

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company and	:	
Thames Water Aqua Holdings, GmbH	:	
	:	
Joint Application for Approval of	:	01-0832
Proposed Reorganization and	:	
Change in Control of Illinois-	:	
American Water Company Pursuant	:	
to Section 7-204 of the Illinois Public	:	
Utilities Act.	:	

ORDER

DATED: November 20, 2002

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By the Commission:

I. PROCEDURAL HISTORY

On December 21, 2001, Illinois-American Water Company ("IAWC"), on behalf of itself and its parent holding company American Water Works Company, Inc. ("AWWC"), and Thames Water Aqua Holdings GmbH ("Thames Holdings"), on behalf of itself and its parent holding company RWE Aktiengesellschaft ("RWE") (IAWC and Thames Holdings are collectively referred to as "Joint Applicants") filed a Verified Application for approval of a proposed reorganization and change in control of IAWC pursuant to Section 7-204 of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq.

Pursuant to due notice, a status hearing was held in this matter before a duly authorized Administrative Law Judge ("ALJ") of the Commission at its offices in Springfield, Illinois on January 15, 2002. Subsequent status hearings were held on March 20, April 10, and April 18, 2002. Petitions to intervene were received from the City of Pekin, the City of Peoria (collectively "the Cities"), and the Village of Orland Hills. All three petitions to intervene were granted. The Village of Orland Hills did not participate in the proceeding. Commission Staff ("Staff") participated as well.

In accordance with the established schedule, Joint Applicants and Staff submitted pre-filed testimony which was later admitted as evidence during the May 21, 2002 evidentiary hearing. Terry L. Gloriod, President of IAWC and Iowa-American Water Company, Michael Carmedy, Senior Vice President and Commercial Director of Thames Water Americas, Georg Lambertz, Senior Vice President Finance for RWE, and M. Alexander Simic, Managing Director, European Rating Advisory Group, Deutsche Bank AG, London, offered testimony on behalf of Joint Applicants. Rochelle Langfeldt, a financial analyst in the Finance Department of the Commission's Financial Analysis Division, Mary H. Everson, an accountant in the Accounting Department of the

Financial Analysis Division, and William R. Johnson, an analyst in the Water Department of the Financial Analysis Division, testified on behalf of Staff.

At the May 21 evidentiary hearing, Mr. Carmedy testified regarding the potential addition of an intermediate holding company between Thames Holdings and AWWC in the RWE/AWWC post-merger capital structure. The potential use of such an intermediate holding company was referenced in both the Verified Application and an exhibit to Mr. Carmedy's direct testimony. In response to Mr. Carmedy's testimony at the hearing, Staff requested that Joint Applicants provide additional information regarding the addition of such intermediate holding company. Based on Staff's request, on June 5, 2002, Joint Applicants filed a Motion for Leave to File Additional Evidence and Request for Additional Hearing, which was granted by the ALJ on June 14, 2002.

To address the intermediate holding company issue, Joint Applicants filed the supplemental testimony of Stephen Smith, Corporate Finance and Tax Director for Thames Water, plc., and Mr. Gloriod, as well as an affidavit from Mr. Lambertz. Staff submitted additional testimony from Ms. Everson, Ms. Langfeldt, and Mr. Johnson. This testimony was admitted into the record as evidence at a July 31, 2002 evidentiary hearing. At the conclusion of the July 31 hearing, the record was marked "Heard and Taken."

Joint Applicants, Staff and the Cities each filed an Initial Brief and Reply Brief. Joint Applicants and the Cities also each filed a proposed draft order with their respective Reply Brief. A Proposed Order was served on the parties. Only the Cities submitted a Brief on Exceptions. Joint Applicants and Staff each filed a Brief in Reply to Exceptions. The Brief on Exceptions and Briefs in Reply to Exceptions were considered in the preparation of this Order.

II. DESCRIPTION OF THE PROPOSED REORGANIZATION AND COMPANIES INVOLVED

The Agreement and Plan of Merger ("Agreement") which is the subject of this proceeding is dated September 16, 2001 and is by and among RWE, Thames Holdings, Apollo Acquisition Company ("Acquisition Corp.") and AWWC. Joint Applicants seek an order authorizing Thames Holdings, RWE, and any other entity owned or controlled directly or indirectly by Thames Holdings and managed by Thames Water plc ("Thames") to acquire control of IAWC. Mr. Carmedy explains that, pursuant to the terms of the Agreement, Acquisition Corp. would be merged with and into AWWC, the parent of IAWC. AWWC would be the surviving corporation, and would continue its corporate existence under Delaware law. Mr. Smith testifies that AWWC would become a wholly owned subsidiary of Thames Water Aqua U.S. Holdings, Inc. ("TWUS"), which is a wholly-owned subsidiary of Thames Holdings.¹ Thames Holdings, in turn, would remain a subsidiary of RWE. IAWC would remain a wholly-owned subsidiary of AWWC,

¹ TWUS was created on July 26, 2002. The question of whether TWUS, as an intermediate holding company, would exist and the potential impact it might have on IAWC was the subject of Joint Applicants' June 5, 2002 motion and the subsequent July 31, 2002 evidentiary hearing.

and would continue to exist as an Illinois public utility, fully subject to the Commission's jurisdiction and regulation under the Act.

Mr. Carmedy further testifies that RWE is Germany's fifth largest industrial group and is an international multi-utility service provider with core businesses in electricity, water, gas, waste management, and utility-related services. RWE is active in more than 120 countries on six continents. Thames Holdings is the holding company of Thames. Thames operates the water division of Thames Holdings, and is the largest water and wastewater company in the United Kingdom ("U.K.") and one of the largest water and wastewater companies in the world, providing water related services to over 43 million people throughout the U.K., Australia, China, Indonesia, Malaysia, Puerto Rico, the United States ("U.S."), Turkey and other countries around the world.

Mr. Smith relates that TWUS is the intermediate holding company that will be located between Thames Holdings and AWWC in the post-reorganization corporate structure. He adds that TWUS has been incorporated under the laws of the State of Delaware and its sole purpose is to hold all of the common shares of Thames Holdings' water businesses in the U.S., making it possible for TWUS to file a consolidated U.S. tax return for the U.S. water businesses.

