COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT PETITION OF KENTUCKY-AMERICAN WATER COMPANY, THAMES WATER AQUA HOLDINGS GmbH, RWE AKTIENGESELLSCHAFT THAMES WATER AQUA US HOLDINGS, INC., APOLLO ACQUISITION COMPANY, AND AMERICAN WATER WORKS COMPANY, INC. FOR APPROVAL OF A CHANGE OF CONTROL OF KENTUCKY-AMERICAN WATER COMPANY	]	Case No. 2002-00317

AFFIDAVIT OF PAUL B. TRAWICK

STATE OF KENTUCKY)
)
COUNTY OF FAYETTE)

Paul B. Trawick, being first duly sworn, states: The prepared pre-filed Direct Testimony constitutes the direct testimony of the Affiant in the above styled case. Affiant further states that, to the best of his belief and knowledge, his statements are true and correct. Further, Affiant saith naught.

Paul B. Trawick

Subscribed and sworn to before me this the 7th day of November, 2002.

Notary Public, State-at-large
My commission expires: 9/6/03

Testimony of Paul B. Trawick

Q. Please state your name and business address:

A. My name is Paul B. Trawick; my business address is 211 Lafferty Hall, Department of Anthropology, University of Kentucky, Lexington, KY. 40506-0024.

Q. By whom are you employed and in what capacity?

A. I am an Assistant Professor of Anthropology employed by the university, and have taught there and done research for six years.

Q. What is the purpose of your testimony in this case?

A. I have been asked by the organization Bluegrass FLOW, Inc., to review case 2002-00317, the proposed acquisition of Kentucky-American Water Company and its parent company, American Water Works, by RWE, a multinational corporation based in Essen, Germany, and to assess whether that action is in the interests of the public interest. I understand the acquisition is being accomplished through a new holding company, Thames Water US (TWUS).

Q. Are you performing the review solely for Bluegrass FLOW, Inc.?

A. Yes.

Q. What are your qualifications for providing such testimony in this case?

A. I am a specialist in irrigation, water management, and international water policy, with experience in analyzing empirically the impact of national water laws as they have been implemented concretely in practice.

During the years 1994 through 1997, I worked as a Consultant for the World Bank in Washington, DC, and its sister organization, the InterAmerican Development Bank, assessing the impact of a proposed privatization law on rural communities in Peru, Ecuador, Brazil and other countries in Latin America. Privatization is one of several approaches to managing water resources, one that is now being widely advocated both here and abroad, and my work has been unique within anthropology, as well as outside it, in comparing the efficiency and effectiveness of the different approaches and property regimes under which such management takes place.

As an anthropologist who works in the Latin America, I naturally have also had to familiarize myself with the North American Free Trade Agreement (NAFTA), and to

consider closely the impact that its widened scope would have under the proposed Free Trade Agreement of the Americas (FTAA), especially on small farmers and the residents of rural communities in the region, with whom I work and who are in some sense my constituents. The same applies to the General Agreement on Trade and Services (GATS), and other pending or possible international trade agreements. All of those agreements, none of which have been made through a process that could be described as truly democratic, have to be taken into account in assessing the wisdom or advisability of the proposed acquisition of Kentucky-American.

Q. What is your understanding of the proposed acquisition?

A. As I understand it, the German company RWE, through its subsidiaries Thames Water and Thames Water US (TWUS), is acquiring all of the common stock of American Water Works (AWW) at a total purchase price of $4.6 billion, at roughly $46 per share. RWE will also be taking on all of the outstanding debt of AWW, estimated at approximately $3 billion, by the time the deal is finally closed, which is projected to happen sometime in 2003. The acquisition by Thames will be carried out with funds provided by RWE, which reportedly intends to cover that cost by issuing bonds in US dollars. AWW will then become a subsidiary, either of Thames or of some new subsidiary created by Thames.

