COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF:

COMPLIANCE OF KENTUCKY-AMERICAN	)	
WATER COMPANY, AMERICAN WATER WORKS	)	
COMPANY, RWE AKTIENGESELLSCHAFT AND	)	
THAMES WATER AQUA HOLDINGS GMBH WITH	)	
THE PROVISIONS OF THE ORDERS	)	**CASE NO.**
APPROVING THE TRANSFER OF CONTROL OF	)	**2002-00277**
KENTUCKY-AMERICAN WATER COMPANY TO	)	
RWE AKTIENGESELLSCHAFT AND THAMES	)	
WATER AQUA HOLDINGS GMBH	)	

NOTICE

Pursuant to Condition No. 23 of the Commission's Order of December 20, 2002 in Case No. 2002-00317, Joint Petitioners provide the attached rating action and related opinion from Moody's Investors Service.

Respectfully submitted,

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CERTIFICATION

In conformity with paragraph 7 of the Commission's Order dated January 30, 2002, in **Case No. 2002-00018**, this is to certify that the electronic version of this pleading is a true and accurate copy of the pleading that will be filed in paper medium with the Public Service Commission on November 9, 2007; that on November 9, 2007, the Petitioners have (1) notified the Commission, the Attorney General, the Lexington-Fayette Urban County Government, and Bluegrass FLOW, Inc. by electronic mail; (2) the electronic version of this pleading has been transmitted to the Commission; and (3) a copy has been served by mail, postage prepaid, upon:

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Rating Action: American Water Capital Corp. (New)

Moody's Downgrades American Water to Baa2; Confirms P-2 Short-Term Rating

New York, October 12, 2007 -- Moody's Investors Service today downgraded to Baa2 from Baa1 the senior unsecured issuer rating of American Water Capital Corp ("Capital"). Moody's also confirmed Capital's P-2 short-term rating. At the same time, Moody's assigned a (P) Baa2 senior unsecured rating to Capital's planned $1.5 billion note offering and a Baa2 senior unsecured issuer rating to Capital's parent, American Water Works Company, Inc ("American Water"). The rating outlook for both issuers is stable. Today's rating action concludes the review for possible downgrade initiated on August 28, 2007.

Moody's review of Capital's short and long-term ratings was prompted by American Water's planned recapitalization of the company in advance of the divestment, via initial public offering, from its current parent, RWE AG (A1 stable). The initial sale of RWE's interest in American Water is expected to happen in late-2007; however, preceding that transaction, Capital is expected to issue $1.5 billion of senior unsecured notes in order to substantially repay approximately $2.0 billion of inter-company debt currently owed to RWE. These notes are expected to be issued in October 2007. It is Moody's understanding that the company will also issue $500 million of "equity units" concurrent with the IPO that will fund out the balance of inter-company debt owed to RWE.

The one-notch downgrade of Capital's senior unsecured issuer rating, and the assignment of a Baa2 issuer rating to its parent, American Water, reflects the loss of implied support from RWE following the IPO, historically weak consolidated credit metrics, and the increase in financial and operating risk going forward as a publicly traded stand-alone company. Moody's has also taken this opportunity to equalize the new rating for American Water, a holding company, with its finance subsidiary, Capital, due to the existence of a "support agreement" between the two entities that effectively backstops Capital's timely payment of principal and interest, as needed. Nevertheless, an additional concern is that approximately 60% of American Water's consolidated debt will be borrowed at Capital, with the balance at the various regulated operating subsidiaries where the material cash flows are generated. We note that debt at Capital does not benefit from any upstream guarantees from the regulated utility operations nor does the debt obligations of the subsidiaries, including Capital, benefit from any downstream guarantee from American Water.

