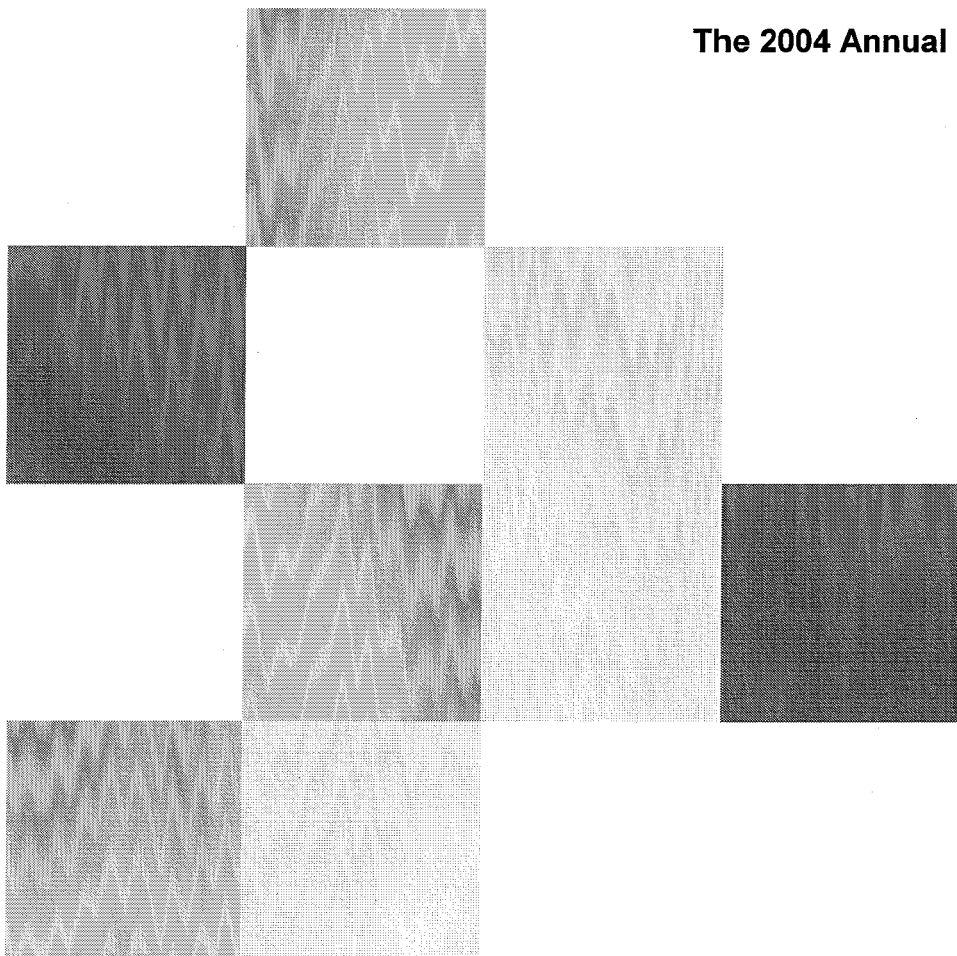




Rewarding Achievement

The 2004 Annual Incentive Plan



The 2004 American Water Annual Incentive Plan

The 2004 American Water Annual Incentive Plan (AIP) recognizes the opportunity and the accountability we share for achieving our goals. Your accomplishments have helped to build American Water's success to this point, and the AIP will reward you for the contribution you make to the achievement of our goals.

Who Is Eligible for the 2004 AIP

As in our previous plan, all full-time management, professional and technical employees (exempt from overtime) in American Water are eligible to participate in the 2004 AIP.

Eligible employees who join American Water before September 30 of a plan year (January 1 – December 31) are also eligible to participate in the plan on a prorated basis.

Eligible employees seconded from RWE/Thames Water will participate in the plan for the duration of their secondment.

Your Award Opportunity

Your award opportunity is based on your role. Your manager will confirm your award opportunity to you in writing.

If you are promoted during the plan year to a position with a higher award level, your opportunity will be prorated to reflect the full months at each award level. Similarly, if you are reclassified to a position with a lower AIP award level, your award opportunity will be prorated to reflect the full months at each award level.

What the Plan Measures

The AIP is designed to reward participants for the performance results they and the Company attain during the plan year. There are three performance components: financial, operational and individual.

- The **Financial** component includes two new measures – Value Added and Free Cash Flow I.

Goals will be set for the business unit in which you work based on the 2004 business plan. In 2003, goals were set at your work and at the next higher organizational level; in 2004, financial goals will only be based on your business unit level, e.g., California American.