Q. What documents have you reviewed in preparing your testimony?

A. I have reviewed the Joint Application (parts 1 and 2) for the RWE acquisition, and NAFTA, the North American Free Trade Agreement, especially its Chapter 11, as well as numerous investor-to-state causes of action that have resulted from that chapter of the agreement, all of which are relevant because they have set legal precedents that reveal possible future consequences of the acquisition. I have also looked closely at the GATS agreement, the General Agreement on Trade and Services, which is also relevant because water and water supply are services that are implicitly included under those covered in that rather vague agreement. There is also the fact that pressure is reportedly being increasing applied by energy companies like RWE (e.g., the French conglomerate Vivendi, also Suez, etc.) to have water explicitly listed as a service covered under the GATS agreement. The very vagueness of the agreement makes this situation worrisome from a long-term point-of-view, for reasons that I have explained in my testimony, but there is a distinct possibility that things may be 'clarified' soon and that the threat posed to the people of Lexington and Central Kentucky will become much more obvious and real. In any case, this evolving, and to some extent uncertain, international legal framework makes the proposed action far more than simply a local or state affair. The decision has parameters, and potential ramifications, that are global in scope that the majority of consumers of this 'service', the people of Lexington and Central Kentucky, are quite unaware. At least with regard to water, Lexington, I would argue, is, as a result of the proposed acquisition, in danger of becoming a part of the Third World.

Q. Are any of those documents subject to protection as confidential information?

A. No, they are all in the public domain.

Q. What bearing does NAFTA and its Chapter 11 have on this case?

A. Chapter 11 of the agreement allows foreign litigants—corporations like Thames Water and RWE—to seek compensation from the government, through a process of investor-to-state tribunals, for any damages or other "expropriation" or "regulatory taking" that are ordered by US or state courts or regulatory agencies. As I understand it, the federal government must pay cash compensation, in potentially unlimited amounts, for the damages that such tribunals decide has been done to the corporation, for example by asserting the will of the people and trying to enforce local, state, or federal law. In other words, under NAFTA, with its tribunals, any effort to assert what we have come to know in this country as sovereignty--and to value so much—is seen as damaging to so-called "free trade" and damaging to corporations. This is true regardless of its effect is on the American people and their welfare. Indeed, democracy itself is clearly under threat because of NAFTA, and the threat lies, not just in these ever-changing trade agreements, which are generally made behind closed doors in faraway places, but more importantly in concrete situations like the one Lexington and Central Kentucky now faces. The term "free trade" in this context, and in this particular case, is quite revealing—"free" of *what*, one might ask, and the answer, as the people are about to find out, is oversight or legal restraint of any kind on corporations and the investors who own them. That, according to what I was taught in school, is either autocracy or anarchy, depending on the context.

These investor-to-state tribunals are already being widely used by foreign investors to demand payment from local and state governments, here in the United States, for any action that impacts negatively on the value of a foreign investor's property. And it is especially important to note that these losses, known in the literature as "*regulatory takings,*" do not exist for US citizens or for American corporations. There is no such thing in this country and its citizens can take no such action against each other or against a government. The US Supreme Court held, in a 1993 decision (Concrete Pipe and Products vs. the Construction Laborers' Pension Trust), that the "mere diminution" of the value of an investment "does not constitute a *taking.*" Yet, under NAFTA, and in its Chapter 11 tribunals, it does constitute a taking for which investors can demand compensation, and governments here in this country, like the Lexington-Fayette Urban County Government, are being successfully sued by foreign multinationals and given heavy compensation from the US Treasury for such alleged losses.

Q. How might this process conceivably play out in the proposed RWE acquisition?

A. Let us say, hypothetically, that the people of Lexington, and the Lexington-Fayette Urban County Council, become dissatisfied with the situation when Thames and RWE raise water rates substantially in order to cover their costs of acquisition. That is likely,

indeed almost certain, to happen; rates immediately went up 23% in Peoria, Illinois after RWE acquired its water company. That such actions are nearly universal today is reflected by the fact that by far the largest percentage of economic activity today that falls under the category of "trade" are in fact monetary transfers resulting, not from the purchase of goods and services, but from the costs of mergers and acquisitions.

Now, if Lexington, in response to such a major price increase, were to decide to condemn the local water company, now under German ownership in this hypothetical, and exercise its right of eminent domain, the federal government would immediately become liable to such an investor-to-state tribunal, a legal battle that the Urban County would have no chance of winning because the right of eminent domain, which is a central concept in Common Law jurisprudence, does not exist under NAFTA. In a best possible outcome scenario, the US taxpayers would have to pay, not only the fair market value of the company (to the degree an international tribunal found a higher valuation than a local jury), but all the associated legal costs, the costs of the prior acquisition, and probably huge punitive damages as well. Moreover, means exist by which the US government could in turn force the people of Lexington either to rescind the condemnation or else contribute heavily to the damage award.