Moody's considers American Water's position as the largest investor-owned water utility in the U.S. and geographic diversity with regulated operations in 20 states as being positive credit qualities. Moody's views investor-owned water utilities in the U.S. as having greater long-term stability and supportive regulatory treatment than most of their electric utility counterparts which has resulted good levels of historical cash flow from such regulated operations. Although American Water's cash flow derived credit metrics have exhibited weakness for some time and are considered somewhat soft for the Baa2 rating (funds from operations (FFO) to total adjusted debt was approximately 7.5% for the trailing twelve month period ended June 30, 2007), Moody's believes there is capacity for improvement as the company has either filed or is planning to file for rate increases in all of the jurisdictions in which it operates after a long period following RWE's acquisition where the company's ability to increase rates was limited due to stay-out provisions agreed to in some jurisdictions. Timely rate increases and the ability to attract new equity capital will be two key drivers for maintaining the rating going forward as the water utility industry remains capital intensive with infrastructure spending often times at a multiple of depreciation. American Water is facing a sizeable capital spending plan and will need to finance additional rate base with debt and equity at levels appropriate for the rating category to avoid future downward pressure on the rating or outlook given the magnitude of the planned expenditures.

We note that American Water also has a much smaller non-regulated water-related services segment (approximately 12% of fiscal 2006 revenues) that will remain a part of its business model going forward. While this business segment is considered a growth area and is less capital intensive, it is also less profitable. Consequently, the regulated operating subsidiaries will continue to be the primary source of funds to service debt and to pay the expected dividends to its public shareholders.

The stable outlook reflects Moody's expectations that going forward there will be no material change to the currently envisioned capital structure. The refinancing will likely have a negative impact on American Water's financial flexibility going forward as the company terminates its historical reliance on funding from its larger and more financially secure parent and switches to meeting those capital needs from the public debt and equity markets as a standalone entity. Moody's expects the company to maintain adequate liquidity for its operations primarily through Capital's $700 million commercial paper program which is currently back-stopped by a committed multi-year $800 million revolving bank facility expiring in September 2012. Although currently lightly drawn, Moody's expects the company may moderately increase its utilization of commercial paper borrowings over the balance of 2007.

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous water utilities in the United States and reported revenue in 2006 of $2.1 billion.

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Credit Opinion: American Water Works Company, Inc.

American Water Works Company, Inc.

New Jersey, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2

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Key Indicators

American Water Works Company, Inc. (New)

	2004	2005	2006	LTM 6-2007
Funds from Operations / Adjusted Debt [1][2]	**7.0%**	**6.7%**	**6.9%**	**7.9%**
Retained Cash Flow / Adjusted Debt [2]	**7.0%**	**6.7%**	**6.9%**	**7.9%**
Common Dividends / Net Income Available for Common	**0.0%**	**0.0%**	**0.0%**	**0.0%**
Funds from Operations + Adjusted Interest / Adjusted Interest [3]	**2.6x**	**2.4x**	**2.2x**	**2.4x**
Adjusted Debt / Adjusted Capitalization [2][4]	**67.0%**	**68.8%**	**59.3%**	**53.5%**
Net Income Available for Common / Common Equity	**-2%**	**-12%**	**-4%**	**-3%**

[1] FFO includes add-back of 2/3 annual operating lease expense [2] Debt is adjusted to include preferred stock, 6X rent, and underfunded pension obligation [3] Interest is adjusted to include 1/3 rent and preferred stock dividends [4] Adjusted capitalization reflects the adjustments made to debt

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Company Profile

Headquartered in Voorhees, New Jersey, American Water Works Company, Inc. ("American Water"), is an indirect wholly-owned subsidiary of RWE AG and is the largest investor-owned provider of water, wastewater and related services in North America. It is the parent company of numerous regulated water utility subsidiaries in the United States and reported revenue in 2006 of $2.1 billion. American Water is multiples larger than other investor owned water utility companies within its peer group in the U. S. Assets supporting this revenue base include its operations in 32 states serving a population of approximately 16.2 million. Although American Water has non-regulated businesses (approximately 12% of revenues) it is primarily viewed, on a consolidated basis, as a regulated water utility company.

