



STOLL · KEENON · OGDEN
PLLC

300 West Vine Street
Suite 2100
Lexington, KY 40507-1801
(859) 231-3000
Fax: (859) 246-3672
www.skofirm.com

LINDSEY W. INGRAM III
Direct Dial: 859-231-3982
L.Ingram@skofirm.com

RECEIVED

March 9, 2007

MAR 09 2007

PUBLIC SERVICE
COMMISSION

VIA HAND DELIVERY

Beth A. O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

Re: *In the Matter of: Application of Kentucky-American Water Company for
Approval of Debt Issuance*

Case No. 2007-00104

Dear Ms. O'Donnell:

Enclosed please find for filing Kentucky American Water's Application for Approval of Debt Issuance and the required copies.

Very truly yours,

STOLL KEENON OGDEN PLLC

By *Lindsey W. Ingram III*
Lindsey W. Ingram III

Enclosures

cc: David Edward Spenard (w/ encl.)
LEX 010311/124828/3493128.1

RECEIVED

MAR 09 2007

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:)
)
APPLICATION OF KENTUCKY-AMERICAN)
WATER COMPANY FOR APPROVAL)
OF DEBT ISSUANCE)

CASE NO. 2007-00104

APPLICATION OF KENTUCKY-AMERICAN WATER COMPANY
FOR APPROVAL OF DEBT ISSUANCE

Comes Kentucky-American Water Company ("Kentucky American Water") and for its Application for approval of its debt issuance in the amount of \$14,000,000 states as follows:

1. Kentucky American Water is a corporation organized and existing under the laws of the Commonwealth of Kentucky with its principal office and place of business at 2300 Richmond Road, Lexington, Kentucky 40502.

2. Kentucky American Water is a wholly-owned subsidiary of American Water Works Company, Inc. ("American Water") and is engaged in the distribution and sale of water in its Central Division, consisting of Bourbon, Clark, Fayette, Harrison, Jessamine, Scott and Woodford Counties and its Northern Division consisting of Gallatin, Owen and Grant Counties. It currently owns, operates and maintains potable water production, treatment, storage, transmission and distribution systems for the purpose of furnishing potable water for residential, commercial, industrial and governmental users in its service territory having an original cost of \$319,393,486 as of December 31, 2006.

3. Kentucky American Water also owns, operates and maintains collection, pumping and treatment systems for the purpose of furnishing wastewater service for residential,

commercial, industrial and governmental users in its service territory having an original cost of \$8,139,600 as of December 31, 2006.

4. A certified copy of the Articles of Incorporation of Kentucky American Water, together with all amendments thereto, are incorporated herein by reference as authorized by 807 KAR 5:001, Section 10, (1), (b), (3) and Section 8, (3), and were filed as Exhibit No. 4 in Case No. 95-554, *Notice of the Adjustment of the Rates of Kentucky-American Water Company effective on and after February 29, 1996*.

5. By Order dated July 21, 2000, in Case No. 2000-189, *Application of Kentucky-American Water Company for Approval of Participation in Borrowing Program*, the Public Service Commission of the Commonwealth of Kentucky ("Commission") authorized Kentucky American Water to enter into a Financial Services Agreement with American Water Capital Corp. and to participate in its borrowing program. A copy of the Financial Services Agreement entered into is attached as Exhibit No. 1. A copy of the Order dated July 21, 2000 is attached as Exhibit No. 2.

6. The Order dated July 21, 2000 also authorized Kentucky American Water to issue securities in the form of notes or debentures in an aggregate amount of \$41,500,000 from time to time prior to December 31, 2005, for the purpose of refunding/refinancing existing short-term and long-term debt. Pursuant to that authorization, including some long-term debt issued by Kentucky American Water with Commission approval prior to Case No. 2000-189, Kentucky American Water now has stock and debt outstanding as shown on the attached financial exhibit, marked Exhibit No. 3, as required by 807 KAR 5:001, Section 11, (2), (a).

7. Kentucky American Water has issued three debt obligations since the Commission's July 21, 2000 Order in Case No. 2000-189. On March 29, 2001, Kentucky

American Water issued a promissory note to American Water Capital Corp. in the amount of \$15,500,000. On June 12, 2002, Kentucky American Water issued a promissory note to American Water Capital Corp. in the amount of \$24,000,000. On March 1, 2004, Kentucky American Water issued a promissory note to American Water Capital Corp. in the amount of \$14,000,000 for the purpose of refunding/refinancing then-existing short and long-term debt. A copy of the March 1, 2004 note is attached as Exhibit No. 4.

8. The March 1, 2004 promissory note raised the total of those three issuances to \$53,500,000, inadvertently exceeding the aggregate issuance amount that was authorized in the Commission's July 21, 2000 Order in Case No. 2000-189. The financial exhibit attached as Exhibit No. 5 contains the information required by 807 KAR 5:001, Section 11, (2), (a) as of December 12, 2003, which was within 90 days of the March 1, 2004 promissory note.

9. Kentucky American Water has conveyed certain property, lands and premises to First Union National Bank (formerly First Fidelity Bank, National Association, formerly First Federal Bank, N.A., Pennsylvania, formerly Fidelity Bank, National Association, and formerly The Fidelity Bank) to secure payment of the specified bonds and indebtedness by an Indenture of Mortgage dated as of May 1, 1968; First Supplemental Indenture dated as of December 1, 1970; a Supplement to the First Supplemental Indenture dated as of December 17, 1970; Second Supplemental Indenture dated as of September 1, 1974; Third Supplemental Indenture dated as of November 1, 1977; Fourth Supplemental Indenture dated as of December 1, 1982; Fifth Supplemental Indenture dated as of June 1, 1983; Sixth Supplemental Indenture dated as of August 1, 1985; Seventh Supplemental Indenture dated as of January 1, 1987; Eighth Supplemental Indenture dated as of September 1, 1988; Ninth Supplemental Indenture dated as of October 1, 1999; Tenth Supplemental Indenture dated as of November 1, 1990; Amended and

Restated Tenth Supplemental Indenture dated as of November 1, 1990; Eleventh Supplemental Indenture dated as of December 1, 1991; Twelfth Supplemental Indenture dated as of December 1, 1992; Thirteenth Supplemental Indenture dated as of December 1, 1993; Fourteenth Supplemental Indenture dated as of September 1, 1995; Fifteenth Supplemental Indenture dated as of February 1, 1997, and Sixteenth Supplemental Indenture dated as of June 1, 1998. The Indenture of Mortgage and Supplements were attached to Kentucky American Water's Application, Exhibit No. 4, in Case No. 2006-00418, *In the Matter of: Application of Kentucky-American Water Company for Continued Participation with American Water Capital Corp.*

10. American Water Capital Corp. is a wholly-owned subsidiary of American Water and is a corporation organized under the laws of the state of Delaware. It has obtained funds from a syndicated bank credit line for short-term loans and from its own debt securities, all with the support of RWE Aktiengesellschaft ("RWE"). A copy of the Certificate of Incorporation of American Water Capital Corp. is attached and marked Exhibit No. 6. American Water Capital Corp. is the Lender as identified in the March 1, 2004 issuance as shown in Exhibit No. 4.

11. As Exhibit No. 3 shows, as of December 31, 2006, Kentucky American Water had outstanding short-term debt in the amount of \$3,297,056 payable to American Water Capital Corp. and six long-term debt issues: (1) 6.960% series in the amount of \$7,000,000 due December 1, 2023; (2) 7.150% series in the amount of \$7,500,000 due February 1, 2027; (3) 6.990% series in the amount of \$9,000,000 due June 1, 2028; (4) 5.650% series in the amount of \$24,000,000 due June 12, 2007; (5) 6.870% series in the amount of \$15,500,000 due March 29, 2011, and (6) 4.750% series in the amount of \$14,000,000 due March 1, 2014. This last note is the subject of this Application. Exhibit No. 5 contains similar information as of December 12, 2003, which was within 90 days of the March 1, 2004 promissory note.

12. Kentucky American Water's short-term debt has been made available through American Water Capital Corp. with the support of RWE. RWE has decided to divest itself of the ownership of the common stock of American Water.¹ RWE has expressed its intention, upon securing the regulatory approvals for the sale of the common stock of American Water, to terminate its support to American Water Capital Corp. and call its notes that support the short-term debt, and both the 4.750% series and the 5.650% series long-term indebtedness of Kentucky American Water.

13. Prior to December 31, 2007, Kentucky American Water anticipates additional short-term debt borrowings; the refinancing of the 5.650% series of its existing long-term debt and the refinancing of its 4.750% series long-term debt. The two long-term debt refinancings may occur in March 2007 by the issuance of \$38,000,000 of new debt. In addition, Kentucky American Water anticipates the issuance of \$15,000,000 additional long-term debt in October 2007. This additional long-term debt issuance will be required to meet sinking fund requirements and reduce short-term debt.

14. Kentucky American Water seeks approval of its issuance of the March 1, 2004 promissory note. Kentucky American Water has used and will continue to use the proceeds obtained from the March 1, 2004 promissory note for a lawful object within the corporate purposes of Kentucky American Water, namely, the refunding/refinancing of short and long-term debt. The issuance of the March 1, 2004 promissory note was necessary and appropriate for and consistent with the proper performance by Kentucky American Water of its services and has

¹ Case No. 2006-00197, the Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holdings GmbH, RWE Aktiengesellschaft, Thames Water Aqua U.S. Holdings, Inc. and American Water Works Company, Inc. for Approval of a Change in Control of Kentucky-American Water Company, pending before the Public Service Commission of the Commonwealth of Kentucky.

not and will not impair its ability to perform services and was and is reasonably necessary and appropriate for such purposes.

15. The issuance of the March 1, 2004 promissory note to American Water Capital Corp. allowed Kentucky American Water to borrow money at a cost that was less than otherwise readily available, although it is and was not precluded from borrowing from other financial institutions as demonstrated in Case No. 2000-189. The March 1, 2004 issuance exceeded the amount but not the authorization of the Commission in Case 2000-189. Therefore, Kentucky American Water seeks approval of the March 1, 2004 issuance.

