (314,577)	\$ (158,552)	\$ (144,904)

The following table provides the components of the Company's accumulated other comprehensive income and regulatory assets that have not been recognized as components of periodic benefit costs as of December 31.

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Net actuarial loss (gain)	\$ 77,927	\$ 79,956	\$ 53,627	\$ 31,309
Prior service cost (credit)	1,053	1,181	(14,482)	(15,663)
Transition obligation (asset)	-	-	867	1,041
Net amount recognized	\$ 78,980	\$ 81,137	\$ 40,012	\$ 16,687

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At December 31, 2007 and 2006, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with a projected obligation in excess of plan assets were as follows:

	Projected Benefit Obligation Exceeds the Fair Value of Plans' Assets	
	2007	2006
Projected benefit obligation	\$ 917,000	\$ 893,000
Fair value of plan assets	626,000	578,000

	Accumulated Benefit Obligation Exceeds the Fair Value of Plans' Assets	
	2007	2006
Accumulated benefit obligation	\$ 793,000	\$ 771,000
Fair value of plan assets	626,000	578,000

The accumulated postretirement benefit obligation exceeds plan assets for all of the Company's other postretirement benefit plans.

In August 2006, the Pension Protection Act (PPA) was signed into law in the U.S. The PPA replaces the funding requirements for defined benefit pension plans by requiring that defined benefit plans contribute to a 100% of the current liability funding target over 7 years. Defined benefit plans with a funding status of less than 80% of the current liability are defined as being "at risk" and additional funding requirements and benefit restrictions may apply. The PPA is effective for the 2008 plan year with short-term phase-in provisions for both the funding target and at-risk determination. The Company's qualified defined benefit plan is currently funded above the at-risk threshold, and therefore the Company expects that the plans will not be subject to the "at risk" funding requirements of the PPA. The Company is proactively monitoring the plan's funded status and projected contributions under the new law to appropriately manage the potential impact on cash requirements.

Minimum funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. The Company plans to contribute at least amounts equal to the minimum required contributions in 2008 to the qualified pension plans. The Company plans to contribute its 2008 other postretirement benefit cost to its Voluntary Employee's Benefit Association Trust.

Information about the expected cash flows for the pension and postretirement benefit plans is as follows:

	Pension Benefits	Other Benefits
2008 expected employer contributions		
To plan trusts	\$ 76,000	\$ 27,352
To plan participants	1,610	44

The Company made 2008 contributions to fund pension benefits and other benefits of \$23,000 and \$6,838, respectively through February 2008.

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The following table reflects the net benefits expected to be paid from the plan assets or the Company's assets:

	Pension Benefits		Other Benefits	
	Expected Benefit Payments	Expected Benefit Payments	Expected Federal Subsidy Payments	Expected Benefit Payments
2008	\$ 34,637	\$ 19,442	\$ 1,616	
2009	37,489	21,646	1,749	
2010	40,748	23,845	1,887	
2011	44,224	26,257	2,014	
2012	48,070	28,167	2,188	
2013 - 2017	303,904	170,973	13,602	

Because the above amounts are net benefits, plan participants' contributions have been excluded from the expected benefits.

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes.

The significant assumptions related to the Company's pension and other postretirement benefit plans are as follows:

	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
Weighted-average assumptions used to determine December 31 benefit obligations						
Discount rate	6.27%	5.90%	5.65%	6.20%	5.90%	5.65%
Rate of compensation increase	4.25%	4.25%	4.25%	N/A	N/A	N/A
Medical trend	N/A	N/A	N/A	graded from 8% in 2008 to 5% in 2014+	graded from 9% in 2007 to 5% in 2011+	graded from 10% in 2006 to 5% in 2011+
Weighted-average assumptions used to determine net periodic cost						
Discount rate	5.90%	5.65%	6.00%	5.90%	5.65%	6.00%
Expected return on plan assets	8.00%	8.25%	8.75%	7.38%	7.95%	8.40%
Rate of compensation increase	4.25%	4.25%	4.75%	N/A	N/A	N/A
Medical trend	N/A	N/A	N/A	graded from 9% in 2007 to 5% in 2011+	graded from 10% in 2006 to 5% in 2011+	graded from 10% in 2005 to 5% in 2010+

N/A - Assumption is not applicable.