Mr. Gloriod testifies that AWWC is a publicly traded company, organized and operating under the laws of the State of Delaware, and is the largest investor-owned water utility holding company in the U.S. AWWC's subsidiaries provide water and wastewater utility service and other water resource management services to approximately 12 million people in 28 states and Canada. IAWC, he continues, is a subsidiary of AWWC, and is a corporation duly organized and existing under, and by virtue of, the laws of the State of Illinois and is a public utility within the meaning of the Act. IAWC has its principal office in Belleville, Illinois, and provided water utility service to approximately 220,000 customers in 87 communities in Illinois prior to its acquisition of the water and wastewater assets of Citizens Utilities Company of Illinois ("CUCI"). Mr. Gloriod explains that, apart from the CUCI area, IAWC has three divisions: the Northern Division, which includes the Peoria, Pekin, and Lincoln operating Districts; the Southern Division, which includes the Interurban, Cairo, and Alton operating districts; and the Eastern division, which includes the Champaign, Streator, Sterling, and Pontiac operating Districts. In Docket No. 00-0476, according to Mr. Gloriod, the Commission approved the acquisition by IAWC of the water/wastewater assets of CUCI. CUCI was a public utility within the meaning of the Act and operated 26 service districts in Cook, Du Page, Will, Kane, Kendall, and Grundy Counties, Illinois. Mr. Gloriod presents evidence that CUCI provided water service to approximately 35,000 customers and wastewater collection and/or treatment to nearly 32,000 customers. Since closing that acquisition agreement, he reports that the areas and water/wastewater customers of CUCI have been served by IAWC.

Mr. Gloriod states further that IAWC receives administrative, engineering, financial, human resources, certain management, information systems, risk management, water quality, and other services from American Water Works Service

Company ("Service Company"), pursuant to an affiliated interest agreement ("Services Agreement") approved by the Commission. He relates that Service Company is a wholly owned subsidiary of AWWC.

III. GOVERNING LAW

As indicated above, Section 7-204 governs reorganizations such as that proposed here. The relevant portions of Section 7-204 read as:

(a) For purposes of this Section, "reorganization" means any transaction which, regardless of the means by which it is accomplished, results in a change in the ownership of a majority of the voting capital stock of an Illinois public utility; or the ownership or control of any entity which owns or controls a majority of the voting capital stock of a public utility; or by which 2 public utilities merge, or by which a public utility acquires substantially all of the assets of another public utility [...].

(b) No reorganization shall take place without prior Commission approval. The Commission shall not approve any proposed reorganization if the Commission finds, after notice and hearing, that the reorganization will adversely affect the utility's ability to perform its duties under this Act. In reviewing any proposed reorganization, the Commission must find that:

(1) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;

(2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;

(3) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;

(4) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

(5) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;

(6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;

(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

(c) The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.

...

(f) In approving any proposed reorganization pursuant to this Section the Commission may impose such terms, conditions or requirements as, in its judgment, are necessary to protect the interests of the public utility and its customers.

No party disagrees that the proposed transaction qualifies as a reorganization under subsection (a). The Cities, however, dispute the Joint Applicants' claim that the Commission can and should find that the proposed reorganization complies with subsections (b)(1), (4), and (7). Each of the relevant criteria of Section 7-204 will be discussed below.

Staff notes that Section 6-103 of the Act also requires that in any reorganization the Commission shall authorize the amount of capitalization of a public utility formed by a merger which shall not exceed the fair value of the property involved. Ms. Langfeldt testifies that IAWC's current capital structure is comprised of approximately 55% debt and 45% equity, which is consistent with its target capital structure of 40% to 50% equity and 50% to 60% debt. She concludes that the transaction complies with the requirement of Section 6-103 since IAWC's capitalization would not change as a result of the transaction. The Commission concurs with Ms. Langfeldt's assessment.

The Commission will also take this opportunity to comment on concerns raised over the fact that a German company, RWE, will be the ultimate parent of IAWC. The Commission acknowledges these concerns, but must also acknowledge that it is bound by Section 7-204 in its decision in this docket. Section 7-204 does not list among the criteria to consider the origin of the company acquiring a regulated Illinois utility.

IV. EVALUATION UNDER SECTION 7-204

A. Section 7-204(b)(1)

1. Joint Applicants' Position

Joint Applicants assert that the proposed reorganization meets the requirements of Section 7-204(b)(1) that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." Mr. Gloriod and Mr. Carmedy testify that, following the reorganization, there will be no impact on the day-to-day operations and management of IAWC and that there will be no adverse impact on customer service. In fact, Joint Applicants assert that RWE and Thames Holdings seek to acquire AWWC in large part due to its reputation for quality management and operation of its subsidiaries, such as IAWC. Therefore, they continue, IAWC's operating headquarters will remain at its current location in Belleville, Illinois and there will be no impact on IAWC's employees or its existing management and officers.

In addition, Mr. Carmedy and Mr. Gloriod state that the partnership between AWWC and Thames will result in a combination of resources and expertise, which will create opportunities for sharing best operating practices, increase access to capital markets, increase opportunities for growth in the water and wastewater market, and enhance research and development. They conclude that this will assist IAWC in responding to the many difficult challenges facing the water industry. As an example, Mr. Gloriod testifies that, over the next two decades, much of this country's drinking water and wastewater infrastructure will have to be replaced because it is approaching or has already exceeded its useful life. Additional investment in facilities and increases in operating and maintenance expenditures will be necessary in order to comply with the increasingly stringent regulatory standards imposed under the Safe Drinking Water Act and Clean Water Act. Further, because the water industry in the U.S. is highly fragmented, the structure of the water industry itself poses particular problems in meeting these challenges. Mr. Gloriod explains that there are approximately 54,000 community water systems, the vast majority of which are small and financially and technologically nonviable. Additionally, the water supply industry is more capital intensive than other public utility services regulated by state public utility commissions, according to Mr. Gloriod. The water industry's infrastructure requirements, quality standards, and security enhancement issues, he continues, result in severe pressure on water utilities to increase their ability to attract capital as well as their technical and operating capabilities. Mr. Gloriod states further that water utilities also have the obligation to undertake these tasks in a way that minimizes costs to consumers, while still maintaining quality service.

Mr. Gloriod avers that AWWC's policy of pursuing consolidation through mergers and acquisitions has been integral to its effort to meet these challenges. IAWC, he points out, has acquired 15 water systems and one wastewater system since 1996, including the acquisition of CUCI, adding approximately 106,000 water and 32,000

wastewater customers. The benefits that consolidation can offer, according to Mr. Gloriod, include the size and financial strength that would permit capital attraction at a lower cost, and an increased ability to retain and attract professional and technical talent. Moreover, following the transaction, he maintains that IAWC will continue to provide high quality water service that meets or exceeds Illinois regulatory requirements and will maintain an adequate level of capital investment and best operating practices to ensure safe and reliable service consistent with the applicable regulatory requirements of the Act.