WHEREFORE, Kentucky American Water requests that the Commission, pursuant to the authority contained in KRS 278.300, approve Kentucky American Water's March 1, 2004 debt issuance.

Respectfully submitted,

Lindsey W. Ingram, Jr.
Lindsey W. Ingram III
STOLL KEENON OGDEN PLLC
300 West Vine Street, Suite 2100
Lexington, Kentucky 40507-1801
Telephone: 859-231-3000

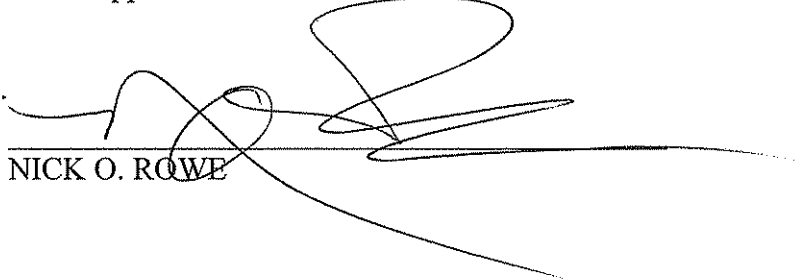
BY: 

ATTORNEYS FOR KENTUCKY-AMERICAN
WATER COMPANY

COMMONWEALTH OF KENTUCKY)

COUNTY OF FAYETTE)

After having been duly sworn, Nick O. Rowe states that he is President of Kentucky-American Water Company, that he has knowledge of the matters set forth in this Application, that he has been designated by Kentucky-American Water Company to sign and file the Application on its behalf, and that he has read the Application and that the statements contained therein are true.



NICK O. ROWE

Subscribed and sworn to before me by Nick O. Rowe this the 6th day of March, 2007.

My Commission expires: August 16, 2008



LOUISE H. MAZER
NOTARY PUBLIC, STATE AT LARGE, KY.

LEX 010311/124828/3481184.4



FINANCIAL SERVICES AGREEMENT

THIS AGREEMENT, dated as of June 15, 2000, by and between Kentucky-American Water Company (the "Company") and American Water Capital Corp. ("AWCC").

B A C K G R O U N D

The Company currently performs its own financial services.

However, the Company has determined that it can obtain these services more efficiently through the consolidation of certain necessary management and staff functions with those performed for other entities that may enter into agreement with AWCC substantially similar to this one ("Co-Participants").

AWCC is dedicated to performing such consolidated functions.

Accordingly, the parties have determined to enter into this Agreement for the provision of financial services by AWCC to the Company and for the proper determination and allocation of the costs of providing such services.

Therefore, the parties agree as follows:

A G R E E M E N T

1. Services. AWCC will provide, either directly or through arrangements with third parties for the benefit of the Company, such financial services as the Company and AWCC may from time to time agree, including but not limited to those more fully described in Appendix I attached to this Agreement.

2. Costs. In consideration of the provision of the services contemplated by paragraph 1, the Company agrees to pay AWCC a portion of the costs and appropriate overhead incurred by AWCC in providing those services, as follows. The costs incurred by AWCC in connection with its bank credit lines and short-term public borrowings will be divided among the Co-Participants in proportion to the maximum principal amount that each Co-Participant requests be made available to it during the course of a year. The costs incurred by AWCC in connection with each long-term borrowing by AWCC will be divided among each Co-Participant in proportion to the principal amount of that borrowing that is loaned to that Co-Participant. AWCC's overhead will be allocated among the Co-Participants in the same proportion as each Co-Participant's long-term and maximum, requested short-term borrowings and investments in a calendar year bear to all of the long and maximum short-term borrowings and investments by all Co-Participants during the same year.

3. Statements. AWCC will prepare and deliver to the Company monthly statements of the services provided by AWCC and amounts payable to AWCC, giving effect to

all the provisions of this Agreement. The Company shall pay the net amount shown on its statement within thirty (30) days after the billing date.

4. Inspection. Upon reasonable notice, AWCC will make available to the Company for its inspection AWCC's books, records, bills, accounts and any other documents which describe or support the costs allocated to the Company under this Agreement.

5. Obligations Not Joint. AWCC and the Company expressly agree: (a) that the obligations of the Company and each Co-Participant to AWCC are several and not joint; (b) that the Company will not be responsible to any Co-Participant, to AWCC or to any assignee or creditor of AWCC for any payment in excess of payments due by the Company to AWCC under this Agreement or a Note in the form attached to this Agreement; and (c) that no Co-Participant will be responsible to the Company, to any other Co-Participant, to AWCC or to any assignee or creditor of AWCC for any payment in excess of payments due by that Co-Participant to AWCC under any agreement substantially similar to this Agreement or under any Note attached to that other agreement. AWCC covenants and agrees that it will require, as a condition to its entering into any such other agreement with a Co-Participant, that such other agreement contains the same provision as that contained in the immediately preceding sentence.

6. Notes. The Company's borrowings under this Agreement will be evidenced by one or more promissory notes in the form of Exhibit A or Exhibit B attached to this Agreement.

7. Non-Exclusivity. Nothing in this Agreement prohibits or restricts the Company from borrowing from third parties, or obtaining services described in this Agreement from third parties, whenever and on whatever terms it deems appropriate.

8. Effectiveness. This Agreement shall be effective as of June 15, 2000, provided that, if prior approval by the regulatory commission of any jurisdiction is required before this Agreement may become effective as to the Company, or before AWCC may provide a particular service hereunder to the Company, this Agreement shall not be effective as to the Company or as to that service, as the case may be, unless and until the required approval has been obtained. Unless and until this Agreement becomes effective as to the Company in whole or in part, the Company shall not be entitled to the benefits of, nor shall it have any rights or duties under, this Agreement. This Agreement may be amended or rescinded only by written instrument signed by the Company and AWCC.

9. Termination. The Company may terminate its participation in this Agreement by giving ten (10) days prior written notice of such termination to AWCC; and (b) AWCC may terminate this Agreement by giving ninety (90) days prior written notice of such termination to the Company. Termination of this Agreement will not affect: (a) the Company's obligations under any Promissory Notes; (b) any party's obligations with respect to any amounts owing under Sections 2 and 3 of this Agreement (including such amounts attributable to obligations of any terminating party under any Promissory Notes that remain outstanding after this Agreement is terminated as to that party); or (c) AWCC's obligations to repay any investments made by a Company pursuant to Appendix I.

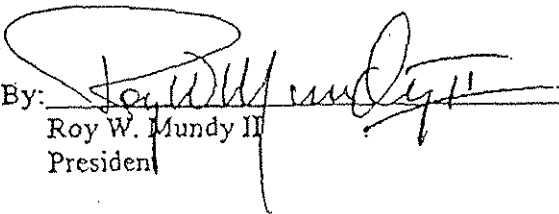
10. Copies. This Agreement may be executed by the parties in one or more copies and each executed copy shall be considered an original.

In witness of the foregoing, each of the Company and AWCC has caused its respective corporate seal to be affixed to this Agreement and has caused this Agreement to be signed on its behalf by its duly authorized officers.

ATTEST:

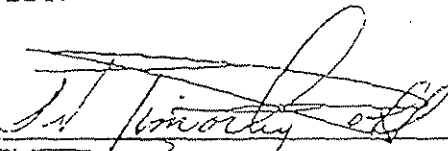
KENTUCKY-AMERICAN WATER COMPANY

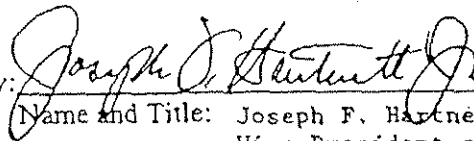
By: 
Herbert A. Miller, Jr.
Secretary

By: 
Roy W. Mundy II
President

ATTEST:

AMERICAN WATER CAPITAL CORP.

By: 
Title: W. Timothy Pohl
Vice President and Secretary

By: 
Name and Title: Joseph F. Hartnett, Jr.
Vice President and Treasurer

APPENDIX I

DESCRIPTION OF FINANCIAL SERVICES

Set forth below is a list of the services which AWCC agrees to provide to the Company upon its request pursuant to the Agreement to which this Appendix is attached.

1. Short-Term Loans. AWCC will provide Short-Term Loans to the Company pursuant to the terms set forth in the promissory notes to be issued by the Company to AWCC, each substantially in the form attached to this Agreement as Exhibit A.
2. Long-Term Borrowings. AWCC will provide loans other than Short-Term Loans to the Company pursuant to the terms set forth in the promissory notes to be issued by the Company to AWCC, each substantially in the form attached hereto as Exhibit B.
3. Cash Management. Cash not required by the Company to pay its daily disbursements or to pay when due the principal of and interest on, the Company's borrowings from AWCC other than Short-Term Loans will be used by AWCC first to reduce the outstanding principal balance of the Company's Short-Term Loans owing to AWCC and any excess will be deemed to be invested with AWCC and will earn a daily rate of interest that is equal to the interest income earned by AWCC on those funds. Upon the request of that Company, AWCC shall execute one or more promissory notes in favor of the Company, in form and substance substantially similar to the Promissory Note attached as Exhibit A to the Agreement as evidence of such investment.

EXHIBIT A
PROMISSORY NOTE
FOR SHORT-TERM LOANS

\$ _____, 2000

FOR VALUE RECEIVED, [NAME OF COMPANY], a _____ corporation (herein "Borrower") hereby promises to pay ON DEMAND to the order of American Water Capital Corp., a Delaware corporation ("Lender"), in same day funds at its offices at Voorhees, New Jersey or such other place as Lender may from time to time designate, the principal sum of _____ dollars (\$ _____) (the "Maximum Principal Sum"), or such lesser amount as shall equal the aggregate unpaid principal amount of the loans made by Lender to Borrower (other than loans evidenced by a promissory note under which the principal amount is due and payable in one or more scheduled installments more than one year after the date of its issue), together with interest thereon from the date hereof until paid in full. Interest will be charged on the unpaid outstanding principal balance of this Note at a rate per annum equal to Lender's actual cost of funds to make such loan, such rate to change as Lender's actual cost of funds changes. Interest on borrowings shall be due and payable on the first business day of each month, commencing with the first business day of the month after the month in which this Note is executed. In the absence of manifest error, the records maintained by Lender of the amount and term, if any, of borrowings hereunder shall be deemed conclusive.