- The **Operational** component includes performance measures tied to the American Water balanced scorecard through which customer service, environmental and health & safety measures and goals, as appropriate to your role, are the key performance indicators. Those in American Water Business Center roles in Voorhees will have a mix of financial and individual measures, but no Operational component.
- The **Individual** component includes objectives (Key Performance Indicators) within the company performance management process.

Financial Measures	Operational Measures	Individual Measures
<ul style="list-style-type: none"> ▪ Value Added ▪ Free Cash Flow I 	<p>Examples include:</p> <ul style="list-style-type: none"> ▪ Customer Service – This will make up 50% of the total operational component. This measure deals with services that directly benefit the customer. ▪ Environmental ▪ Health & Safety <p>...as applicable to your business unit and role</p>	<ul style="list-style-type: none"> ▪ 5 Key Performance Indicators (KPI's) to be agreed by AIP participant and their manager by the end of April.

A Note on “Value Added” and “Free Cash Flow I”

In the 2003 AIP Plan, the measures were Operating Result and Net Debt. For 2004, we've chosen Value Added and Free Cash Flow I as the measures for the Financial component of the AIP because they are critical gauges of our business success, and are now the standard used by RWE. Here's how we define these new terms.

- **Value Added**

An established measure which reflects the contribution made by a business unit to the Group, relative to its cost of capital

It is calculated using operating result and operating assets

- **Free Cash Flow I**

An important operating figure that is also linked to net debt performance.

It is defined as the cash flow from operating activities (after interest and tax) plus capital expenditure. It does not include the impact of financial restructuring or any impact of acquisitions or disposals.

Each measure has equal weighting and business plan performance will deliver half the relevant financial bonus element. Therefore, if only one measure is met, there could be a potential award under the plan.

Each performance measure has a straight-line payment profile, with the mid-point defining “on-target” performance, i.e. 100%. The slope of the payment profile is determined by reference to the volatility (inconsistency) associated with the measure. For Value Added, volatility is determined by potential variations in operating result; for Free Cash Flow I (“FCFI”), volatility is determined by Earnings Before Interest Tax Depreciation and Amortization (EBITDA).

In all cases, the 2004 plans have been adjusted for the capital expenditure challenge that we have set as a company.

How Your Award Is Weighted

Your award opportunity is based on up to three performance components, depending on your role. You can earn part of your award for each component independent of the others. That means you can receive an award based on all, some or none of the applicable components, depending on actual performance results.

Note that the American Water Board reserves the right to determine whether incentives are payable to any individual or group of individuals. The Board may withhold all incentive payments in exceptional circumstances, such as failing to meet minimum financial goals. In any case, individuals who do not meet our performance expectations will not be eligible to receive an incentive award.

The portion of your award opportunity you can earn for each component is reflected in weightings assigned to each, based on your role in the organization, as the following chart shows.

If your position is...	Your Financial component weighting is...	Your Operational component weighting is...	And your Individual component weighting is...
Regional Managing Directors & their direct reports*	70%	20%	10%
Business Center employees (Voorhees, Procurement, IT, Belleville, SSC)	70%	N/A	30%
Other eligible management and exempt employees	60%	25%	15%

* (Does not apply for administrative or short-term special assignment employees who report to Regional Managing Directors. Those individuals would fit under the "other eligible management and exempt employee category in the chart above.)

Note that award opportunities for all Business Center (Voorhees) roles will have a mix of Financial and Individual measures, but no Operational component.

Your manager will discuss these with you and confirm in writing the measures and weightings that apply to you.