Joint Applicants also present evidence that IAWC and its customers will realize numerous benefits as a result of the proposed reorganization. First, Mr. Carmedy testifies that, like AWWC, Thames is committed to service excellence in its water quality and service standards. Thames' record of compliance with drinking water standards in the U.K. is currently 99.89%, and its wastewater effluent compliance is 99.99%. Thames has invested more than \$6 billion in enhancing service quality, including construction of an advanced water treatment system and major renovations of water mains and sewage treatment works. Thames has also established programs to improve service quality, including cost-optimized network renewal and refurbishment, and development of ultra-violet disinfection of drinking water. Thames is dedicated to using its expertise in water quality and service standards to help maintain AWWC's and IAWC's strong reputation for service quality.

Second, Joint Applicants maintain that AWWC and IAWC will benefit from Thames' strong commitment to environmental protection. In support of this contention, Mr. Carmedy states that numerous Thames Water sites have been awarded the internationally recognized ISO 14001 Environmental Standard, and Thames works with and supports a wide range of environmental and conservation groups internationally. In addition, he relates that Thames utilizes "green energy," with seventeen combined heat and power plants running bio-gas and two sludge-powered generators. The proposed reorganization will enable AWWC and Thames to pool their resources and expertise in order to continue and enhance environmentally-friendly service for their customers.

Third, Mr. Carmedy reports that Thames plans to enhance AWWC's and IAWC's ability to provide customers with continuous customer service. Specifically, Thames has developed a customer service center that has won the U.K. Utility Industry Achievement Award for Excellence three years in a row. This system employs an integrated approach to service management inquiries by installing the latest information technology for mobile field applications, which provides a direct, real-time link between the system in use in the call center and the technicians in the field. The new system results in a much more professional and problem-free service, and reduces the need for customers to make repeated calls to different parts of the organization. AWWC and IAWC will be able to take advantage of Thames' experience to implement a similar service, provided that it is justified on a cost-benefit basis, thereby further improving service and reducing the time and cost of delivery.

Fourth, Mr. Carmedy testifies that AWWC's standing as an industry leader in research and development will be enhanced by Thames' expertise in cutting edge technologies, such as distribution and transmission, and its annual research and development budget of \$13 million. Thames expects that, together, the Thames/AWWC combination will prove to be a world leader in technological innovation, which will benefit IAWC and its customers.

Finally, Mr. Carmedy states that Thames, like AWWC and IAWC, has a long and illustrious track record of investing in local communities, particularly in support of the environment and extra-need customers, and Thames is committed to continuing the existing philosophy of corporate responsibility that resides at the core of the RWE, Thames, and AWWC cultures.

2. Staff's Position

Staff witness Johnson agrees with the Joint Applicants that the merger would not diminish IAWC's ability to provide adequate, reliable, efficient, safe, and least-cost public utility service. Mr. Johnson notes that currently IAWC is a subsidiary of AWWC and receives administrative and operational services from Service Company, also a subsidiary of AWWC. The merger will not impact IAWC's affiliation with AWWC or with AWWC's subsidiary, Service Company.

Mr. Johnson testifies that Thames can provide IAWC with supplemental expertise in water and sewer operational areas that could enhance IAWC's ability to provide adequate, reliable, efficient, safe, and least-cost public utility service to its customers. He states further that Thames has experience in infrastructure improvements, which is currently a hot topic in Illinois and the U.S. As an example of such experience, he relates that Thames invested in a 50-mile water main ring in a tunnel under London. As a result of the ring main, Thames did not impose a watering ban, despite record drought conditions experienced in England in the mid-1990's. The asset planning necessary to maximize the benefits of the ring main resulted in reduced operating costs since fewer distribution sites needed to be maintained. Mr. Johnson also points out that since 1995, Thames has renovated over 2,500 miles of mains resulting in improved water quality and pressure for the benefit of nearly a million customers.

Thames experience in implementing and developing Geographical Information Systems ("GIS") based asset management systems is also of interest to Mr. Johnson. He notes that Thames is currently developing third generation GIS systems, integrating customer and asset information with satellite location and job management of field workers to improve service to customers. Thames has indicated that it would like to implement a similar service in IAWC's territory to further improve service and reduce the time and cost of delivery, if it proves to be appropriate based on a balancing of cost and service considerations.

In the area of sewage treatment, Mr. Johnson found that Thames has invested heavily in sewage treatment works to ensure that wastewater returned to the

environment is of the highest quality. According to Mr. Johnson, the River Thames is now thought to be the cleanest major metropolitan river in the world. During the summer months, he states that approximately 80% of the River Thames' flow comes from Thames' Sewage Treatment Works. With IAWC's recent acquisition of CUCI, a water and wastewater company, this expertise in sewage treatment could be very beneficial.

In the area of research and development, Mr. Johnson reports that Thames is on the cutting edge in burst pipe prediction and trenchless technologies. Thames has invested in advanced water treatments that have resulted in pioneering a way to treat water using granular activated carbon in slow sand filters. Thames was able to patent this use and now has ten years of experience in applying it.

Mr. Johnson also testifies that Thames has experience in water reuse in the U.K., Australia, and the U.S. Through its subsidiary, Applied Water Management, Inc., Thames owns and operates 30 membrane bioreactor systems in the Philadelphia-New York-Boston region that perform a combination of direct and indirect water reuse. These systems were developed in 1987 with the first installation achieving 55% to 95% reuse, depending on the application. Also under construction is the first direct residential reuse system in the U.S., located in New York. Applied Water Management, Inc., is the water reuse consultant. This apartment building is the first residential "green" building in New York and is expected to be a model for sustainable urban development when completed. Mr. Johnson contends that Thames' experience in water reuse could, in the future, assist IAWC in dealing with any future water supply problems.

Additionally, facility security is a major concern these days. Only recently, IAWC implemented various initiatives to ensure that safety is a priority. Thames, on the other hand, has considerable experience in the security area, according to Staff. Terrorists have been a threat to the U.K. water industry for many years. Thames has developed methodologies that have allowed the company to live with and mitigate this hindrance. In Izmit, Turkey, Thames has been involved in a design, build, operate, and transfer project to provide a major water treatment facility, which is now in full operation under direct management by Thames. Thames was involved in specification of the security measures for the infrastructure and operation at the design stage, based on an initial risk assessment carried out in the U.K. and in-country by Thames' local partners. Turkey has for many years suffered from terrorism by groups who have carried out numerous violent attacks on government and civilian assets, notably using suicide bombers. Staff notes that Mr. Carmedy emphasizes Thames commitment to security following the tragic events of September 11, 2001 and promised to share their security initiatives with AWWC.