Borrower may borrow, repay and reborrow hereunder in amounts which do not, in the aggregate outstanding at any time, exceed the Maximum Principal Sum.

The occurrence of one or more of any of the following shall constitute an event of default hereunder:

(a) Borrower shall fail to make any payment of principal and/or interest due hereunder or under any other promissory note between Lender and Borrower within five business days after the same shall become due and payable, whether at maturity or by acceleration or otherwise;

(b) Borrower shall apply for or consent to the appointment of a receiver, trustee or liquidator of itself or any of its property, admit in writing its inability to pay its debts as they mature, make a general assignment for the benefit of creditors, be adjudicated a bankrupt or insolvent or file a voluntary petition in bankruptcy or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any bankruptcy, reorganization, insolvency, readjustment of debt, dissolution or liquidation of law or statute, or an answer admitting the material allegations of a petition filed against it in any proceeding under any such law, or if action shall be taken by Borrower for the purposes of effecting any of the foregoing; or

(c) Any order, judgment or decree shall be entered by any court of competent jurisdiction, approving a petition seeking reorganization of Borrower or all or a substantial part of the assets of Borrower, or appointing a receiver, trustee or liquidator of

Borrower or any of its property, and such order, judgment or decree shall continue unstayed and in effect for any period of sixty (60) days.

Upon the occurrence of any event of default, the entire unpaid principal sum hereunder plus all interest accrued thereon plus all other sums due and payable to Lender hereunder shall, at the option of Lender, become due and payable immediately. In addition to the foregoing, upon the occurrence of any event of default, Lender may forthwith exercise singly, concurrently, successively or otherwise any and all rights and remedies available to Lender by law, equity, statute or otherwise.

Borrower hereby waives presentment, demand, notice of nonpayment, protest, notice of protest or other notice of dishonor in connection with any default in the payment of, or any enforcement of the payment of, all amounts due hereunder. To the extent permitted by law, Borrower waives the right to any stay of execution and the benefit of all exemption laws now or hereafter in effect.

Following the occurrence of any event of default, Borrower will pay upon demand all costs and expenses (including all amounts paid to attorneys, accountants, and other advisors employed by Lender), incurred by Lender in the exercise of any of its rights, remedies or powers hereunder with respect to such event of default, and any amount thereof not paid promptly following demand therefor shall be added to the principal sum hereunder and will bear interest at the contract rate set forth herein from the date of such demand until paid in full. In connection with and as part of the foregoing, in the event that this Note is placed in the hands of an attorney for the collection of any sum payable hereunder, Borrower agrees to pay reasonable attorneys' fees for the collection of the amount being claimed hereunder, as well as all costs, disbursements and allowances provided by law.

If for any reason one or more of the provisions of this Note or their application to any entity or circumstances shall be held to be invalid, illegal or unenforceable in any respect or to any extent, such provisions shall nevertheless remain valid, legal and enforceable in all such other respects and to such extent as may be permissible. In addition, any such invalidity, illegality or unenforceability shall not affect any other provisions of this Note, but this Note shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

This Note inures to the benefit of Lender and binds Borrower and Lender's and Borrower's respective successors and assigns, and the words "Lender" and "Borrower" whenever occurring herein shall be deemed and construed to include such respective successors and assigns.

This Promissory Note is one of the promissory notes referred to in the Financial Services Agreement dated as of June 15, 2000 between Borrower and Lender to which reference is made for a statement of additional rights and obligations of the parties hereto.

IN WITNESS WHEREOF, Borrower has executed this Promissory Note the day and year first written above.

[BORROWER]

By: _____
Name and Title:

EXHIBIT B
PROMISSORY NOTE
FOR LONG-TERM BORROWINGS

§ _____, 2000

FOR VALUE RECEIVED, [NAME OF COMPANY], a _____ corporation (herein "Borrower") hereby promises to pay to the order of American Water Capital Corp., a Delaware corporation ("Lender"), in same day funds at its offices at _____ or such other place as Lender may from time to time designate, the principal sum of _____ dollars (\$ _____), together with interest thereon from the date hereof until paid in full. Interest shall be charged on the unpaid outstanding principal balance hereof at a rate per annum equal to the rate paid and to be paid by Lender with respect to the borrowings it made in order to provide funds to Borrower hereunder. Interest on borrowings shall be due and payable in immediately available funds on the same business day on which the Lender must pay interest on the borrowings it made in order to provide funds to the Borrower hereunder. The principal amount hereof shall be due and payable hereunder at such times and in such amounts and in such installments hereunder as the Lender must pay with respect to the borrowings it made in order to provide funds to the Borrower hereunder. Lender has provided Borrower with a copy of the documentation evidencing the borrowings made by Lender in order to provide funds to Borrower hereunder. In the absence of manifest error, such documentation and the records maintained by Lender of the amount and term, if any, of borrowings hereunder shall be deemed conclusive.

The occurrence of one or more of any of the following shall constitute an event of default hereunder:

(a) Borrower shall fail to make any payment of principal and/or interest due hereunder or under any other promissory note between Lender and Borrower within five business days after the same shall become due and payable, whether at maturity or by acceleration or otherwise;

(b) Borrower shall apply for or consent to the appointment of a receiver, trustee or liquidator of itself or any of its property, admit in writing its inability to pay its debts as they mature, make a general assignment for the benefit of creditors, be adjudicated a bankrupt or insolvent or file a voluntary petition in bankruptcy or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any bankruptcy, reorganization, insolvency, readjustment of debt, dissolution or liquidation of law or statute, or an answer admitting the material allegations of a petition filed against it in any proceeding under any such law, or if action shall be taken by Borrower for the purposes of effecting any of the foregoing; or

(c) Any order, judgment or decree shall be entered by any court of competent jurisdiction, approving a petition seeking reorganization of Borrower or all or a substantial part of the assets of Borrower, or appointing a receiver, trustee or liquidator of Borrower or any of its property, and such order, judgment or decree shall continue unstayed and in effect for any period of sixty (60) days.

Upon the occurrence of any event of default, the entire unpaid principal sum hereunder plus all interest accrued thereon plus all other sums due and payable to Lender hereunder shall, at the option of Lender, become due and payable immediately. In addition to the foregoing, upon the occurrence of any event of default, Lender may forthwith exercise singly, concurrently, successively or otherwise any and all rights and remedies available to Lender by law, equity, statute or otherwise.

Borrower hereby waives presentment, demand, notice of nonpayment, protest, notice of protest or other notice of dishonor in connection with any default in the payment of, or any enforcement of the payment of, all amounts due hereunder. To the extent permitted by law, Borrower waives the right to any stay of execution and the benefit of all exemption laws now or hereafter in effect.

Following the occurrence of any event of default, Borrower will pay upon demand all costs and expenses (including all amounts paid to attorneys, accountants, and other advisors employed by Lender), incurred by Lender in the exercise of any of its rights, remedies or powers hereunder with respect to such event of default, and any amount thereof not paid promptly following demand therefor shall be added to the principal sum hereunder and will bear interest at the contract rate set forth herein from the date of such demand until paid in full. In connection with and as part of the foregoing, in the event that this Note is placed in the hands of an attorney for the collection of any sum payable hereunder, Borrower agrees to pay reasonable attorneys' fees for the collection of the amount being claimed hereunder, as well as all costs, disbursements and allowances provided by law.

If for any reason one or more of the provisions of this Note or their application to any entity or circumstances shall be held to be invalid, illegal or unenforceable in any respect or to any extent, such provisions shall nevertheless remain valid, legal and enforceable in all such other respects and to such extent as may be permissible. In addition, any such invalidity, illegality or unenforceability shall not affect any other provisions of this Note, but this Note shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

This Note inures to the benefit of Lender and binds Borrower and Lender's and Borrower's respective successors and assigns, and the words "Lender" and "Borrower" whenever occurring herein shall be deemed and construed to include such respective successors and assigns.

This Promissory Note is one of the promissory notes referred to in the Financial Services Agreement dated as of June 15, 2000 between Borrower and Lender to which reference is made for a statement of additional rights and obligations of Lender and Borrower.

IN WITNESS WHEREOF, Borrower has executed this Promissory Note the day and year first written above.

[BORROWER]

By: _____
Name and Title:

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF)
KENTUCKY-AMERICAN WATER)
COMPANY FOR APPROVAL OF) CASE NO. 2000-189
PARTICIPATION IN)
BORROWING PROGRAM)

O R D E R

On May 5, 2000, Kentucky-American Water Company ("Kentucky-American") filed an application for Commission approval to participate in a borrowing program. This program has been made available to Kentucky-American through its parent corporation, American Water Works Company, Inc. ("American Water Works"). As a participant in the program, Kentucky-American must enter into a Financial Services Agreement with American Water Works Financing Corporation. On May 12, 2000, Kentucky-American amended its application to reflect the change in the name of American Water Works Financing Corporation to American Water Capital Corporation ("AWCC").

Kentucky-American seeks to enter into this agreement in conjunction with each of American Water Works' subsidiaries as well as American Water Works. It is anticipated that AWCC could obtain more advantageous funding for the individual participants by utilizing the borrowing power and combined borrowing efficiency of all of the participants in the borrowing program.

AWCC, a wholly owned subsidiary of American Water Works, will obtain its funds primarily from two sources. It will arrange for a syndicated bank credit line to provide short-term loans and it will register its own debt securities for sale in the public market by filing a shelf registration with the United States Securities and Exchange Commission. Based on estimated borrowing requirements provided by each program participant for the coming year as well as future needs, AWCC will arrange borrowing commitments and borrowing programs to provide funds necessary to meet those requirements.¹

As a participant in the borrowing program, Kentucky-American will obtain short-term and long-term loans from AWCC. Kentucky-American expects to periodically issue, prior to December 31, 2005, securities in the form of notes or debentures for the purpose of refunding/refinancing certain outstanding debt in the aggregate principal amount of \$41,500,000. Kentucky-American also intends to borrow funds from AWCC to finance its construction program and the acquisition of other utility systems.