The discount rate assumption was determined for the pension and postretirement benefit plans independently. A yield curve was developed for a universe containing the majority of U.S. - issued Aa - graded corporate bonds, all of which were non callable (or callable with make-whole provisions). For each plan, the discount rate was developed as the level equivalent rate that would produce the same present value as that using spot rates aligned with the projected benefit payments.

The expected long-term rate of return on plan assets is based on historical and projected rates of return for current and planned asset classes in the plans' investment portfolios. Assumed projected rates of return for each of the plans' projected asset classes were selected after analyzing historical experience and future expectations of the returns and volatility of the various asset classes. Based on the target asset allocation for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to the benchmark returns and for the effect of expenses paid from plan assets. The Company's pension expense increases as the expected return on

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assets decreases.

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	One-Percentage- Point Increase	One-Percentage- Point Decrease
Effect on total of service and interest cost components	\$ 6,143	\$ (5,001)
Effect on other postretirement benefit obligation	\$ 57,868	\$ (48,220)

The following table provides the components of net periodic benefit costs for the years ended December 31:

	2007	2006	2005
Components of net periodic pension benefit cost			
Service cost	\$ 25,611	\$ 24,308	\$ 26,987
Interest cost	53,288	49,622	47,594
Expected return on plan assets	(47,052)	(42,304)	(41,136)
Amortization of:			
Prior service cost (credit)	127	494	710
Actuarial (gain) loss	262	1,482	384
Periodic pension benefit cost	\$ 32,236	\$ 33,602	\$ 34,539
Special termination pension benefit charge	93	373	890
Curtailment charge	-	971	135
Settlement charge (credit)	-	65	240
Net periodic pension benefit cost	\$ 32,329	\$ 35,011	\$ 35,804
Other changes in plan assets and benefit obligations recognized in other comprehensive income			
Amortization of prior service (credit) cost	\$ (36)		
Current year actuarial (gain) loss	(924)		
Amortization of actuarial (gain) loss	(72)		
Total recognized in other comprehensive income	\$ (1,032)		
Total recognized in net periodic benefit cost and comprehensive income	\$ 31,297		

	2007	2006	2005
Components of net periodic other postretirement benefit cost			
Service cost	\$ 12,683	\$ 11,613	\$ 13,660
Interest cost	25,383	24,348	25,156
Expected return on plan assets	(21,065)	(19,689)	(18,657)
Amortization of:			
Transition obligation (asset)	173	173	282
Prior service cost (credit)	(1,180)	(1,145)	81
Actuarial (gain) loss	-	2,011	634
Periodic other postretirement benefit cost	\$ 15,994	\$ 17,311	\$ 21,156
Curtailment charge	-	(18)	655
Net periodic other postretirement benefit cost	\$ 15,994	\$ 17,293	\$ 21,811

The Company's policy is to recognize curtailments when the total expected future service of plan participants is reduced by greater than 10% due to an event that results in terminations and/or

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retirements. The Company reflected curtailments in 2006 and 2005 due to a significant number of aggregate terminations and retirements at one of its subsidiaries.

The estimated amounts that will be amortized from accumulated other comprehensive income and regulatory assets into net periodic benefit cost in 2008 are as follows:

	Pension Benefits	Other Benefits
Actuarial (gain) loss	\$ 5	\$ 774
Prior service cost (credit)	102	(1,180)
Transition obligation (asset)	-	173
Total	<u>\$ 107</u>	<u>\$ (233)</u>

Savings Plans for Employees

The Company maintains 401(k) savings plans that allow employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution, subject to certain limitations. Due to the Company's discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plans totaling \$7,305 for 2007, \$6,898 for 2006 and \$5,511 for 2005. All of the Company's contributions are invested in one or more funds at the direction of the employee.