What this all means, in the final analysis in terms of the most likely outcome, is that the acquisition by RWE, once it takes place and is approved, will simply be irreversible.

Q. Can you mention and briefly discuss the outcome of a few cases where these tribunals have already taken place?

A. Yes. The tribunals have been used by private investors in the US, Canada, and Mexico to challenge a variety of national, state and local environmental and public health policies, domestic judicial decisions, and even a federal procurement law, decisions on which in most cases are still pending; but some corporations have already succeeded in their challenges.

In one pending case, a huge Canadian funeral conglomerate called the Loewen Group is using NAFTA's protections to reverse a Mississippi court ruling in favor of a small funeral home operator and against the conglomerate for breach of contract and even fraud—a jury award that totaled $500 million in punitive and compensatory damages. The company was forced to settle for $150 million, but Loewen is now suing the US taxpayers for $725 million, nearly five times that amount, for the "expropriation" of those assets, a fight that they seem to be about to win. The resulting NAFTA tribunal has to date placed no limits on the types of court decisions that could be open to challenge. Indeed, such tribunals have been used to challenge not only federal law, such as a "buy American" federal procurement law, but a variety of measures taken by state, provincial and municipal authorities, and the hypothetical condemnation of a foreign-owned water company by a city like Lexington would, relatively speaking, have to be considered uncontroversial compared to the many cases that have been filed thus far.

Again, let me emphasize that US corporations do not have the power to push such costs on to the US taxpayers. I should also note that these tribunals take place behind closed doors; they are strictly confidential with no access by the press or the public.

In another case, perhaps more similar to the situation we are discussing here, the Mondev corporation of Canada has attacked the rulings of the Boston Redevelopment Authority, the city of Boston, and even the Massachusetts Supreme Court over a real estate deal, arguing that NAFTA overcomes the US common law right of sovereign immunity. Mondev's attempt to buy the land was blocked by the local government, which then claimed such immunity, a centuries-old legal concept which holds that governments cannot be sued unless the lawsuit is explicitly allowed by law, an argument that was upheld by the court. In its NAFTA tribunal, Mondev is challenging that concept, perhaps better called a right of local governments, and is seeking $50 million in compensation, a case that is still pending.

Finally, in a still more alarming case that relates directly to water, Sunbelt, a California-based water company, has challenged the right or power of the government of British Colombia to put a moratorium on the bulk export of its water. Sunbelt seeks to buy huge amounts of the fresh water resource and ship it in supertankers to drought-stricken California, in a joint venture with a Canadian company that was in fact granted a license to export a limited amount of fresh water in the early 1990's. In 1991, the government was forced by a storm of public protest to impose a temporary moratorium on such licenses, a ban that was extended and made permanent in 1995. In response to the demands of the people, and widespread concern that water was becoming a commodity that would fall under such agreements as NAFTA, the government blocked the action, in effect simply asserting sovereignty over its own resources.

In a resulting lawsuit, the Canadian partner was awarded $245,000 by the provincial government in compensation for the now-worthless, but Sunbelt was given nothing. Sunbelt is in effect challenging this most basic kind of sovereignty and seeking $10.5 billion in compensation from the Canadian government under NAFTA, before a tribunal which case is still pending. Under various provisions of Chapter 11, the corporation is alleging that the State's action constitutes an expropriation, or a "regulatory taking" in the form of the lost business and revenue, and that the government violated the equal treatment for foreign and domestic investors that is guaranteed under the agreement.

There are several other cases against governments that have been settled in NAFTA tribunals in favor of the foreign corporations, but these are the cases that are perhaps most relevant to the current situation. This is the kind of legal morass into which Lexington and the Fayette County Urban Government will fall if the proposed acquisition is allowed, and the water in which we are going to have to swim is murky indeed. NAFTA, with its Chapter 11 and its Tribunals, are the main reason why the acquisition is not at all in the public interest. Although only national governments can be named as defendants in these very private legal disputes, such governments have many ways of forcing concessions from local bodies as a result and even sharing in the resulting costs, and in any case it is the taxpayers, the public, who will pay the bill.