The Commission, having reviewed the evidence of record and being otherwise sufficiently advised, finds that:

1. Kentucky-American's entry into the Financial Services Agreement and participation in the borrowing program with AWCC is for a lawful object within the corporate purposes of its utility operation, is necessary and appropriate for and consistent with the

¹ For a complete description of the financial arrangements between AWCC and the American Water Works subsidiaries who are parties to the Financial Services Agreement and who participate in the borrowing program and the benefits that these arrangements confer, see Illinois-American Water Company, Docket No. 00-0306 (Ill. C.C. May 18, 2000) at 2-5.

proper performance of the utility's service to the public and will not impair its ability to perform that service, and is reasonable, necessary, and appropriate for such purposes.

2. Kentucky-American's proposed issuance of securities in the form of notes or debentures in an aggregate amount of \$41,500,000 for the purpose of refunding/refinancing existing short-term and long-term debt is reasonable and consistent with the performance of its service to the public and should be approved.

3. The specific terms and conditions of each issuance under the borrowing program set forth in the Agreement are not known at this time. Therefore, Kentucky-American should be required to inform the Commission of the terms and conditions of each issuance covered by the borrowing program.

4. Kentucky-American should obtain Commission approval prior to the issuance of any security or long-term evidence of indebtedness not specifically set forth in its application and included in the \$41,500,000 refunding/refinancing.

IT IS THEREFORE ORDERED that:

1. Kentucky-American is authorized to enter into the Financial Services Agreement with AWCC and to participate in its borrowing program.

2. Kentucky-American is authorized to issue securities in the form of notes or debentures in an aggregate amount of \$41,500,000 from time to time prior to December 31, 2005 for the purpose of refunding/refinancing existing short-term and long-term debt.

3. The proceeds from the financing authorized herein shall be used only for the lawful purposes set out in the application.

4. For all securities or evidences of indebtedness that have a term exceeding 2 years and that are issued under the Financial Services Agreement's borrowing program, Kentucky-American shall file a report detailing the terms and conditions of the particular securities issued. Kentucky-American shall include an analysis showing that the interest rate for the securities was the most reasonable under the circumstances at the time of issuance. This report shall be filed with the Commission within 10 days of the completion of the issuance.

5. Kentucky-American shall obtain approval from the Commission prior to the issuance of any security or long-term evidence of indebtedness not specifically identified in its application and included in the \$41,500,000 refunding/refinancing approved herein.

Nothing contained herein shall be deemed a warranty of the Commonwealth of Kentucky, or any agency thereof, of the financing herein accepted.

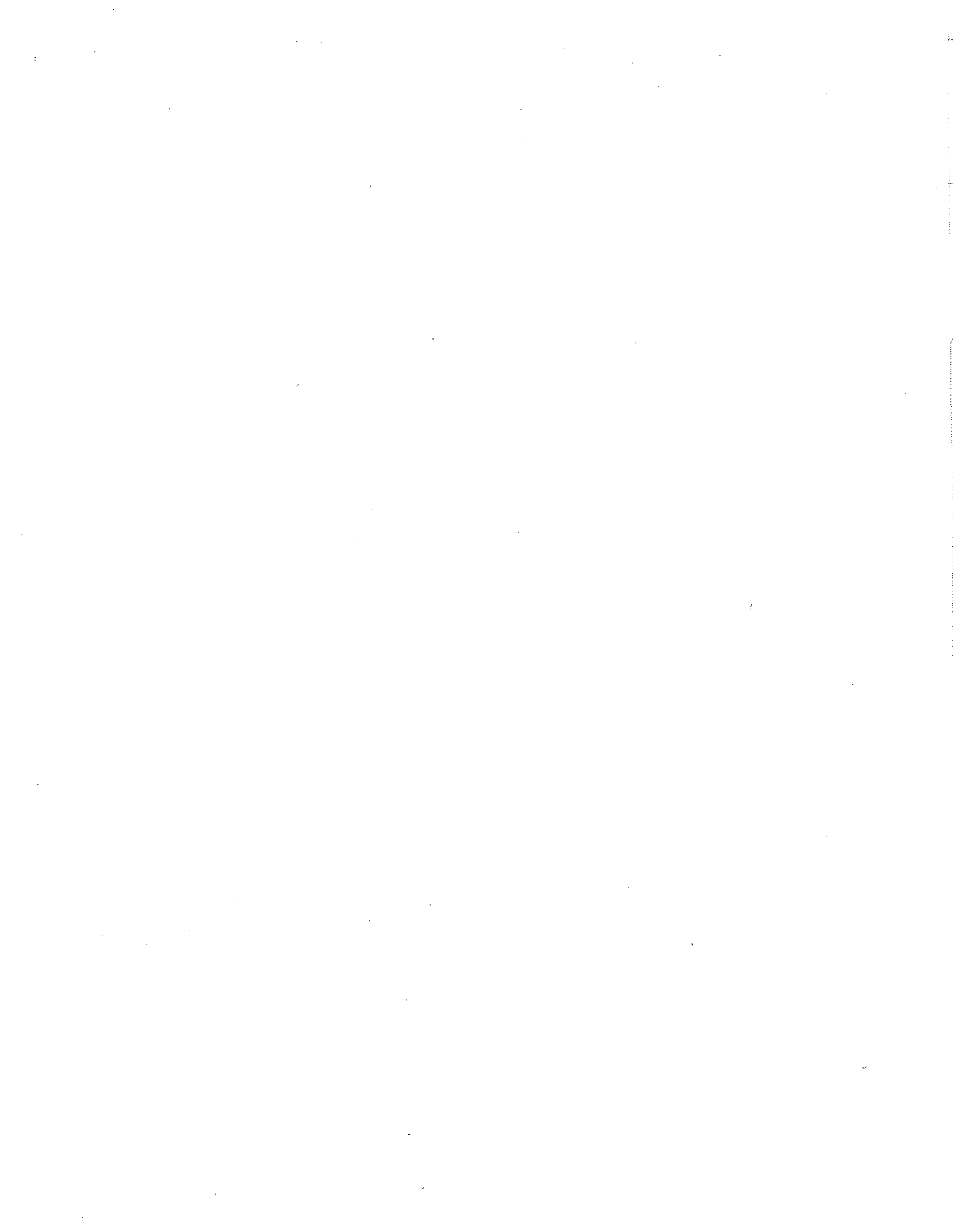
Done at Frankfort, Kentucky, this 21st day of July, 2000.

By the Commission

ATTEST:

W. H. Bowen
Executive Director

nty



**FINANCIAL STATEMENT
OF
KENTUCKY-AMERICAN WATER COMPANY**

(as of December 31, 2006 except where noted)

(1) The amount and kinds of stock of the Applicant authorized are as follows:

Cumulative Preferred Stock, par value \$100 per share:

Series B, 5 - $\frac{3}{4}$ %	5,000 Shares
Series C, 5 - $\frac{1}{2}$ %	5,000 Shares
Series D, 5%	6,000 Shares
Unclassified	5,000 Shares

Preference Stock, par value \$100 per share:

8.47% Series	45,000 Shares
Unclassified	85,000 Shares

Common Stock, no par value 2,000,000 Shares

(2) The amounts and kinds of stock of the Applicant issued and outstanding as of December 31, 2006 are as follows:

Cumulative Preferred Stock, par value \$100 per share:

Series B, 5 - $\frac{3}{4}$ %	3,918 Shares
Series C, 5 - $\frac{1}{2}$ %	4,889 Shares
Series D, 5%	5,866 Shares

Preference Stock, par value \$100 per share:

8.47% Series	45,000 Shares
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Common Stock, no par value 1,567,391 Shares

(3) The Cumulative Preferred Stock is cumulative as to dividends. If dividends on the Cumulative Preferred Stock shall be in arrears and such arrears shall aggregate an amount equal to or in excess of four (4) quarterly dividends upon such stock, the number of directors then constituting the Board of

Directors shall be increased by two (2) and the holders of the Preferred Stock voting separately as a class shall be entitled to elect the two (2) additional directors.

The Cumulative Preferred Stock is redeemable at any time upon thirty (30) days' notice at the following prices: the Series B at \$101 per share; the Series C at \$100.50 per share; and the Series D at \$100.

The Cumulative Preferred Stock, Series B, Series C and Series D are redeemable at par (\$100) in cases of (a) governmental or municipal acquisition of the Applicant's facilities or common stock, or (b) upon liquidation or dissolution of the Applicant.

The Preference Stock is cumulative as to dividends. If dividends on the Preference Stock shall be in arrears and such arrears shall aggregate an amount equal to or in excess of eight (8) quarterly dividends upon such stock, the number of directors then constituting the Board of Directors shall be increased by one (1) and the holders of the Preference Stock voting separately as a class shall be entitled to elect the one (1) additional director.

The shares of the 8.47% Preference Stock may be redeemed at any time, or from time to time, on or after December 1, 2001 at the option of the Company, in whole or in part, upon payment of a redemption price equal to the sum of \$100 per share plus a premium equal to the Make-Whole Premium as defined in the Articles of Incorporation.

At any time during the period of twelve (12) consecutive calendar months beginning on December 1, 2011 and ending November 30, 2012, both dates inclusive, and during each like period of twelve (12) consecutive calendar months thereafter so long as any shares of the 8.47% Series remain outstanding, the Company may at its option redeem up to and including, but not exceeding, four thousand five hundred (4,500) shares of the 8.47% Series at a redemption price equal to the sum of \$100 per share.

All then outstanding shares of the 8.47% Series shall be redeemed by the Company on December 1, 2036 at a redemption price equal to the sum of \$100 per share.

(4) The following are the only mortgages on the property of the Applicant:

General Mortgage Indenture dated as of May 1, 1968, executed by the Applicant to The Fidelity Bank (now US Bank), as Trustee, and supplemental indentures thereto dated as of December 1, 1970 (as supplemented on

December 17, 1970); September 1, 1974; November 1, 1977; December 1, 1982; June 1, 1983; August 1, 1985; January 1, 1987; September 1, 1988; October 1, 1989; November 1, 1990; December 1, 1991; December 1, 1992; December 1, 1993; September 1, 1995; February 1, 1997, and June 1, 1998.