Employees' Investment Plan

Upon completion of the American Water Works Company, Inc. acquisition, the Company created the Employees' Investment Plan and converted the former American Water Works Company, Inc. Employees' Stock Ownership Plan into this plan. Each participating employee can elect to contribute an amount that does not exceed 2% of their wages. In addition to the employee's participation, the Company makes a contribution equivalent to 1/2% of each participant's qualified compensation, and matches 100% of the contribution by each participant. The Company made contributions to the plan totaling \$1,010 for 2005 that were primarily invested in a retirement trust fund. This plan was discontinued as of May 22, 2005.

Long-Term Incentive Plan

The Company participates in a RWE long-term incentive plan for executives ("RWE LTIP"). Under the RWE LTIP, Company employees were granted 120,004 performance shares of RWE common stock which vest over three years beginning January 1, 2005. Subject to the vesting provisions, the performance shares are payable in cash. In accordance with SFAS 123R "Share-Based Payment", the performance shares have been accounted for as a liability. The liability will be remeasured at fair value at each reporting period until settlement. The Company recorded a liability of \$8,398 and \$4,271 related to the performance shares at December 31, 2007 and 2006, which has been included in Other current liabilities. For the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately \$4,127, \$2,604 and \$1,667, respectively, of share-based compensation expense related to the performance shares in operations and maintenance expense.

The fair value of the performance shares was estimated using Monte Carlo simulations. The fair value of the performance shares granted on January 1, 2005 was \$25.09 per share of RWE common stock at the grant date and \$81.54 and \$65.42 per share of RWE common stock at December 31, 2007 and 2006.

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The following table summarizes performance share transactions under the RWE LTIP plan:

	2005 tranche
Outstanding at January 1, 2007	104,816
Granted	-
Forfeited	(1,817)
Outstanding at December 31, 2007	102,999
Vested at December 31, 2007	102,999

Retention Bonuses

The Company established a retention bonus program that is intended to retain employees in key leadership roles through the timely completion of the IPO. If a participant remains employed by the Company through March 31, 2008, the participant will receive a cash bonus based on a predetermined percentage of his or her base salary in effect on January 1, 2006, or his or her hire date, if he or she was hired after January 1, 2006. For the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately \$2,498, \$2,907 and \$0, respectively, of expense related to the retention bonuses in operations and maintenance expense.

Completion Bonuses

The Company has offered a completion bonus to reward selected senior executives for their contributions to the IPO process. Each eligible executive is entitled to receive a cash bonus based on a predetermined percentage of his or her base salary in effect on January 1, 2006, or his or her hire date, if he or she was hired after January 1, 2006. For the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately \$832, \$1,750 and \$0, respectively, of expense related to the completion bonuses in operations and maintenance expense.

Note 15: Commitments and Contingencies

OMI/Thames Water Stockton, Inc. ("OMI/TW") is a 50/50 joint venture between a subsidiary of the Company and Operations Management International, Inc. ("OMI"). In February 2003, OMI/TW and the City of Stockton California (the "City") entered into a 20-year service contract for water, wastewater and storm water utilities capital improvements and management services. In 2007, OMI/TW and the City of Stockton mutually agreed to end the contract effective February 29, 2008, at which time the responsibility for management and operation of the system will be returned to the City. Under the agreement, OMI/TW is required to provide a warranty relating to certain construction activities and is required to pay for certain employee transition costs. The length and the exact nature of that warranty and certain other details are subject to the conclusion of a supplemental agreement still being negotiated by the parties. In addition, the City received a Settlement Communication from the California State Water Resources Control Board ("the Board") related to a discharge into an adjacent river. Under the agreement, OMI/TW is responsible for financial settlement of this matter with the Board. Given the uncertainties related to resolving the remaining issues surrounding the transition and termination of the contract, financial settlement of the Board matter and the construction warranty, the Company has recorded a loss reserve of approximately \$4,000 at December 31, 2007.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At December 31, 2007, the Company has accrued approximately \$5,000 as probable losses and it is reasonably possible that losses could range up to \$19,000 for these matters. For certain matters, the Company is unable to estimate any possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

Commitments have been made in connection with certain construction programs. The estimated capital expenditures required under legal and binding contractual obligations amounted to \$163,930 at December 31, 2007.