Q. Based on these cases, do you thank that any change that might be made in the treaty in the future would be applicable to the water company once it was owned by RWE?

A. No. I am not a lawyer, of course, but I do not see how it could. That is the thing about this decision: it seems quite clear that it will be irreversible. To my knowledge there has been no case yet filed that deals with, and seeks to reverse, the actual acquisition of a company or even of substantial property once it has taken place. Reversal of such an action, for example through condemnation, would certainly not be allowed by any NAFTA tribunal as things stand now, and even if some of the provisions of the agreement were changed in response to all the lawsuits it has generated, it seems hard to imagine that any such improvements would go to that extreme. The vulnerability of the people of Lexington and Central Kentucky and their interests under NAFTA alone is, compared to the many other cases that have been filed and are still being disputed, extreme. As I see it, we would not have a leg to stand on, no matter what changes were made. And there is also the GATS agreement, which has to be taken into account.

Q. Please explain how GATS enters in to the equation.

A. The question is very difficult to answer, and therein lies the problem as well as the risk. The existing GATS agreement is deeply troubling. Essentially a kind of global version of NAFTA that applies to services as well as to trade, it is disturbingly comprehensive. It covers all service sectors and modes of supply as well as most government measures, including laws, practices, regulations and guidelines, both written and unwritten. No government measure that affects trade in services, whatever its aim, whether environmental or consumer protection, or to enforce labor standards, is beyond the scope of the GATS.

Essentially, the agreement prohibits discrimination against any foreign supplier of a service in all covered areas, notwithstanding the conditions under which services are provided and regardless of the human rights or environmental record of the provider. Parties have also agreed that some rules apply "horizontally" or across-the-board, whether or not the area has already been explicitly listed in the GATS. This potentially applies to all services, even ones that are still protected in some countries, like health and education. Similarly, under the horizontal rule, all regulations in any given sector, including social services, must be "Least Trade Restrictive," and all member countries of the World Trade Organization must be prepared to include market mechanisms wherever possible, even in social programs. That is the basic agenda of GATS.

At present, public services provided by government are technically applicable for exemptions. Thus some countries have claimed exemptions for their social security programs, which are publicly funded. But under GATS article 1.3C, for a service to be considered to be under government authority, is must be provided "entirely free." That means that the sector in question must be completely financed by government and have no commercial purpose. All government services supplied on a commercial basis - even if it is not-for-profit - are subject to GATS rules, as are government services publicly

supplied but in competition with commercial suppliers. Since hardly any service sector in the world is entirely commercial free, this exemption is increasingly meaningless.

Once can immediately see how this would threaten eventually any public utility that might be created after the hypothetical condemnation of the water company after it has been acquired by RWE. However, there is an even more basic problem, potentially, under the GATS which would raise its head immediately even if the acquisition were allowed to go through.

Q. Please explain further what that problem would be.

A. As it stands now, water and water supply are not among the services listed in the GATS agreement. However, there is reportedly pressure that is increasingly being mounted at the international level by the big energy companies (RWE, Vivendi, Suez) to have it explicitly included. However, given the breadth and vagueness of the agreement, it is almost a moot point, since a strong argument could be made that water supply falls under the GATS in court. As I understand it, what this means for the people of Lexington and Central Kentucky is that, if the acquisition is allowed to go through, and RWE then raises water rates substantially (as it has immediately done in other municipalities, in order to cover its acquisition costs), the people of Lexington will be able to do nothing about it. And they will be able to do nothing whatsoever about rates, water quality, or quality of service thereafter without being sued for unfair trade practices, for restricting "Free Trade." Again, in this situation, "free" trade will mean freedom from social responsibility and from any and all legal restraint, for a company that will be a local monopoly.

Q. In summary, then, is foreign ownership of a Kentucky water company consistent with the public interest?

A. No, it certainly is not. Given the nature of these international trade agreements, from which we are all supposed to benefit, for the people of Lexington and Central Kentucky, the deal will basically mean: "Welcome to the Third World."