The Indenture of Mortgage provides for the issue of General Mortgage Bonds which together with all other long-term debt cannot exceed 65% of Applicants total capitalization, which percentage is \$104,418,855 as of August 25, 2006. The amount of indebtedness actually secured by a lien on all the property owned or hereafter acquired by the Company is \$23,500,000. There are no sinking fund provisions associated with the General Mortgage Bonds.

- (5) At December 31, 2006, \$23,500,000 in General Mortgage Bonds were issued and outstanding.

General Mortgage Bonds:

Principal amount authorized by Indenture:

No maximum limit of bonds fixed

Name of utility issuing bonds:

All bonds were issued by Kentucky-American Water Company

Principal amount issued and outstanding:

GMB:	<u>Issued</u>	<u>Outstanding</u>
6.96% Series	\$ 7,000,000	\$ 7,000,000
7.15% Series	7,500,000	7,500,000
6.99% Series	9,000,000	9,000,000

Date of issue (nominal date):

6.96% Series	December 22, 1993
7.15% Series	February 20, 1997
6.99% Series	June 17, 1998

Rate of interest:

6.96% Series	6.96%
7.15% Series	7.15%
6.99% Series	6.99%

Date of maturity:

6.96% Series	December 1, 2023
7.15% Series	February 1, 2027
6.99% Series	June 1, 2008

Security: All outstanding General Mortgage Bonds are secured by the lien of the General Mortgage Indenture upon all property of the Company.

Interest paid during the 12 months ended December 31, 2006

6.96% Series	\$487,000.00
7.15% Series	\$536,250.00
6.99% Series	\$629,100.00

(6) Notes are payable to AWCC, bear interest as listed below.

<u>Payee</u>	<u>Date of Issue</u>	<u>Interest Rate*</u>	<u>12/31/06 Amount Outstanding</u>	<u>Maturity Date</u>	<u>Interest paid 12 mos. ended 12/31/06</u>
AWCC	January 1, 2006	Variable	\$3,297,056	Revolver	\$408,695

* Interest is calculated at the LIBOR market index rate.

<u>Payee</u>	<u>Date of Issue</u>	<u>Interest Rate*</u>	<u>12/31/06 Amount Outstanding</u>	<u>Maturity Date</u>	<u>Interest paid 12 mos. ended 12/31/06</u>
AWCC	June 12, 2002	5.65%	\$24,000,000	June 12, 2007	\$1,356,000
AWCC	March 29, 2001	6.87%	\$15,500,000	March 29, 2011	\$1,064,850
AWCC	March 1, 2004	4.75%	\$14,000,000	March 1, 2014	\$665,000

(7) There is no other indebtedness of the Applicant, but there are liabilities shown on its Balance Sheet annexed hereto and marked "Amended Exhibit 3, page 7" consisting of, as of December 31, 2006, current and accrued items on which no interest is payable.

(8) Dividends were paid by the Applicant during the five fiscal years as follows:

Common Stock

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
2002	\$ 3.01	1,567,391	\$ 4,717,847
2003	2.17	1,567,391	3,401,238
2004	1.22	1,567,391	1,912,217
2005	1.10	1,567,391	1,724,130
2006	1.28	1,567,391	2,006,260

Cumulative Preferred Stock, Series B, 5 – ¾%

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
2002	\$ 5.75	4,700	\$ 27,025
2003	5.75	4,642	26,692
2004	5.75	4,642	26,692
2005	5.75	3,918	22,529
2006	5.75	3,918	22,529

Cumulative Preferred Stock, Series B, 5 – ½%

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
2002	\$ 5.50	5,000	\$ 27,500
2003	5.50	4,947	27,209
2004	5.50	4,947	27,209
2005	5.50	4,889	26,890
2006	5.50	4,883	26,890

Cumulative Preferred Stock, Series D, 5%

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
2002	5.00	6,000	\$ 30,000
2003	5.00	5,939	29,695
2004	5.00	5,896	29,480
2005	5.00	5,866	29,330
2006	5.00	5,861	29,330

Preference Stock, 8.47% Series

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
2002	8.47	45,000	\$ 381,150
2003	8.47	45,000	381,150
2004	8.47	45,000	381,150
2005	8.47	45,000	381,150
2006	8.47	45,000	381,150

- (9) Applicant's Balance Sheet as of December 31, 2006 and a statement of Applicant's earnings and expenses for the twelve months ended on such date are shown on pages 7 and 8, respectively, which are annexed hereto.

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American Water Works Company
Kentucky-American Water-00 12
Total Company (USGAAP)
Comparative Balance Sheet
For the Period Ending 12/31/2006

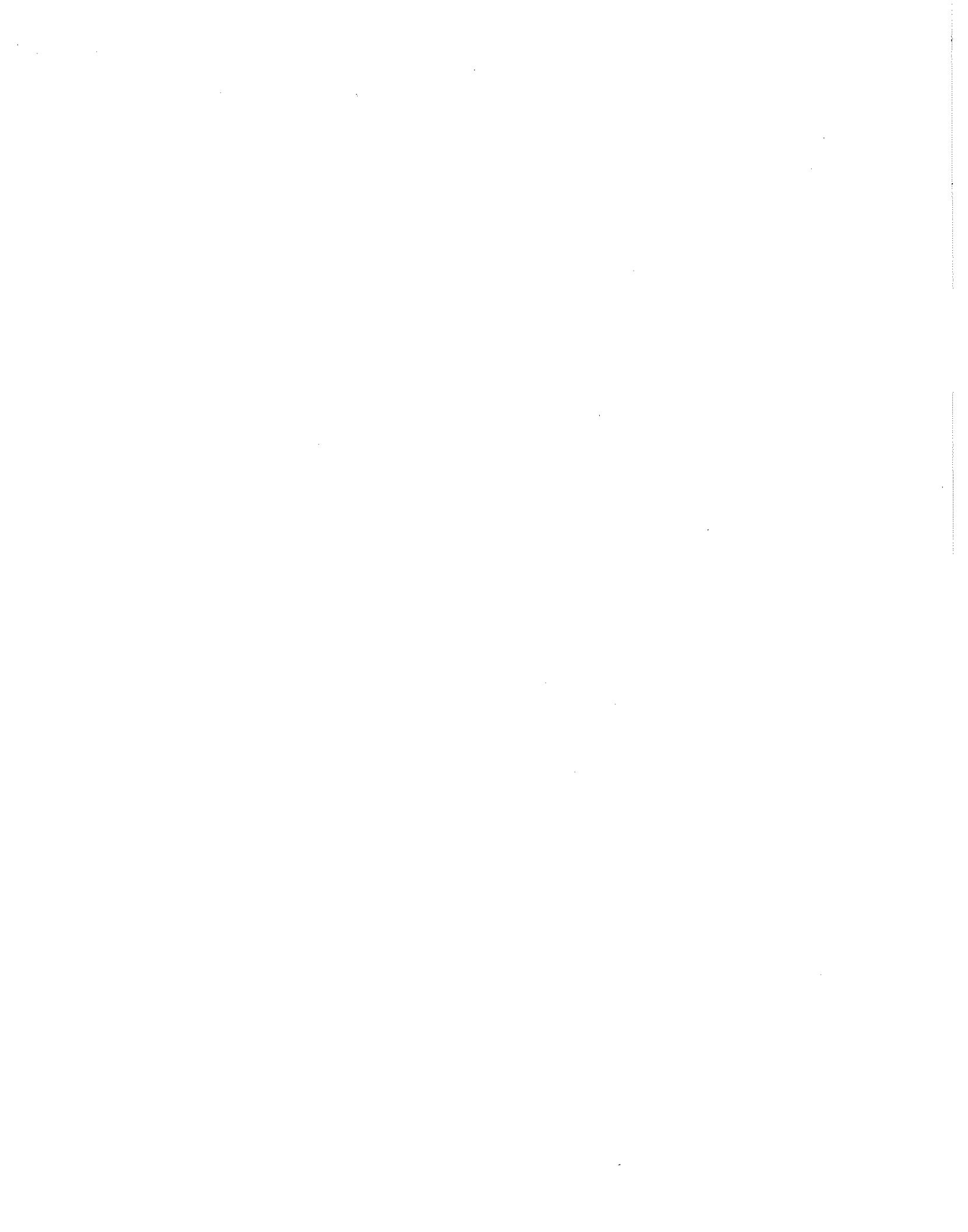
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Kentucky-American Water Co.

ASSETS	Description	Current Year	Prior Year
1	Utility plant	377,533,086	303,733,315
2	Construction work in progress	11,775,396	11,475,985
3	Accumulated depreciation	75,828,389	58,858,790
4	Utility plant acquisition adjustment	75,347,966	58,338,485
5	Other utility plant adjustments		
6	Sub-total Utility Plant	263,788,012	246,609,415
7	Non-Utility property	249,738	249,738
8	Other investments		
Current Assets			
9	Cash and cash equivalents	904,169	840,222
10	Temporary investments	2,453,029	3,428,301
11	Accounts receivable	510,924	4,258,293
12	Accounts receivable - collectible accounts	2,098,177	2,122,198
13	Unbilled revenues	4,603,960	2,590,576
14	Prepaid expenses	515,515	421,930
15	Prepaid income tax	265,971	261,361
16	Miscellaneous receivables		
17	Materials and supplies		
18	Other		
19	Sub-total	11,088,008	11,982,286
20	Deferred debits		
21	Debt and preferred stock	463,792	535,655
22	Expense of rate proceeding	421,207	782,497
23	Rate of return survey & invest charges	125,657	136,963
24	Other	5,183,484	5,897,357
25	Asset-income tax recovery		
26	Other		
27	Sub-total	12,603,610	13,618,425
28	Total Assets	287,729,368	272,459,864
CAPITAL AND LIABILITIES			
29	Common Stock	36,568,777	36,568,777
30	Retained Earnings	8,056,319	56,139
31	Unearned Compensation	29,756,141	27,082,028
32	Reacquired C/S & Accum		
33	Comp Inc		
34	Total common equity	74,381,237	63,706,944
35	Preferred stock	1,466,100	1,468,700
36	Long term debt	54,400,000	81,500,000
37	Total capitalization	130,247,337	146,675,644
38	Current liabilities		
39	Bank debt	3,297,056	7,992,103
40	Current portion of LTD	27,100,000	5,350,141
41	Accounts Payable	7,291,797	2,549,648
42	Taxes accrued	7,996,057	1,365,851
43	Interest accrued	611,746	6,560
44	Customer deposits		
45	Dividends declared		
46	Other		
47	Sub-total	5,699,322	6,025,034
48	Total Liabilities	51,995,978	23,290,337
49	Sub-total		
50	Deferred credits		
51	Customer adv. for construction	16,492,638	16,448,419
52	Deferred income taxes	34,386,753	36,293,243
53	Deferred investment tax credits	1,302,648	1,365,134
54	Reg. liab.-inc. tax.refund thru rates	10,470,383	8,680,469
55	Other	2,998,399	4,024,810
56	Sub-total	65,650,821	66,812,075
57	Contributions in aid of construction	39,835,232	35,681,810
58	Total capital and liabilities	287,729,368	272,459,866

Kentucky-American Water Co.