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The Company's regulated subsidiaries maintain agreements with other water purveyors for the purchase of water to supplement their water supply. The Company's subsidiaries purchased water expense under these types of agreements amounted to approximately \$92,403, \$85,345, and \$92,395 during the years ended December 31, 2007, 2006 and 2005, respectively. The estimated annual commitment related to the minimum quantities of water purchased is expected to approximate \$44,678 in 2008, \$43,016 in 2009, \$43,625 in 2010, \$44,386 in 2011, \$45,417 in 2012 and \$560,962 thereafter.

Note 16: Net loss per Common Share

Basic net loss per common share, loss from continuing operations per common share and loss from discontinued operations, net of tax per common share are based on the weighted average number of common shares outstanding. Diluted net loss per common share, loss from continuing operations per common share and loss from discontinued operations, net of tax per common share are based on weighted average number of common shares outstanding and potentially dilutive shares. The Company had no potentially dilutive shares for the years ended December 31, 2007, 2006 and 2005. All common shares are held by a wholly-owned subsidiary of RWE.

On November 5, 2007, the Company's Board of Directors authorized 500,000 shares of common stock, par value \$.01 per share and declared a one hundred and sixty thousand-for-one common stock split effective November 7, 2007 for all common shares outstanding. The Company's par value of \$1.00 per share changed to \$.01 per share and \$1,599 was transferred from paid-in capital to common stock to record the split. All share and per share data for all periods presented have been restated to give effect to the stock split.

Note 17: Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities: The carrying amount reported in the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt due to the short-term maturities and variable interest rates, approximates their fair values.

Preferred stock with mandatory redemption requirements and long-term debt: The fair values of preferred stock with mandatory redemption requirements and long-term debt are estimated using discounted cash flow analyses based on current incremental financing rates for similar types of securities.

The carrying amounts and fair values of the financial instruments at December 31 are as follows:

2007	Carrying Amount	Fair Value
Preferred stocks with mandatory redemption requirements	\$ 24,514	\$ 25,264
Long-term debt (excluding capital lease obligations)	4,769,092	4,653,765
2006	Carrying Amount	Fair Value
Preferred stocks with mandatory redemption requirements	\$ 1,774,863	\$ 1,786,027
Long-term debt (excluding capital lease obligations)	3,381,208	3,390,536

Note 18: Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were \$34,946 for 2007, \$36,136 for 2006 and \$34,662 for 2005. The operating leases for facilities will expire over the next 20 years and the operating leases for equipment will expire over the next five years. Certain operating leases have renewal options ranging from one to five years.

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At December 31, 2007, the minimum annual future rental commitment under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are \$28,248 in 2008, \$27,128 in 2009, \$23,527 in 2010, \$17,704 in 2011, \$11,901 in 2012 and \$119,410 thereafter.

The Company has a series of agreements with various public entities to establish certain joint ventures, commonly referred to as "public-private partnerships". The Company agreed to transfer and convey some of its real and personal property ("facilities"), to various public entities, subject to lien of its General Mortgage Indenture, in exchange for an equal principal amount of Industrial Development Bonds ("IDBs"), to be issued by the various public entities under a state Industrial Development Bond and Commercial Development Act. The Company leased back the facilities under capital leases for a period of 40 years. The leases have payments that approximate the payments required by the terms of the IDBs. In accordance with Financial Accounting Standards Board Interpretation Number 39, "Offsetting of Amounts Related to Certain Contracts", the transaction is presented on a net basis. The carrying value of the facilities was \$161,803 and \$162,627 at December 31, 2007 and 2006, respectively.

At December 31, 2007, the minimum annual future rental commitment under these additional operating leases that have initial or remaining non-cancelable lease terms in excess of one year included in the proceeding minimum annual rental commitments are \$3,471 in 2008, \$3,475 in 2009, \$3,472 in 2010, \$3,472 in 2011, \$3,472 in 2012 and \$96,430 thereafter.