American Water is a parent holding company with no direct debt obligations. Its primary financing vehicle is American Water Capital Corp. ("Capital"), a finance subsidiary. American Water also incurs debt at the regulated subsidiary level.

Recent Developments

On October 12, 2007, Moody's downgraded to Baa2 from Baa1 the senior unsecured issuer rating of Capital. Moody's also confirmed Capital's P-2 short-term rating. At the same time, Moody's assigned a (P) Baa2 senior unsecured rating to Capital's planned $1.5 billion note offering and a Baa2 senior unsecured issuer rating to Capital's parent, American Water.

The downgrade of Capital's long-term rating was prompted by RWE AG's planned divestiture of the company, via initial public offering. The initial sale of RWE's interest in American Water is expected to happen in late-2007; however, preceding that transaction, Capital is expected to issue $1.5 billion of senior unsecured notes in order to substantially repay approximately $2.0 billion of inter-company debt currently owed to RWE. These notes are expected to be issued in October 2007. It is Moody's understanding that the company will also issue $500 million of "equity units" concurrent with the IPO that will fund out the balance of inter-company debt owed to RWE.

The one-notch downgrade of Capital's senior unsecured issuer rating, and the assignment of a Baa2 issuer rating to its parent, American Water, reflects the loss of implied support from RWE following the IPO, historically weak consolidated credit metrics, and the increase in financial and operating risk going forward as a publicly traded, stand-alone company. Moody's has also taken this opportunity to equalize the new rating for American Water, a holding company, with its finance subsidiary, Capital, due to the existence of a "support agreement" between the two entities that effectively backstops Capital's timely payment of principal and interest, as needed.

Rating Rationale

American Water has a number of positive rating factors contributing to its investment grade rating including geographic diversity of operations and a mostly regulated rate structure which provides stability to cash flows over time (approximately 88% of revenues were derived from regulated operations in 2006). The importance of water to the communities it serves is also an important rating consideration. The ratings also reflect the company's current soft consolidated credit metrics, large capital spending forecast, and risks surrounding the company's transition to a stand-alone publicly traded company.

The key factor's influencing American Water's rating and outlook include:

GEOGRAPHIC DIVERSITY AND REGULATED OPERATIONS

With operations in 32 states and areas of Canada, American Water's operating reach is considerable. On the regulated side, American Water operates in 20 states including its largest operations in New Jersey, Pennsylvania, and Illinois, which together accounted for nearly 50% of consolidated revenues in 2006. Although there can be differences in the level of profitability at each subsidiary jurisdiction, the regulated nature of the business should ensure a relatively stable and healthy return over time. Barriers to entry in this business are also very high given the importance of water and the constraints related to collection and distribution of water. The geographic diversity can also provide a balancing effect on the company's cash flows due to seasonal weather effects or timing of rate filings.

SOFT CREDIT METRICS

American Water's cash flow derived credit metrics have exhibited weakness for some time and are considered somewhat soft for the Baa2 rating (funds from operations (FFO) to total adjusted debt was approximately 7.9% for the trailing twelve month period ended June 30, 2007). Moody's believes there is capacity for improvement as the company has either filed or is planning to file for rate increases in many of the jurisdictions in which it operates after a long period following RWE's acquisition where the company's ability to increase rates was limited due to stay-out provisions agreed to in some jurisdictions. Going forward as a public company, we expect American Water will also be under pressure to initiate and continually pay dividends on its common stock.

CAPITAL INTENSIVE INDUSTRY

The regulated water utility business is highly capital intensive. Capital spending rates for American Water have averaged 240% of depreciation from 2004-06 and this level of expenditures often leads to negative free cash flow, which is not uncommon for regulated water and electric utilities. This funding is often financed with debt until "rate-base" is established and factored into allowed returns. This typically requires equity contributions to maintain the targeted balance of debt and equity in the capital structure. Timely rate increases and the ability to attract new equity capital will be two key drivers for maintaining the rating going forward as the water utility industry remains capital intensive with infrastructure spending often a multiple of depreciation. American Water is facing a sizeable capital spending plan and will need to finance additional rate base with debt and equity at levels appropriate for the rating category to avoid future downward pressure on the rating or outlook given the magnitude of the planned expenditures.