Description	December Actual	December Plan	December Variance	December Prior Year	Yc to Date Actual	Yc to Date December Plan	Yc to Date Variance	Yr to Date December prior Year	Annual Forecast
OPERATING REVENUES									
1 Water	3,592,545	4,090,159	490,605	3,567,695	46,795,023	49,309,002	2,513,979	48,260,315	49,109,002
2 Sewer	76,285	2,436	2,436	20,358	302,692	352,692	50,000	123,350	352,692
4 Other	145,819	145,819	186	139,375	1,912,432	1,747,596	164,836	1,735,954	1,747,596
5 Management									
TOTAL REVENUES	3,772,319	4,265,174	492,855	3,727,318	49,010,147	51,409,290	2,399,143	50,119,619	51,409,290
OPERATIONS & MAINTENANCE EXPENSE									
8 Labor	446,956	437,132	9,824	484,630	5,170,895	5,156,940	13,945	4,706,772	5,156,940
9 Purchased Water	38,130	41,750	3,620	31,020	505,636	516,126	10,490	481,098	516,126
10 Gas & Power	247,965	211,800	36,165	169,375	2,638,270	2,127,630	510,640	2,385,918	2,127,630
11 Waste Disposal	95,161	130,967	35,806	131,750	1,495,887	1,348,517	147,370	1,282,090	1,348,517
12 Management Fees	141,928	15,480	126,448	13,047	324,447	253,117	71,330	5,912,684	253,117
13 Group Insurance	716,927	521,000	195,927	762,487	6,612,414	6,254,000	358,414	5,912,684	6,254,000
14 Pensions	129,059	153,599	24,540	139,429	1,644,303	1,824,563	180,260	1,608,316	1,824,563
15 Regulatory Expense	38,066	67,008	28,942	66,340	748,274	804,072	55,798	782,335	804,072
16 Insurance Other Than Group	105,003	41,821	63,182	30,091	370,067	351,412	18,655	320,004	351,412
17 Customer Accounting	101,070	96,512	4,558	96,512	1,399,605	1,160,838	238,767	1,377,865	1,160,838
18 Rent	24,028	3,756	20,272	13,372	649,162	649,162	0	464,344	649,162
19 General Office Expense	58,178	26,421	31,757	52,237	45,072	45,072	0	60,506	45,072
20 Miscellaneous	349,016	165,346	183,670	1,018,444	2,931,012	2,229,239	701,773	913,427	2,229,239
21 Other Maintenance	199,679	70,511	129,168	1,224,793	2,284,873	1,748,184	536,689	3,940,664	2,284,873
TOTAL MAINTENANCE & OPERATIONS EXPENSE	2,768,908	2,012,471	756,437	3,768,839	27,295,475	24,412,728	2,882,747	26,852,111	24,412,728
27 Depreciation	618,619	626,522	7,903	655,718	6,746,503	7,139,261	392,758	5,813,673	7,139,261
28 Amortization	40,427	22,507	17,920	48,477	459,264	486,084	26,820	486,084	486,084
29 General Taxes	21,659	22,507	848	319,287	2,860,457	2,721,809	138,648	2,736,877	2,721,809
30 State Income Taxes	13,121	79,282	65,161	58,640	123,297	123,297	0	863,928	123,297
31 Federal Income Taxes	1,098,684	293,687	804,997	868,611	1,353,830	3,568,510	2,214,680	1,081,477	3,568,510
32 Tax Savings Acquisition Adjustment									
TOTAL OPERATING EXPENSES	2,320,782	3,279,768	958,976	4,536,865	38,808,926	39,535,617	726,691	39,581,949	39,535,617
34 Utility Operating Income	1,452,527	985,406	467,121	809,527	10,201,321	11,873,673	1,672,352	10,537,678	11,873,673
OTHER INCOME & DEDUCTIONS									
35 Non-Operating Rental Income	2,213	17,273	2,213	45,571	2,213	175,832	2,213	346,533	175,832
37 Dividend Income-Common	15,815	10,233	5,582	337	273,684	66,058	186,376	20,772	66,058
38 Dividend Income-Preferred	54,434		54,434						
39 Interest Income									
40 AFUDC Equity									
42 M & J Miscellaneous Income									
43 Gain/Loss on Disposition									
TOTAL OTHER INCOME	36,406	27,506	8,900	44,634	145,579	241,890	26,311	367,305	241,890
45 Miscellaneous Income	35	54	19		531	768	1,299		768
46 Miscellaneous Acquisitions									
47 Tax Savings Acquisition Adjustment									
48 Misc. Other Deductions	4,929	2,033	2,896	8,770	278,501	280,419	1,918	330,320	280,419
49 General Taxes	5,513	263	5,250	22,509	28,426	23,044	5,382	22,229	23,044
50 State Income Taxes	27,562	1,427	26,135	112,944	142,126	89,708	52,418	111,145	89,708
51 Federal Income Taxes	28,161	3,387	24,774	126,763	107,418	169,435	61,017	204,954	169,435
TOTAL OTHER DEDUCTIONS	8,225	24,119	15,894	171,397	38,161	21,455	16,706	162,351	21,455
52 Total Other Income	1,443,302	1,009,529	433,773	630,130	10,239,482	11,947,128	1,707,646	10,700,021	11,947,128
54 Income Before Interest Charges	418,134	394,067	24,067	426,629	5,111,245	4,739,404	371,841	5,368,517	4,739,404
55 INTEREST CHARGES	6,073	6,009	64	6,073	72,873	72,108	765	77,198	72,108
56 Interest on Long-Term Debt	37,878	57,435	19,557	37,156	408,698	625,948	217,250	183,637	625,948
57 Amortization and Debt Expense	2,457	7,844	5,387	5,882	4,102	4,102	0	5,523	4,102
58 Interest-Short Term Bank Debt	2,262		2,262		116,516	75,851	36,665	147,644	75,851
60 AFUDC-Debt									
TOTAL INTEREST CHARGES	462,470	456,467	5,003	450,364	5,460,399	5,356,609	103,790	5,485,231	5,356,609
62 Net Income	980,832	558,058	422,774	1,088,494	4,759,803	6,590,519	1,091,438	5,214,750	6,590,519
64 Preferred Dividend Declared	6,515	38,425	31,910	6,568	78,708	459,900	381,494	75,874	459,900
65 Net Income to Common Stock	974,317	520,733	453,584	1,095,062	4,681,095	6,130,619	1,450,242	5,134,916	6,130,619



PROMISSORY NOTE FOR LONG-TERM BORROWING
Interest Rate - 4.75%; Maturity - March 1, 2014

\$14,000,000.00

March 1, 2004

FOR VALUE RECEIVED, Kentucky – American Water Company, a Kentucky corporation (herein "Borrower") hereby promises to pay to the order of American Water Capital Corp., a Delaware corporation ("Lender"), in same day funds at its offices at Voorhees, NJ or such other place as Lender may from time to time designate, the principal sum of Fourteen Million dollars (\$14,000,000.00), together with interest thereon from the date hereof until paid in full. Interest shall be charged on the unpaid outstanding principal balance hereof at a rate per annum equal to the rate paid and to be paid by Lender with respect to the borrowings it made in order to provide funds to Borrower hereunder. Interest on borrowings shall be due and payable in immediately available funds on the same business day on which the Lender must pay interest on the borrowings it made in order to provide funds to the Borrower hereunder. ~~The principal amount hereof shall be due and payable hereunder at such times and in such amounts and in such installments hereunder as the Lender must pay with respect to the borrowings it made in order to provide funds to the Borrower hereunder.~~ Lender has provided Borrower with a copy of the documentation evidencing the borrowings made by Lender in order to provide funds to Borrower hereunder. In the absence of manifest error, such documentation and the records maintained by Lender of the amount and term, if any, of borrowings hereunder shall be deemed conclusive.

The occurrence of one or more of any of the following shall constitute an event of default hereunder:

(a) Borrower shall fail to make any payment of principal and/or interest due hereunder or under any other promissory note between Lender and Borrower within five business days after the same shall become due and payable, whether at maturity or by acceleration or otherwise;

(b) Borrower shall apply for or consent to the appointment of a receiver, trustee or liquidator of itself or any of its property, admit in writing its inability to pay its debts as they mature, make a general assignment for the benefit of creditors, be adjudicated a bankrupt or insolvent or file a voluntary petition in bankruptcy or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any bankruptcy, reorganization, insolvency, readjustment of debt, dissolution or liquidation of law or statute, or an answer admitting the material allegations of a petition filed against it in any proceeding under any such law, or if action shall be taken by Borrower for the purposes of effecting any of the foregoing; or

(c) Any order, judgment or decree shall be entered by any court of competent jurisdiction, approving a petition seeking reorganization of Borrower or all or a substantial part of the assets of Borrower, or appointing a receiver, trustee or liquidator of Borrower or any of its property, and such order, judgment or decree shall continue unstayed and in effect for any period of sixty (60) days.