Note 19: Related Party Transactions

Thames Water Plc, formerly an affiliate and wholly owned subsidiary of RWE, provided certain management services to the Company which amounted to \$0 in 2007, \$1,386 in 2006 and \$9,147 in 2005.

Thames Water International Services Limited, formerly an affiliate and wholly owned subsidiary of RWE, provided services of expatriate employees to the Company which amounted to \$0 in 2007, \$1,763 in 2006 and \$4,970 in 2005.

Interest on the Company's borrowings with RWE amounted to \$26,797, \$131,005, and \$93,907 in 2007, 2006 and 2005, respectively.

TWILUX, an affiliate and wholly owned subsidiary of RWE, was the holder of \$1,750,000 of the Company's preferred stock. Preferred dividends included in interest expense amounted to \$74,569, \$103,270, and \$103,250 in 2007, 2006 and 2005, respectively. The preferred stock was redeemed in 2007 utilizing the proceeds from \$1,750,000 in variable rate borrowings from RWE. The variable rate borrowings from RWE were subsequently redeemed with proceeds from the senior notes issuance. (See Note 10)

The Company maintains agreements with both public and private water providers for the purchase of water to supplement water supply, particularly during periods of peak demand. The President and CEO of the Company is a Commissioner of one of these water providers. The Company purchased approximately \$16,793, \$16,374, and \$16,693 of water from this provider in the years ended December 31, 2007, 2006 and 2005, respectively. The minimum purchase quantity amounts are known and the rates are set annually. Assuming an annual inflationary rate adjustment of 3.5%, the estimated commitments related to the minimum quantities of purchased water under these agreements are \$14,925 in 2008, \$15,448 in 2009, \$15,988 in 2010, \$16,548 in 2011, \$17,127 in 2012 and \$301,822 thereafter.

Note 20: Guarantees

A subsidiary holds a 50% interest in American Water-Pridesa LLC ("AW-Pridesa"), a Delaware limited liability company. Pridesa America Corporation, a former subsidiary of RWE also holds a 50% interest. AW-Pridesa has contracted with Tampa Bay Water ("Tampa Bay"), an interlocal governmental agency of the State of Florida, to remedy and operate the Tampa Bay Seawater Desalination Plant. The Company entered into a guarantee with Tampa Bay in November 2004 for the full and prompt performance of certain contractual obligations limited to a total aggregate liability of \$35,000. Contractual obligations call for certain construction activities and management services to be completed satisfactorily. AW-Pridesa took over operation of the plant in January

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2005. At December 31, 2007, the plant was fully operational and successful performance testing of the construction activities had been completed.

The Company provides financial guarantees or deposits to ensure performance of certain of its obligations on its non-regulated military agreements and O&M agreements. These guarantees and deposits totaled \$475,278 and \$476,244 at December 31, 2007 and 2006, respectively.

Note 21: Discontinued Operations

Based on management's ongoing evaluation of the non-regulated businesses, it was determined that the Company's Residuals, Underground, Ashbrook, and Engineering businesses were not meeting growth expectations and were not considered core businesses of the Company's operations. Accordingly, the Company sold and/or disposed of these businesses. As a result of these dispositions, the Company recorded a net gain/loss of \$0 in 2007, a net loss of \$1,001 in 2006, and a net loss of \$15,407 in 2005.

In 2006, the Company sold a group of assets of the Residuals business for \$2,500 and reported the related operations within discontinued operations. In June 2007, the Company sold another component of Residuals business for \$9,660. The Company completed the sale of this component in 2007.

The Company's Underground business was sold for \$27,651. As a result of the sale, the Company recorded a loss of \$1,001 in 2006.

During the fourth quarter of 2005, the Company sold Engineering's Canadian operations, a provider of engineering services to corporate and municipal clients, for initial consideration of \$489 and contingent consideration of \$430. Furthermore, the Company disposed through abandonment components of Engineering's operations based in the United States. As a result of the disposition of these components of Engineering in 2005, the Company recorded a loss of \$15,407 which included a goodwill write-off \$16,216.