SUPPORT AGREEMENT WITH AMERICAN WATER CAPITAL CORP

Capital, a Delaware corporation, is the wholly-owned finance subsidiary of American Water and whose purpose is to streamline the financing function, create cash management efficiency, and lower the cost of capital for American Water's regulated water utility subsidiaries. Capital's senior unsecured Baa2 rating is now equalized with its parent, American Water. We note that American Water has provided credit enhancement through a support agreement between American Water and Capital. American Water will continue to own, during the term of the support agreement, all of the voting stock of Capital. American Water has also committed to ensure that a positive tangible net worth at Capital will be maintained at all times. In addition, if Capital is unable to make timely payment of interest, principal, or premium on any debt issued and outstanding, American Water has committed to provide immediate and timely funds to Capital.

Moody's effectively views this structure a guarantee and has made no notching differentiation between the two entities. Nevertheless, we note that approximately 60% of American Water's consolidated debt will be borrowed at Capital, with the balance at the various regulated operating subsidiaries where the material cash flows are generated. We note that debt at Capital does not benefit from any explicit upstream guarantees from the regulated utility operations nor does the debt obligations of the subsidiaries, including Capital, benefit from any explicit downstream guarantee from American Water. Also important to note is that American Water's primary source of cash to service debt at Capital comes from the company's regulated utility operations. Although Moody's believes the current ratings capture the cash generating ability of those subsidiary operations, we note that dividends will be limited to the retained, undistributed or current earnings of each jurisdiction.

NON-REGULATED OPERATIONS

We note that American Water also has a much smaller non-regulated water-related services segment (approximately 12% of fiscal 2006 revenues) that will remain a part of its business model going forward. While this business segment is considered a growth area and is less capital intensive, it is also less profitable. We note the segment reported negative EBIT in 2005 and 2006. Consequently, the regulated operating subsidiaries will continue to be the primary source of funds to service debt and to pay the expected dividends to its public shareholders.

Liquidity

In terms of internal liquidity, Moody's generally expects American Water to generate at least $500 million in FFO per year, with a weighting towards the second half of the year due to seasonality. In addition to internally generated cash flows, Moody's expects that American Water will fund some short-term capital needs with commercial paper borrowings. The $700 million commercial paper program established at Capital is backstopped by a five-year $800 million revolving credit agreement that expires in September 2012. There is a relatively balanced maturity schedule for existing debt. Although currently lightly utilized, Moody's expects the company may moderately increase its utilization of commercial paper borrowings over the balance of 2007. Despite the modest negative free cash flow expected over the next four quarters, American Water's liquidity appears to be sufficient to meet the company's needs.

Rating Outlook

The rating outlook is stable. Moody's considers the company's current weak cash flow driven credit metrics but also the room for improvement as the company files for additional rate increases across many of its operating jurisdictions. Although Moody's does not expect a material increase in leverage post-IPO, there are number of other potential cash flow uncertainties to consider, including possible dividend pressure as new publicly traded company.

What Could Change the Rating - Up

The ratings for American Water are not likely to be upgraded in the near-term given the credit metrics and the planned large capital spending program. Levels that would be seen as appropriate for the category include consolidated FFO to adjusted debt in the mid teens with retained cash flow (FFO - dividends) to adjusted debt measuring near 10%.

What Could Change the Rating - Down

There are a number of considerations that Moody's would take into account and likely see as placing negative pressure on American Water or Capital's rating. These considerations include any changes to the existing support agreement between Capital and American Water as well as any significant deterioration in credit metrics due to fundamental business pressure. A prolonged period of financial results leading to FFO to adjusted debt in the low-to-mid single digits for an extended period would place severe pressure on the rating.