Overall, Mr. Johnson concludes that since operational control of IAWC, which is a subsidiary of AWWC, will remain as it is today, he saw no adverse changes that would indicate that IAWC's ability to provide adequate, reliable, efficient, safe, and least-cost public utility service to its customers will diminish because of the proposed merger. On the contrary, he believes that Thames will enhance IAWC's ability to meet the daily

challenges. Thames' expertise in infrastructure improvements, customer service initiatives, water/wastewater treatment processes, research and development, and facility security, are indicators of the potential benefits IAWC customers could realize.

3. The Cities' Position

The Cities did not present evidence regarding the proposed reorganization's compliance with Section 7-204(b)(1), but still assert in their joint Initial Brief that the record does not support a finding under Section 7-204(b)(1) that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service." In support of this claim, they point out in their Initial Brief that the recent downgrading of RWE's corporate credit rating is the result of RWE's aggressive acquisition strategy. The Cities maintain that there is nothing in the record to indicate that this strategy will not continue. They further insist that the conditions proposed by Staff do nothing to address this concern and lament the fact that RWE's corporate credit rating will reflect upon AWWC and IAWC. They note the absence of any commitment by RWE to refrain from any additional acquisitions until such time as it would be able to proceed without further downgrading by Standard & Poor's or Moody's.

In their Reply Brief, the Cities contend further that the Commission can not approve the proposed reorganization under Section 7-204(b)(1) because Joint Applicants have represented to the Commission that there will be no savings passed on to the ratepayers in Illinois. To support this claim, they note that RWE is paying a 39% premium for the acquisition of the stock of AWWC. Prior to the tender offer by RWE, the Cities presume that informed investors placed a reasonable value on the stock of AWWC. The Cities relate that RWE indicates that there will be no synergy savings to occur in Illinois as a result of the proposed reorganization because Thames does not currently maintain operations in Illinois. The Cities surmise that RWE will have to recoup its premium by either providing a lower level of service or a higher-cost public utility service. They then add that this assumes that RWE made an astute business decision herein. If RWE can justify the premium it is paying for AWWC on the basis of synergy savings, the Cities argue that a reasonable estimate of these savings should have been presented herein. The Commission, under such circumstances, would have a duty to allocate such savings, according to the Cities.

4. Commission Conclusion

The Commission finds the Cities' arguments misplaced in the context of subsection (b)(1). Concerns regarding credit ratings would be more appropriately raised in relation to subsection (b)(4) while concerns pertaining to savings should be discussed in the context of subsection (c). In any event, the record demonstrates that RWE's credit rating is still higher than that of American Water Capital Corporation ("AWCC") and, with regard to savings, the Joint Applicants have expressly requested a Commission finding that savings reflected in future rate case test years, if any, should be allocated in full to customers.

In light of the evidence presented by Joint Applicants and Staff and absent any evidence that the proposed reorganization will diminish IAWC's ability to provide adequate, reliable, efficient, safe, and least-cost utility service, the Commission finds that subsection (b)(1) is satisfied. The record shows that, through the proposed reorganization, IAWC will be able to benefit from the combination of the best practices of AWWC and Thames, and IAWC and its customers will benefit from Thames' commitment to infrastructure security, environmental matters, service standards, customer and community service, and research and development.

B. Section 7-204(b)(2) and (3)

1. Joint Applicants' Position

Joint Applicants maintain that the proposed reorganization complies with subsections (b)(2) and (3) of Section 7-204. The former requires the Commission to find that "the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers" and the latter requires a finding that "costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes."

Mr. Gloriod asserts that the proposed reorganization will not result in any unjustified subsidization of non-utility activities by IAWC or its customers because IAWC does not engage in a significant level of such activity. To the extent IAWC engages in such activities in the future, he testifies that it will continue to maintain its books and records in such a manner as to fairly and reasonably allocate utility and non-utility activities so that the Commission may identify those costs and facilities that are properly included for ratemaking purposes. Moreover, Mr. Gloriod explains that all affiliated interest agreements approved by the Commission, including the Services Agreement between IAWC and Service Company, will continue in effect following the proposed reorganization, unless or until such agreements terminate and/or an amended agreement is approved by the Commission. Therefore, the Commission will still be able to identify those costs and facilities which are properly included by the utility for ratemaking purposes following the proposed reorganization.

2. Staff's Position

Staff observes that Service Company and IAWC have an approved affiliate agreement that specifies that services are to be provided to IAWC by Service Company at cost or are to be based on identifiable allocation factors. The costs that can be identified as specific to IAWC are to be directly charged to IAWC. Costs that are not directly identifiable to only one Service Company affiliate are to be allocated based on the number of customers. Staff witness Everson notes that the Services Agreement between IAWC and Service Company will continue following the proposed reorganization. She also requests that IAWC acknowledge its responsibility to provide

all necessary information that Staff may require in any future rate proceeding. IAWC states that work papers documenting the assignment method or process will be made available to Staff. IAWC also acknowledges that if an affiliated company other than Service Company were to provide services for which IAWC would be charged, IAWC would seek Commission approval of the arrangement or agreement. Staff concludes that the reorganization would not result in unjustified subsidization of non-utility activities and that the affiliate agreement provides that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities that are properly included by the utility for ratemaking purposes.

3. Commission Conclusion

Based on the evidence, the Commission finds that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by IAWC or its customers and that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and activities which are properly included by the utility for ratemaking purposes. The Commission also agrees with Staff that the methods for allocating costs set forth in the Services Agreement between IAWC and Service Company, which will continue in effect following the reorganization, satisfy the requirements under subsections (b)(2) and (3).