During the first quarter of 2005, the Company sold substantially all the assets of its Ashbrook subsidiary, a provider of wastewater treatment services, for \$14,847. There was no gain or loss recorded at the time of sale.

A summary of the assets and liabilities classified as discontinued operations in the Consolidated Balance Sheets includes the following:

	<u>2006</u>
Assets of discontinued operations	
Non-utility property	\$ 1,690
Other receivables, net	2,151
Other current assets	6,323
Goodwill	<u>2,670</u>
Total assets of discontinued operations	<u>12,834</u>
Liabilities of discontinued operations	
Accounts payable	654
Other liabilities	<u>1,824</u>
Total liabilities of discontinued operations	<u>2,478</u>
Net assets of discontinued operations	<u>\$ 10,356</u>

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A summary of discontinued operations presented in the Consolidated Statements of Operations include the following:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating revenues	\$ 7,128	\$ 59,872	\$ 80,979
Operating expenses			
Operation, maintenance and depreciation	7,071	60,297	84,277
Impairment charges	-	6,117	34,936
Total operating expenses, net	<u>7,071</u>	<u>66,414</u>	<u>119,213</u>
Operating income (loss)	<u>57</u>	<u>(6,542)</u>	<u>(38,234)</u>
Other income (deductions)			
Interest, net	56	322	(21)
Other, net	(749)	1,875	1,135
Total other income (deductions)	<u>(693)</u>	<u>2,197</u>	<u>1,114</u>
Loss before income taxes	(636)	(4,345)	(37,120)
Provision for income taxes	<u>(85)</u>	<u>1,047</u>	<u>(2,617)</u>
Loss from operations	(551)	(5,392)	(34,503)
Loss on sale, net of tax benefit	<u>-</u>	<u>(1,001)</u>	<u>(15,407)</u>
Loss from discontinued operations	<u>\$ (551)</u>	<u>\$ (6,393)</u>	<u>\$ (49,910)</u>

Note 22: Segment Information

The Company has two operating segments which are also the Company's two reportable segments referred to as the Regulated Businesses and Non-regulated Businesses segments. The Company's chief operating decision maker regularly reviews the operating results of the Regulated and Non-regulated Businesses segments to assess segment performance and allocate resources. The evaluation of segment performance and the allocation of resources are based on several measures. The measure that is most consistent with that used by management is adjusted earnings before interest and income taxes from continuing operations ("Adjusted EBIT"). Management has grouped the Company's businesses into its Regulated and Non-regulated Businesses segments based upon the products and services they provide and whether they function under the rules and regulations of the public utility regulatory environment.

The Regulated Businesses segment includes the Company's 23 utility subsidiaries that provide water and wastewater services to customers in 20 U.S. states. With the exception of one company, each of these public utility subsidiaries is subject to regulation by public utility commissions and local governments. In addition to providing similar products and services and being subject to the public utility regulatory environment, each of the regulated subsidiaries has similar economic characteristics, production processes, types and classes of customers and water distribution or wastewater collection processes. Each of these companies is also subject to both federal and state regulation regarding the quality of water distributed and the discharge of wastewater residuals.

The Non-regulated Businesses segment is comprised of non-regulated businesses that provide a broad range of non-regulated water and wastewater services and products including homeowner water and sewer line maintenance services, water and wastewater facility operations and maintenance services, granular carbon technologies and products for cleansing water and wastewater, wastewater residuals management services and water and wastewater facility engineering services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 2). The Regulated and Non-regulated Businesses

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segment information includes intercompany costs that are allocated by American Water Works Service Company, Inc. and intercompany interest that is charged by AWCC, which are eliminated to reconcile to the consolidated results of operations. Inter-segment revenues, which are primarily recorded at cost plus mark-up that approximates current market prices, include carbon regeneration services and leased office space, furniture and equipment provided by the Company's non-regulated subsidiaries to its regulated subsidiaries.