Upon the occurrence of any event of default, the entire unpaid principal sum hereunder plus all interest accrued thereon plus all other sums due and payable to Lender hereunder shall, at the option of Lender, become due and payable immediately. In addition to

the foregoing, upon the occurrence of any event of default, Lender may forthwith exercise singly, concurrently, successively or otherwise any and all rights and remedies available to Lender by law, equity, statute or otherwise.

Borrower hereby waives presentment, demand, notice of nonpayment, protest, notice of protest or other notice of dishonor in connection with any default in the payment of, or any enforcement of the payment of, all amounts due hereunder. To the extent permitted by law, Borrower waives the right to any stay of execution and the benefit of all exemption laws now or hereafter in effect.

Following the occurrence of any event of default, Borrower will pay upon demand all costs and expenses (including all amounts paid to attorneys, accountants, and other advisors employed by Lender), incurred by Lender in the exercise of any of its rights, remedies or powers hereunder with respect to such event of default, and any amount thereof not paid promptly following demand therefore shall be added to the principal sum hereunder and will bear interest at the contract rate set forth herein from the date of such demand until paid in full. In connection with and as part of the foregoing, in the event that this Note is placed in the hands of an attorney for the collection of any sum payable hereunder, Borrower agrees to pay reasonable attorneys' fees for the collection of the amount being claimed hereunder, as well as all costs, disbursements and allowances provided by law.

If for any reason one or more of the provisions of this Note or their application to any entity or circumstances shall be held to be invalid, illegal or unenforceable in any respect or to any extent, such provisions shall nevertheless remain valid, legal and enforceable in all such other respects and to such extent as may be permissible. In addition, any such invalidity, illegality or unenforceability shall not affect any other provisions of this Note, but this Note shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

This Note inures to the benefit of Lender and binds Borrower and Lender's and Borrower's respective successors and assigns, and the words "Lender" and "Borrower" whenever occurring herein shall be deemed and construed to include such respective successors and assigns.

This Promissory Note is one of the promissory notes referred to in the Financial Services Agreement dated as of June 15, 2000 between Borrower and Lender to which reference is made for a statement of additional rights and obligations of Lender and Borrower.

IN WITNESS WHEREOF, Borrower has executed this Promissory Note the day and year first written above.

Kentucky – American Water Company

By: Michael A. Miller V.P. Finance
Name and Title:

**FINANCIAL STATEMENT
OF
KENTUCKY-AMERICAN WATER COMPANY**

(as of December 12, 2003 except where noted)

(1) The amount and kinds of stock of the Applicant authorized are as follows:

Cumulative Preferred Stock, par value \$100 per share:

Series B, 5 - $\frac{3}{4}$ %	5,000 Shares
Series C, 5 - $\frac{1}{2}$ %	5,000 Shares
Series D, 5%	6,000 Shares
Unclassified	5,000 Shares

Preference Stock, par value \$100 per share:

8.47% Series	45,000 Shares
Unclassified	85,000 Shares

Common Stock, no par value 2,000,000 Shares

(2) The amounts and kinds of stock of the Applicant issued and outstanding as of December 12, 2003 are as follows:

Cumulative Preferred Stock, par value \$100 per share:

Series B, 5 - $\frac{3}{4}$ %	4,642 Shares
Series C, 5 - $\frac{1}{2}$ %	4,947 Shares
Series D, 5%	5,939 Shares

Preference Stock, par value \$100 per share:

8.47% Series	45,000 Shares
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Common Stock, no par value 1,567,391 Shares

(3) The Cumulative Preferred Stock is cumulative as to dividends. If dividends on the Cumulative Preferred Stock shall be in arrears and such arrears shall aggregate an amount equal to or in excess of four (4) quarterly dividends upon such stock, the number of directors then constituting the Board of

Directors shall be increased by two (2) and the holders of the Preferred Stock voting separately as a class shall be entitled to elect the two (2) additional directors.

The Cumulative Preferred Stock is redeemable at any time upon thirty (30) days' notice at the following prices: the Series B at \$101 per share; the Series C at \$100.50 per share; and the Series D at \$100.

The Cumulative Preferred Stock, Series B, Series C and Series D are redeemable at par (\$100) in cases of (a) governmental or municipal acquisition of the Applicant's facilities or common stock, or (b) upon liquidation or dissolution of the Applicant.

The Preference Stock is cumulative as to dividends. If dividends on the Preference Stock shall be in arrears and such arrears shall aggregate an amount equal to or in excess of eight (8) quarterly dividends upon such stock, the number of directors then constituting the Board of Directors shall be increased by one (1) and the holders of the Preference Stock voting separately as a class shall be entitled to elect the one (1) additional director.

The shares of the 8.47% Preference Stock may be redeemed at any time, or from time to time, on or after December 1, 2001 at the option of the Company, in whole or in part, upon payment of a redemption price equal to the sum of \$100 per share plus a premium equal to the Make-Whole Premium as defined in the Articles of Incorporation.

At any time during the period of twelve (12) consecutive calendar months beginning on December 1, 2011 and ending November 30, 2012, both dates inclusive, and during each like period of twelve (12) consecutive calendar months thereafter so long as any shares of the 8.47% Series remain outstanding, the Company may at its option redeem up to and including, but not exceeding, four thousand five hundred (4,500) shares of the 8.47% Series at a redemption price equal to the sum of \$100 per share.

All then outstanding shares of the 8.47% Series shall be redeemed by the Company on December 1, 2036 at a redemption price equal to the sum of \$100 per share.

(4) The following are the only mortgages on the property of the Applicant:

General Mortgage Indenture dated as of May 1, 1968, executed by the Applicant to The Fidelity Bank (now US Bank), as Trustee, and supplemental indentures thereto dated as of December 1, 1970 (as supplemented on

December 17, 1970); September 1, 1974; November 1, 1977; December 1, 1982; June 1, 1983; August 1, 1985; January 1, 1987; September 1, 1988; October 1, 1989; November 1, 1990; December 1, 1991; December 1, 1992; December 1, 1993; September 1, 1995; February 1, 1997, and June 1, 1998.

The Indenture of Mortgage provides for the issue of General Mortgage Bonds which together with all other long-term debt cannot exceed 65% of Applicants total capitalization, which percentage is \$100,307,033 as of December 12, 2003. The amount of indebtedness actually secured by a lien on all the property owned or hereafter acquired by the Company is \$29,000,000. There are no sinking fund provisions associated with the General Mortgage Bonds.

- (5) At December 12, 2003, \$29,000,000 in General Mortgage Bonds were issued and outstanding.

General Mortgage Bonds:

Principal amount authorized by Indenture:

No maximum limit of bonds fixed

Name of utility issuing bonds:

All bonds were issued by Kentucky-American Water Company

Principal amount issued and outstanding:

<u>GMB:</u>	<u>Issued</u>	<u>Outstanding</u>
6.79% Series	\$ 5,500,000	\$ 5,500,000
6.96% Series	7,000,000	7,000,000
7.15% Series	7,500,000	7,500,000
6.99% Series	9,000,000	9,000,000

Date of issue (nominal date):

6.79% Series	September 20, 1995
6.96% Series	December 22, 1993
7.15% Series	February 20, 1997
6.99% Series	June 17, 1998

Rate of interest:

6.79% Series	6.79%
6.96% Series	6.96%
7.15% Series	7.15%
6.99% Series	6.99%

Date of maturity:

6.79% Series	September 1, 2005
6.96% Series	December 1, 2023
7.15% Series	February 1, 2027
6.99% Series	June 1, 2008

Security: All outstanding General Mortgage Bonds are secured by the lien of the General Mortgage Indenture upon all property of the Company.

Interest paid during the 12 months ended December 12, 2003:

6.79% Series	\$373,450.00
6.96% Series	\$487,200.00
7.15% Series	\$536,250.00
6.99% Series	\$629,100.00

(6) Notes are payable to AWCC, bear interest as listed below.

<u>Payee</u>	<u>Date of Issue</u>	<u>Interest Rate*</u>	<u>12/12/03 Amount Outstanding</u>	<u>Maturity Date</u>	<u>Interest paid 12 mos. ended 12/12/06</u>
AWCC	January 1, 2003	Variable	\$17,076,366	Revolver	\$181,253

* Interest is calculated at the LIBOR market index rate.

<u>Payee</u>	<u>Date of Issue</u>	<u>Interest Rate*</u>	<u>12/12/03 Amount Outstanding</u>	<u>Maturity Date</u>	<u>Interest paid 12 mos. ended 12/12/03</u>
AWCC	June 12, 2002	5.65%	\$24,000,000	June 12, 2007	\$1,356,000
AWCC	March 29, 2001	6.87%	\$15,500,000	March 29, 2011	\$1,064,850

(7) There is no other indebtedness of the Applicant, but there are liabilities shown on its Balance Sheet annexed hereto and marked "Amended Exhibit 3, page 7" consisting of, as of December 12, 2003, current and accrued items on which no interest is payable, other than an insignificant amount of interest payable on customer deposits of \$6,560.

(8) Dividends were paid by the Applicant during the five fiscal years as follows:

Common Stock

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
1999	\$ 3.29	1,567,391	\$ 5,156,716
2000	2.60	1,567,391	4,075,217
2001	3.06	1,567,391	4,796,216
2002	3.01	1,567,391	4,717,847
2003	2.17	1,567,391	3,401,238

Cumulative Preferred Stock, Series B, 5 – ¾%

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
1999	\$ 5.75	4,700	\$ 27,025
2000	5.75	4,700	27,025
2001	5.75	4,700	27,025
2002	5.75	4,700	27,025
2003	5.75	4,642	26,692

Cumulative Preferred Stock, Series B, 5 – ½%

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
1999	\$ 5.50	5,000	\$ 27,500
2000	5.50	5,000	27,500
2001	5.50	5,000	27,500
2002	5.50	5,000	27,500
2003	5.50	4,947	27,209

Cumulative Preferred Stock, Series D, 5%

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
1999	5.00	6,000	\$ 30,000
2000	5.00	6,000	30,000
2001	5.00	6,000	30,000
2002	5.00	6,000	30,000
2003	5.00	5,939	29,695

Preference Stock, 8.47% Series

<u>12 Mos. Ended December 31</u>	<u>Rate per Share</u>	<u>Number of Shares Outstanding</u>	<u>Amount</u>
1999	8.47	45,000	\$ 381,150
2000	8.47	45,000	381,150
2001	8.47	45,000	381,150
2002	8.47	45,000	381,150
2003	8.47	45,000	381,150

- (9) Applicant's Balance Sheet as of December 12, 2003 and a statement of Applicant's earnings and expenses for the twelve months ended on such date are shown on pages 7 and 8, respectively, which are annexed hereto.