C. Section 7-204(b)(4)

1. Joint Applicants' Position

As for subsection (b)(4), rather than impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure, Joint Applicants maintain that the proposed reorganization will actually enhance AWWC's ability to raise capital which, in turn, will increase IAWC's access to capital markets. Mr. Lambertz testifies that, since announcement of RWE's acquisition of AWWC, both Standard & Poor's and Moody's have reviewed and amended the credit ratings of AWCC, which is the AWWC subsidiary that provides IAWC with access to short-term and long-term debt capital on behalf of AWWC. In each case, he reports that the credit rating agencies placed AWCC's existing ratings on Credit Watch positive, reflecting the proposed acquisition of AWWC by RWE, which is a higher-rated entity. Mr. Simic adds that, while AWCC has maintained a stable financial profile for its rating category in line with that of other water utilities with similar ratings, following the proposed reorganization, the resulting implied credit rating for IAWC will be based upon RWE's credit rating, which is higher than AWCC's credit rating. Accordingly, Joint Applicants contend that an upgrade to AWCC's credit ratings would enhance AWWC's credit quality and increase AWWC's access to international markets, which would improve IAWC's ability to raise necessary capital on reasonable terms and to maintain a reasonable capital structure.

Specifically, Mr. Lambertz states that following announcement of RWE's acquisition of AWWC, RWE's credit ratings were affirmed as AA-, Outlook Stable by Standard & Poor's and Aa3, Outlook Negative by Moody's. When RWE announced its acquisition of the Czech Republic-based utility Transgas, Standard & Poor's amended RWE's credit rating to Outlook Negative, retaining the AA- rating, and Moody's declined to amend its rating. Following RWE's announcement of its acquisition of Innogy, plc, Moody's downgraded RWE to A1 with a Negative Outlook, from Aa3 with a Negative Outlook, reflecting RWE's reduced financial flexibility at the Aa3 rating level. Despite the downgrade, however, Moody's March 22, 2002 Report recognized the beginning of a consolidation phase of RWE's development and noted that RWE should have additional financial flexibility within the then-current rating to grow and develop the businesses it currently owns and is acquiring. Similarly, Mr. Lambertz notes that, while Standard & Poor's assigned RWE an AA-, Negative Outlook rating following the announcement, its March 22, 2002 Report recognized that RWE's acquisition of Innogy, plc is in line with RWE's strategy to become a leading multi-utility in Europe and North America, and that RWE continues to benefit from a strong business position, robust balance sheet, and disposable non-core assets. In addition, Standard & Poor's stated that "Any ratings downgrade on RWE as a result of the Innogy acquisition is likely to be limited to one notch."

This expectation was confirmed on June 13, 2002, when RWE's long-term corporate credit rating was lowered one notch from AA- to A+. Joint Applicants point out, however, that RWE's A+ credit rating remains higher than AWCC's A- credit rating and thus, RWE's utility subsidiaries, including IAWC, will benefit from the reorganization. Moreover, the June 13, 2002 Standard & Poor's report notes that "All ratings on RWE and affiliates, including Innogy, were removed from Credit Watch where they were placed on March 22, 2002, following RWE's bid for Innogy. The outlook on all companies is stable." That report, according to Joint Applicants, further states, "RWE is committed to a period of consolidation and expects its financial profile to stabilize, despite the planned acquisition of American Waterworks Co., Inc."

Finally, Mr. Gloriod testifies that IAWC commits to report to the Commission and Manager of the Finance Department future information regarding the credit ratings of RWE, Thames, AWCC, AWWC, IAWC, Thames Holdings, and TWUS consistent with Staff's proposed condition.

2. Staff's Position

Although she believes that the proposed reorganization currently satisfies the requirements of subsection (b)(4), Staff witness Langfeldt nevertheless recommends that the Commission impose a condition upon approval of the reorganization that would assist the Commission to monitor the credit ratings of RWE and its subsidiaries, including AWCC. Ms. Langfeldt agrees that IAWC currently obtains equity capital through AWWC and that AWCC provides IAWC access to short-term and long-term debt capital on behalf of AWCC, pursuant to an agreement the Commission approved in Docket No. 00-0306.

Ms. Langfeldt testifies that AWCC has access to the capital markets on reasonable terms. In doing so she explains that Standard & Poor's categorizes debt securities on the basis of the risk that a company will default on its interest or principal payment obligations. The resulting credit rating reflects both the operating and financial risk of a utility. Standard & Poor's rates AWCC A-, which reflects a strong support arrangement with AWCC, according to Ms. Langfeldt.

Following the reorganization, AWCC or IAWC, whichever can provide financing at a lower cost, would continue to raise debt capital in accordance with the agreement approved by the Commission in Docket No. 00-0306. Ms. Langfeldt states that AWCC would remain the sole provider of common equity capital to IAWC. Nonetheless, she acknowledges that the reorganization would result in RWE becoming AWWC's indirect parent company, and ultimately, RWE would be responsible for providing equity capital to IAWC if AWWC did not have sufficient funds on hand. The impact of the reorganization on IAWC's ability to raise capital on reasonable terms and maintain a reasonable capital structure ultimately depends on the financial strength of RWE. When RWE acquired Thames Water plc, Ms. Langfeldt reports that Standard & Poor's stated that RWE's water operations could not be separated on a rating basis.

Despite the recent downgrade, Ms. Langfeldt notes that RWE's A+/A1 credit ratings exceed AWCC's A- credit rating. Thus, she concludes that the reorganization currently satisfies the requirements of subsection (b)(4). Nevertheless, IAWC's ability to access the capital markets and maintain a reasonable capital structure could become significantly impaired if RWE's financial condition continues to deteriorate. Ms. Langfeldt testifies that RWE's aggressive acquisition strategy has put downward pressure on its long-term corporate credit rating. To protect the interests of IAWC's customers, Ms. Langfeldt recommends that IAWC should inform the Commission of any changes to the corporate credit ratings of RWE, Thames, and AWCC by filing a copy of the complete credit report, within 15 days of publication, with the Chief Clerk of the Commission with a second copy provided to the Finance Department Manager. In addition, Ms. Langfeldt recommends that credit rating reporting requirement be extended to AWWC, Thames Holdings, and TWUS should those entities get credit ratings.

Ms. Langfeldt states that notification of credit rating changes would allow the Commission to monitor the financial condition of IAWC and its affiliates, including each of the companies within the chain of ownership from IAWC to its ultimate parent company, RWE. Specifically, the reports would alert the Commission should IAWC's financial condition become significantly impaired and whether action pursuant to Section 7-103 of the Act is warranted. Ms. Langfeldt states that Section 7-103 authorizes the Commission to limit public utilities' dividend payments if the Commission finds that the capital of a public utility has become impaired or will become impaired by the payment of a dividend.