Other includes corporate costs which are not allocated to the Company's subsidiaries, eliminations of inter-segment transactions, and fair value adjustments and associated income and deductions related to the Acquisitions which have not been allocated to the segments for evaluation of segment performance and allocation of resource purposes. The adjustments related to the Acquisitions are reported in Other, as they are excluded from segment performance measures evaluated by management. The following table includes the Company's summarized segment information:

	As of or for the Year Ended December 31, 2007			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	\$ 1,987,565	\$ 242,678	\$ (16,028)	\$ 2,214,215
Depreciation and amortization	254,998	10,295	2,042	267,335
Impairment charges	-	-	509,345	509,345
Total operating expenses, net	1,490,794	225,600	482,692	2,199,086
Adjusted EBIT (1)	500,088	23,579		
Total assets	10,163,227	280,692	2,490,153	12,934,072
Capital expenditures	746,583	11,986	-	758,569

	As of or for the Year Ended December 31, 2006			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	\$ 1,854,618	\$ 248,451	\$ (10,002)	\$ 2,093,067
Depreciation and amortization	243,311	13,990	1,880	259,181
Impairment charges	-	-	221,685	221,685
Total operating expenses, net	1,387,418	253,850	199,286	1,840,554
Adjusted EBIT (1)	468,701	(4,725)		
Total assets	9,439,975	339,761	3,003,323	12,783,059
Capital expenditures	662,135	26,708	-	688,843

	As of or for the Year Ended December 31, 2005			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	\$ 1,836,061	\$ 310,771	\$ (10,086)	\$ 2,136,746
Depreciation and amortization	246,802	15,187	(625)	261,364
Impairment charges	-	4,850	380,584	385,434
Total operating expenses, net	1,373,677	319,135	332,359	2,025,171
Adjusted EBIT (1)	469,921	(106)		
Total assets	8,941,859	402,803	3,197,367	12,542,029
Capital expenditures	512,519	45,927	-	558,446

(1) Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flow for periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

American Water Works Company, Inc. and Subsidiary Companies
(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)
Notes to Consolidated Financial Statements
(In thousands, except per share data)

The following table reconciles Adjusted EBIT, as defined by the Company, to loss from continuing operations before income taxes:

	For the Year Ended December 31, 2007		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	\$ 500,088	\$ 23,579	\$ 523,667
Add:			
Allowance for other funds used during construction	7,759	-	7,759
Allowance for borrowed funds used during construction	3,449	-	3,449
Less:			
Interest, net	(219,371)	(8,629)	(228,000)
Preferred dividends of subsidiaries	(225)	-	(225)
Amortization of debt expense	(5,169)	-	(5,169)
Segments income from continuing operations before income taxes	\$ 286,531	\$ 14,950	\$ 301,481
Impairment charges			(509,345)
Interest, net			(55,165)
Other			7,510
Loss from continuing operations before income taxes			\$ (255,519)

	For the Year Ended December 31, 2006		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	\$ 468,701	\$ (4,725)	\$ 463,976
Add:			
Allowance for other funds used during construction	5,980	-	5,980
Allowance for borrowed funds used during construction	2,652	-	2,652
Less:			
Interest, net	(209,589)	(12,163)	(221,752)
Preferred dividends of subsidiaries	(273)	-	(273)
Amortization of debt expense	(5,196)	-	(5,196)
Segments income from continuing operations before income taxes	\$ 262,275	\$ (16,888)	\$ 245,387
Impairment charges			(221,685)
Interest, net			(144,218)
Other			11,578
Loss from continuing operations before income taxes			\$ (108,938)

	For the Year Ended December 31, 2005		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	\$ 469,921	\$ (106)	\$ 469,815
Add:			
Allowance for other funds used during construction	5,810	-	5,810
Allowance for borrowed funds used during construction	2,420	-	2,420
Less:			
Impairment charges	-	(4,850)	(4,850)
Interest, net	(202,901)	(12,301)	(215,202)
Preferred dividends of subsidiaries	(285)	-	(285)
Amortization of debt expense	(5,327)	-	(5,327)
Segments income from continuing operations before income taxes	\$ 269,638	\$ (17,257)	\$ 252,381
Impairment charges			(380,584)
Interest, net			(130,055)
Other			34,107
Loss from continuing operations before income taxes			\$ (224,151)