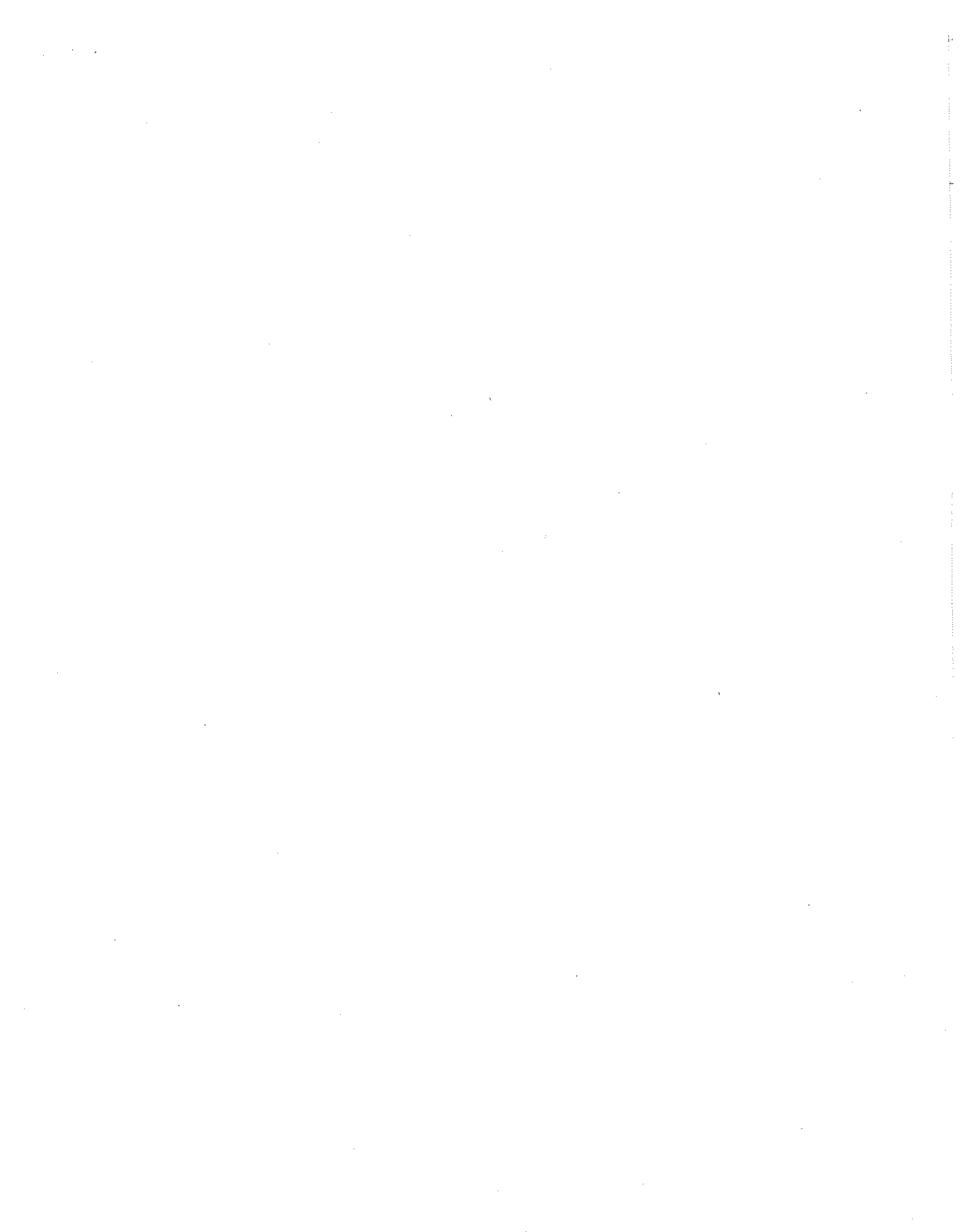
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American Water Works Company
Kentucky-American Water-Co 12
Total Company (USGAP)
Comparative Balance Sheet
As of December 12, 2003

12/17/03
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Kentucky-American Water Co.

Description	Current Year	Prior Year
ASSETS		
1 Utility plant	269,700,275	252,519,205
2 Construction work in progress	59,283,197	57,209,811
3 Accumulated depreciation	428,141	445,752
4 Utility plant acquisition adjustment		
5 Other utility plant adjustments		
6 Sub-total Utility Plant	215,262,510	206,934,434
7 Non-Utility property	249,738	249,738
8 Other investments		
Current Assets	1,001,714	698,520
9 Cash and cash equivalents	2,849,892	1,799,485
10 Temporary investments	70,816	66,969
11 Customer accounts receivable	3,753,572	2,117,835
12 Allowance for uncollectible accounts	1,082,182	722,858
13 Prepaid items	513,647	465,213
14 Intergovernmental assoc. companies		
15 Miscellaneous receivables		
16 Materials and supplies		
17 Other		
18 Sub-total	11,932,959	6,203,351
22 Deferred debits	692,207	785,873
23 Debt and preferred stock	5,572	
24 Expense of rate proceeding	1,480,981	1,604,520
25 Prelim survey & invest charges	7,269,334	7,343,660
26 Reg Asset-income tax recovery	11,292,893	11,046,080
27 Other		
28 Sub-total	20,740,987	20,780,133
30 Total Assets	248,186,194	234,167,656
CAPITAL AND LIABILITIES		
33 Common Stock	36,568,777	36,568,777
34 Paid in Capital	30,489	21,329
35 Retained Earnings	26,090,081	25,177,597
36 Unearned Compensation		
37 Reacquired C/S & Accum Comp Inc		
38 Total common equity	62,689,347	61,767,703
39 Preferred stock	6,052,800	6,210,000
40 Long term debt	68,500,000	68,500,000
41 Total capitalization	137,242,147	137,177,703
42 Current liabilities	17,076,366	14,648,828
43 Bank debt		
44 Current portion of LTD	4,033,084	523,838
45 Accounts Payable	2,136,905	99,584
46 Taxes accrued	1,456,724	1,456,725
47 Interest accrued	6,560	6,910
48 Customer deposits		
49 Dividends declared	2,467,940	34,759
50 Other		1,981,037
51 Sub-total	27,177,579	18,751,681
52 Sub-total	248,186,192	234,167,656
54 Deferred credits	12,506,787	11,047,336
55 Customer adv. for construction	32,487,805	31,251,269
56 Deferred income taxes	1,556,324	1,641,676
57 Deferred investment tax credits	3,484,140	2,646,926
58 Reg-liab-inc.tax.refund thru rates	2,478,726	2,513,873
59 Other	52,513,782	49,101,680
60 Sub-total	31,252,684	29,137,192
62 Contributions in aid of construction		
Total capital and liabilities	248,186,192	234,167,656



CERTIFICATE OF INCORPORATION

OF

AMERICAN WATER CAPITAL CORP.

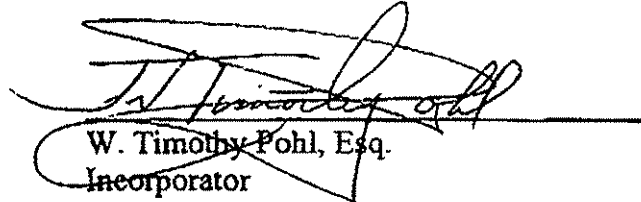
The undersigned, for the purpose of forming a corporation pursuant to the General Corporation Law of the State of Delaware, does hereby state as follows:

1. Name. The name of the Corporation is American Water Capital Corp. (the "Company")
2. Registered Office and Agent. The address of the Company's registered office in the State of Delaware is Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.
3. Purpose. The purposes for which the Company is formed are to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware and to possess and exercise all of the powers and privileges granted by such law and any other law of Delaware.
4. Authorized Capital. The total number of shares of stock which the Company shall have authority to issue is 10,000 shares, all of which shall be Common Stock of the par value of \$1.00 per share.
5. Incorporator. The name and mailing address of the incorporator are as follows: W. Timothy Pohl, 1025 Laurel Oak Road, P.O. Box 1770, Voorhees, NJ 08043.
6. Term. The Company is to have perpetual existence.
7. Bylaws. The board of directors of the Company shall have the power to adopt, amend or repeal the bylaws of the Company, except as otherwise specifically provided therein.
8. Elections of Directors. Elections of directors need not be by written ballot unless the bylaws of the Company shall so provide.
9. Limitation on Liability. The directors of the Company shall be entitled to the benefits of all limitations on the liability of directors generally that are now or hereafter become available under the General Corporation Law of Delaware, including, without limitation, as permitted by the provisions of

paragraphs (7) of subsection (b) of § 102 of the Delaware General Corporation Law, as the same may be amended and supplemented. Any repeal or modification of this Section 9 shall be prospective only, and shall not affect, to the detriment of any director, any limitation on the personal liability of a director of the Company existing at the time of such repeal or modification.

10. Right to Amend. Subject to the provisions of this Certificate, the Company reserves the right to amend any provision contained in this Certificate of Incorporation and in any certificate amendatory hereof in the manner now or hereafter prescribed by law, and all rights conferred on stockholders or others hereunder are subject to such reservation.

IN WITNESS WHEREOF, the undersigned, being the incorporator hereinbefore named, as hereunto set his hand, this 11 day of May, 2000.


W. Timothy Pohl, Esq.
Incorporator