3. The Cities' Position

The Cities did not present evidence regarding the proposed reorganization's compliance with subsection (b)(4). In their Initial Brief and Reply Brief, however, they discuss the recent downgrading of RWE's corporate credit rating and argue that subsection (b)(4) can not be considered satisfied. The Cities state that it is clear from the record that the corporate credit rating of RWE will reflect upon the corporate credit rating of AWWC which, in turn, will reflect upon the corporate credit rating of IAWC. In light of the downward trend in the rating of RWE by both Standard & Poor's and Moody's, the Cities conclude that the rating agencies look with disfavor upon the aggressive acquisition policy of RWE. They further note that RWE has made no commitment to amend this policy in any respect. The Cities also point out that the Commission is without power to limit future acquisitions by RWE unless such acquisitions would involve an Illinois-regulated public utility. The Cities assert that the reporting requirements suggested by Staff offer limited protection in that the Commission would be informed after the fact as to any changes in the corporate credit rating. Given the Commission's lack of power to require RWE to take any remedial action and the fact that there is no reason to believe that RWE will not continue with its acquisition policy, the Cities argue that continuation of such a policy would impair IAWC's ability to raise necessary capital on reasonable terms.

4. Commission Conclusion

While the recent downgrades in RWE's corporate credit ratings are not ideal, the fact remains that RWE's credit rating is still higher than that of AWCC. The higher credit rating will reflect upon AWWC and IAWC, and enhance IAWC's ability to raise necessary capital on reasonable terms and to maintain a reasonable capital structure. Nor, despite the Cities' assertion, is there sufficient evidence to conclude that RWE's credit rating will continue to decline. Rather, it appears that RWE's credit rating is stabilizing while RWE consolidates its operations. Furthermore, the Commission accepts IAWC's commitment to comply with the reporting requirements proposed by Staff. Ms. Langfeldt's recommendation will permit the Commission to monitor the financial condition of IAWC and its affiliates, including each of the companies within the chain of ownership from IAWC to its ultimate parent company, RWE (to the extent credit ratings exist). This will alert the Commission if IAWC's condition becomes impaired and will enable the Commission to determine whether additional action under the Act is warranted. Accordingly, the Commission finds that the proposed reorganization will not significantly impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.

D. Section 7-204(b)(5)

1. Joint Applicants' Position

Subsection (b)(5) requires that the Commission find that IAWC will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the

regulation of Illinois public utilities. Mr. Carmedy testifies that, following the proposed reorganization, which will include TWUS as an intermediate holding company in the RWE corporate structure, IAWC will continue to exist in the same corporate form as it does today and will continue to be a subsidiary of AWWC, subject to the Commission's comprehensive jurisdiction under the Act and the Commission's rules. Accordingly, Joint Applicants contend that the proposed reorganization satisfies the requirement of subsection (b)(5). Mr. Smith further testifies that, in response to Staff's concern that Section 8.09 of the Agreement could at least arguably permit future reorganizations, RWE and Thames Holdings commit, consistent with Mr. Johnson's recommendation, that IAWC will seek approval of any future proposed corporate structure change that requires Commission approval under Section 7-204. This commitment was supported by Mr. Lambertz's affidavit.

2. Staff's Position

Mr. Johnson testifies that IAWC will continue to be under the jurisdiction of the Commission and will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of public utilities. He proposes that the Commission approve the following corporate structure for IAWC: IAWC will continue to be a subsidiary of AWWC and AWWC, through TWUS, will be a wholly-owned subsidiary of Thames Holdings, which is a wholly-owned subsidiary of RWE. He also proposes that approval be conditioned upon the commitment by Thames Holdings and RWE that if at any time in the future there is a proposed corporate structure change that requires Commission approval, IAWC will seek approval from the Commission for those changes.

3. Commission Conclusion

The Commission finds that the proposed reorganization, including inclusion of TWUS as an intermediate holding company, satisfies subsection (b)(5) because, following the reorganization, IAWC will continue to exist in the same corporate form as it does today and will continue to be a subsidiary of AWWC subject to the Commission's jurisdiction under the Act and the Commission's rules. In addition, Staff's proposed condition – to which Joint Applicants have agreed – is reasonable and should be adopted. The corporate structure of IAWC will also be approved as Staff recommends.

E. Section 7-204(b)(6)

1. Joint Applicants' Position

Joint Applicants contend that the proposed reorganization also satisfies the requirement of subsection (b)(6), which requires a Commission finding that "the proposed reorganization is not likely to have an adverse effect on competition in those markets over which the Commission has jurisdiction." Mr. Gloriod explains that, following the proposed reorganization, IAWC will continue to operate in its current certificated service territories under the same market conditions that currently exist.

Because no present operating company or other entity owned by Thames Holdings has, or plans to conduct, water or wastewater operations in Illinois, Joint Applicants assert that there is no competition between IAWC and any entity owned by Thames Holdings. Therefore, they conclude that the proposed reorganization will not, and can not, have a significant effect on competition in those markets subject to the Commission's jurisdiction.

2. Staff's Position

Mr. Johnson testifies that none of Thames Holdings' U.S. entities presently has water or wastewater public utility operations in Illinois, or any plans to conduct such operations. The only water or wastewater companies owned by RWE, through its subsidiaries, are operated in New Jersey. Mr. Johnson agrees with Joint Applicants that due to geographical separation, the merger will not result in the elimination of a competitor in the water and wastewater services market. He further states that since the only change that is occurring is the changing of a parent company, and AWWC will survive as a wholly-owned subsidiary of Thames Holdings, the proposed merger is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction.

3. Commission Conclusion

The Commission finds that the evidence presented by Joint Applicants and Staff clearly demonstrates that the proposed reorganization satisfies the requirement of Section 7-204(b)(6).

F. Section 7-204(b)(7)

1. Joint Applicants' Position

Subsection (b)(7) requires that the Commission find that the proposed reorganization is not like to result in any adverse rate impacts on retail customers. Mr. Gloriod and Mr. Carmedy testify that the proposed reorganization satisfies this subsection. Following the proposed reorganization, Joint Applicants explain that IAWC will continue to operate under its existing tariffs and rate structures, unless and until such tariffs and rate structures are revised in accordance with Illinois law and in the ordinary course of business. Joint Applicants state that they do not seek any rate increase or changes to IAWC's tariffs as a result of the reorganization.

2. Staff's Position

Mr. Johnson testifies that Joint Applicants are not requesting any rate increases or changes to tariffs as a result of the merger and are not seeking recovery of any acquisition premium or costs; therefore, the merger will not result in an increased cost-of-service or any increase in rates. He also notes that no costs associated with TWUS would be allocated to IAWC and therefore no costs related to TWUS would be reflected

in rates. Because Joint Applicants plan to operate under current rates without interruption or change, he sees no adverse rate impacts on customers.

3. The Cities' Position

The Cities did not present evidence regarding the proposed reorganization's compliance with subsection (b)(7). In their Initial Brief, however, the Cities assert that the Commission can not find that the proposed reorganization satisfies subsection (b)(7) because, in the Cities' view, Joint Applicants have made no commitment with regard to future rate increases. In their Reply Brief, they suggest that IAWC commit to not raise rates for a certain number of years. The Cities also repeat their earlier claim that RWE will seek to recover the premium it is paying for AWWC through either a rate increase and/or a decrease in service.

4. Commission Conclusion

The Cities have offered no evidence in support of their assertion that retail customer rates are likely to be adversely affected by the reorganization. In the absence of any evidence, the Commission can not adopt the Cities' position. The record does contain, however, Joint Applicants' commitment to continue to provide service pursuant to IAWC's current rates and tariffs. This being the case, the Commission finds that the proposed reorganization satisfies the requirement of Section 7-204(b)(7).

G. Section 7-204(c)

1. Joint Applicants' Position

Subsection (c) requires the Commission to rule upon the allocation of any savings resulting from the reorganization and whether Joint Applicants should be allowed to recover any costs incurred in accomplishing the reorganization. Mr. Carmedy testifies that no synergy savings are expected to occur in Illinois as a result of the proposed reorganization because Thames does not currently maintain operations in Illinois. He explains, however, that to the extent that synergy savings are reflected in future rate case test years, the Commission should find under Section 7-204(c)(i) that such savings should be allocated in full to customers. In addition, Mr. Carmedy explains that Joint Applicants do not seek recovery of any acquisition premium or costs to accomplish the reorganization, and Thames does not intend to pass such costs through to IAWC. Therefore, Joint Applicants request that the Commission rule, under Section 7-204(c)(ii), that no costs incurred in accomplishing the reorganization are recoverable in IAWC's rates.

2. Staff's Position

Staff agrees that Joint Applicants' proposed findings under Section 7-204(c)(i) and (ii) are appropriate. In addition, Ms. Everson testifies that Staff's position in this

respect remains unchanged in light of the information provided by Joint Applicants regarding establishment of TWUS.

3. Commission Conclusion

Consistent with the evidence presented by Joint Applicants and Staff, the Commission finds under Section 7-204(c)(i) that, to the extent any synergy savings resulting from the proposed reorganization are reflected in future rate case test years, such savings should be allocated in full to customers. In addition, under Section 7-204(c)(ii), no costs incurred in accomplishing the reorganization are recoverable in IAWC's rates.

V. OVERVIEW OF PROPOSED CONDITIONS

As indicated above, Staff proposes certain conditions which it recommends be made a part of any order approving the proposed reorganization. Joint Applicants accept all of Staff's conditions, which, for convenience, are grouped together below:

1. The rates, rules, regulations, and conditions of service applicable to the service areas of IAWC shall remain the same as those currently on file with the Commission, until such time as any changes are approved by the Commission.
2. The final corporate structure approved by the Commission shall be the following: IAWC will continue to be a subsidiary of AWWC; AWWC, through TWUS, will be a wholly-owned subsidiary of RWE.
3. Commission approval consistent with Section 7-204 of the Act must be sought for any additional changes to the corporate structure involving IAWC.
4. IAWC shall inform the Commission of any changes to the corporate credit ratings of RWE, Thames, and AWCC by filing a copy of the complete credit report, within 15 days of publication, with the Chief Clerk of the Commission with a second copy provided to the Finance Department Manager. In addition, the reporting requirement shall be extended to AWWC, Thames Holdings, and TWUS if those entities get credit ratings.
5. Although no savings resulting from the reorganization are currently identified, any savings identified at a later date shall be passed on to ratepayers through traditional cost of service-based ratemaking.
6. No costs resulting from the reorganization shall be recovered from IAWC customers.

Staff, however, is not alone in its discussion of conditions. The Cities also make reference to several conditions imposed by the Kentucky Public Service Commission ("Kentucky Commission") in its approval of the same transaction as it relates to Kentucky-American Water Company. They point out in their Initial Brief that the Kentucky Commission imposed 56 conditions and urge this Commission to do the same.² At the end of their Initial Brief, however, the Cities conclude that imposing such conditions would create an unreasonable burden on Staff and, ultimately, Illinois taxpayers. Instead, the Cities recommend denying the approval sought by Joint Applicants. Joint Applicants insist that the conditions imposed by the Kentucky Commission are not relevant to this proceeding while Staff states that the action taken by the Kentucky Commission should be considered by the Commission only to the extent that they are consistent with the facts in this proceeding, are necessary to protect the interests of the utility and its customers, and comply with Section 7-204.

The Commission notes again that the Cities, despite having the opportunity to do so, did not offer any evidence in this proceeding. Therefore, there is simply no evidence to support simply lifting the conditions from the Kentucky Commission's approval order and inserting them in this Commission's order. In any event, the Cities neglect to note that some of the Kentucky Commission's conditions are already covered by Staff's conditions and Joint Applicants' commitments.

VI. FINDINGS AND ORDERING PARAGRAPHS

Having considered the entire record herein and being fully advised in the premises, the Commission is of the opinion and finds that:

- (1) IAWC is engaged in the business of providing water and/or sanitary sewer services to the public in the State of Illinois and, as such, is a public utility within the meaning of Section 3-105 of the Act;
- (2) the Commission has jurisdiction over IAWC and the subject matter herein;
- (3) the recitals of fact and conclusions reached in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact;
- (4) the evidence of record demonstrates that the proposed reorganization is in the public interest and is not detrimental to the interests of IAWC's customers;
- (5) pursuant to Section 7-204 of the Act:
 - (A) the proposed reorganization will not diminish the ability of IAWC to provide adequate, reliable, efficient, safe, and least-cost public utility service;

² The Cities note that any conditions which clearly would not apply to IAWC should be excluded.

- (B) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by IAWC or its customers;
 - (C) costs and facilities will be fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by IAWC for ratemaking purposes;
 - (D) the proposed reorganization will not impair the ability of IAWC to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
 - (E) IAWC will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;
 - (F) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and
 - (G) the proposed reorganization is not likely to result in any adverse rate impacts on IAWC's retail customers;
- (6) the Verified Application for approval of the proposed reorganization should be approved subject to the conditions proposed by Staff and listed in Section V above;
- (7) all objections, motions, and petitions in this proceeding that have not specifically been ruled on should be disposed of in a manner consistent with the findings and conclusions herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the proposed reorganization described herein, subject to the conditions referenced in Finding (6), should be, and hereby is, approved.

IT IS FURTHER ORDERED that any objections, motions, or petitions in this proceeding that have not specifically been ruled on shall be disposed of in a manner consistent with the findings and conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this 20th day of November, 2002.

(SIGNED) KEVIN K. WRIGHT

Chairman

Commissioner Kretschmer dissented; a written opinion will be filed.

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company :
and Thames Water Aqua Holdings, :
GmbH :
 :
 :
 :
Joint Application for Approval of : 01-0832
Proposed Reorganization and :
Change in Control of Illinois- :
American Water Company :
Pursuant to Section 7-204 of the :
Illinois Public Utilities Act. :

DISSENTING OPINION OF COMMISSIONER RUTH K. KRETSCHMER,
ON THE ORDER ENTERED BY THE COMMISSION ON
NOVEMBER 20, 2002

December 6, 2002, dissenting opinion filed by Commissioner Ruth K. Kretschmer to the Notice of Commission Action entered by the Commission on November 20, 2002 in the above-captioned proceeding:

I am troubled by the Majority's decision to approve the proposed reorganization and change in control of Illinois-American Water Company ("IAWC"). The law clearly states that a decision in a reorganization proceeding must include an assessment of the applicants' financial stability.¹ Given the incomplete record in this case regarding pertinent financial matters, and other issues outlined below, I believe it was premature for the Commission to grant approval of the reorganization.

Agreement

The agreement and plan of merger ("Agreement") in this proceeding is by and among the parent holding company RWE Aktiengesellschaft ("RWE"), Thames Water Aqua Holdings GmbH ("Thames Holdings"), Apollo Acquisition Company ("AAC") and American Water Works Company, Inc. ("AWWC"). AWWC is the parent company of IAWC. Pursuant to the terms of the Agreement, AAC would be merged with and into AWWC, the surviving corporation, which would be a wholly owned subsidiary of Thames Water Aqua U.S. Holdings, Inc., which is a

wholly owned subsidiary of Thames Holdings, which would remain a subsidiary of RWE. IAWC would remain a wholly owned subsidiary of AWWC.

Governing Law

Section 7-204 of the Public Utilities Act governs reorganizations such as that proposed in this docket. "In reviewing any proposed reorganization, the Commission must find that:

1. the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;
2. the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
3. costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;
4. the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
5. the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
6. the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and
7. the proposed reorganization is not likely to result in any adverse rate impacts on retail customers."²

Incomplete Record

In order for the Commission to make a sound decision in any reorganization, the law requires us to consider the parent company's financial condition. I had asked the Administrative Law Judge a number of questions about information I needed to review prior to making a decision in this case. Issues not covered in the record, which were requested during my consideration of the Application, include the following:

- the current book value of American Water Works, the parent company of Illinois-American Water Company;

¹ See 220 ILCS 5/7-204.

² Id.

- the financial strength and stability of RWE after July 31, 2002. This period of time is important as it reflects the timeframe where corporate finances worldwide have come under increased scrutiny and corporate ratings have declined;
- the financial and management plans of RWE for the next five years.

The deterioration of credit quality for utilities began well before the California and Enron debacles of 2001, but they certainly have exacerbated it. This erosion of credit quality can be traced to several causes, including, but not limited to, the weakening of bondholder protection parameters, caused by:

- diminished liquidity and financing flexibility;
- increased business risk derived from growing investments outside the traditional regulated utility business;
- regulatory challenges;
- capital and corporate restructuring efforts; and
- to a lesser extent, by mergers and acquisitions.

Cumulatively, the convergence of these factors has subsequently resulted in weakened bondholder protection parameters.³ This trend evolved as a result of companies' strategies to enhance shareholder value in an environment that had become increasingly uncertain and competitive. This phenomenon goes beyond our own national border; it also is now an international trend. In the instant proceeding, RWE acquired Thames Water in September 2000 and then began an aggressive acquisition phase, largely debt financed. RWE now pursues a multi-utility strategy in electricity, water, gas and waste, with a geographic focus on Europe and North America. I believe it was essential to reopen the record in the instant proceeding to gather more financial information prior to making a decision on the Agreement.

Regulators in Europe require companies to submit a five-year business plan, which is updated annually. I believe it was critical to include this plan in the record, to assure us that the company is on the right track. Both Standard & Poor's and Moody's analysts have stated that RWE needs to consolidate holdings, both financially and from a managerial perspective, in order to maintain current ratings, which have started to slip. It is not unreasonable to request documentation of the five-year business plan, specifically since analysts have repeatedly stated

³ Eiseman, Credit Quality for U.S. Utilities Continues Negative Trend in First Half, Standard & Poor's, Utility Industry Commentary, October 2002.

that they rely on commissions to determine the financial stability and viability of proposed reorganizations.

Reorganization Conditions

The conditions imposed on the Agreement reflect the Commission's desire to maintain the existing status quo. They are the standard conditions for mergers and reorganizations – with one exception. The [summarized] conditions include:

- maintaining the rates, rules, regulations, and conditions of service applicable to the service areas, until changes are approved by the Commission;
- maintaining the corporate structure stated in the Agreement, as approved, until further changes are approved by the Commission;
- passing on identified savings, if any, to ratepayers at a later date, through traditional cost of service-based ratemaking;
- not recovering reorganization costs from ratepayers; and
- reporting changes in corporate and affiliate credit ratings to the Commission as they occur.

The final condition pertaining to future credit ratings perplexes me. If the Majority has determined that changes to the ratings of corporate and affiliated companies' credit in the instant proceeding are important for the future health and well being of IAWC as a regulated Illinois public utility, then why is this information irrelevant when considering the decision to grant approval for the reorganization? This information should have been included in the evidentiary record and carefully considered by the Commission in its deliberations.

Conclusion

Given the global nature of the proposed reorganization and its effect in 20 states, including Illinois, I believe the Majority approved the Agreement without forethought as to the financial consequences to ratepayers in Illinois. Specifically, I believe the Majority erred in granting the reorganization in the instant proceeding based on:

- an inadequate record before the Commission;
- the lack of current and relevant financial information on the joint applicants, their affiliates and the holding company RWE; and

- the lack of five-year, forward-looking financial and management plans for the joint applicants, their affiliates and the holding company RWE.

For all the foregoing reasons, I respectfully dissent.