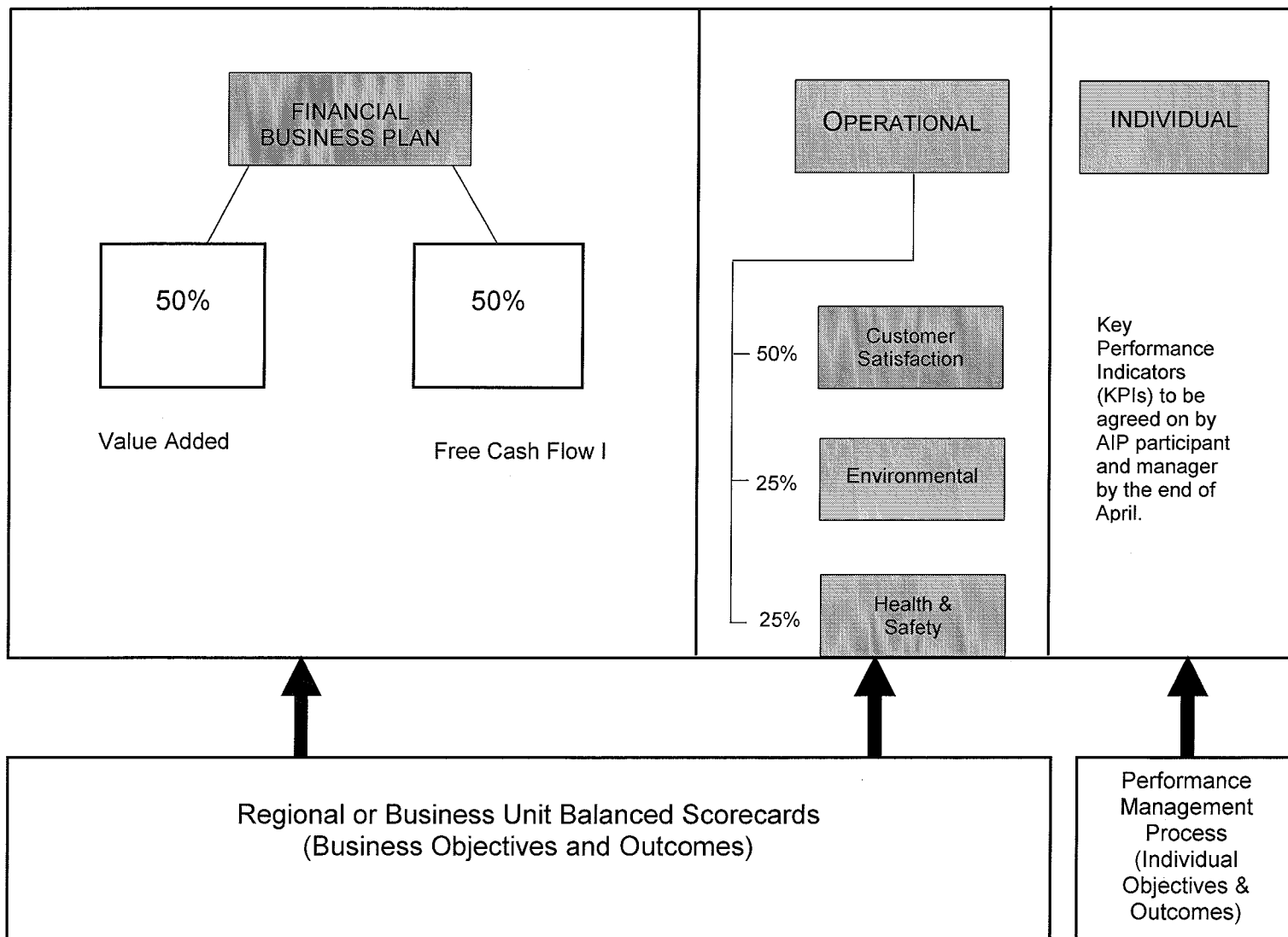
How the Weightings Come Together

Here is an **example** of how the three performance components and their weightings come together. As you can see, the measures within each component are also weighted.

The weightings within the financial component are always based on your business unit measures of Value Added and Free Cash Flow I, to determine the portion of the financial component award opportunity that is payable.

You will receive a graph for your business unit. Each will detail the percentage of your financial award opportunity payable at a given level of combined Value Added and Free Cash Flow I achievement, ranging from a minimum level of achievement that qualifies for an award up to the maximum level. The closer actual results come to target financial performance, the higher the award for the financial component.

EXAMPLE



Performance You Can Impact

We believe it's essential that participants be accountable for, measured on and rewarded for performance that they can directly impact or influence. That's why performance measures for the financial component are based on your local or "home" organization, i.e., the business unit where you work.

Similarly, the operational and individual measures and goals that apply to you will reflect your role. Your manager will review and discuss all applicable financial and operational measures and goals with you.

Individual Performance

The individual performance will be assessed using American Water's Performance Management and Development Review (PDR) process. This process has been revised to align with the new Balanced Scorecard. The first section of the PDR form contains a scorecard in which your individual Key Performance Indicators (KPIs) will be documented. KPIs are individual performance objectives. You will jointly identify and agree to your individual KPIs and relative weightings to be achieved during the year with your direct supervisor.

In overview, the PDR requires each individual to have 5 KPIs agreed at the beginning of 2004. The KPIs should be specific and measurable and linked to the Balanced Scorecard. Each KPI needs to be weighted (out of 100%) according to its importance relative to other KPIs. In this way excelling at your highest priority KPI, which has the heaviest weighting, will drive a bigger award. At least one of the KPIs should be linked to a personal development objective. At the beginning of 2005, a structured performance review will be conducted to determine how well individuals performed against their KPIs in 2004.

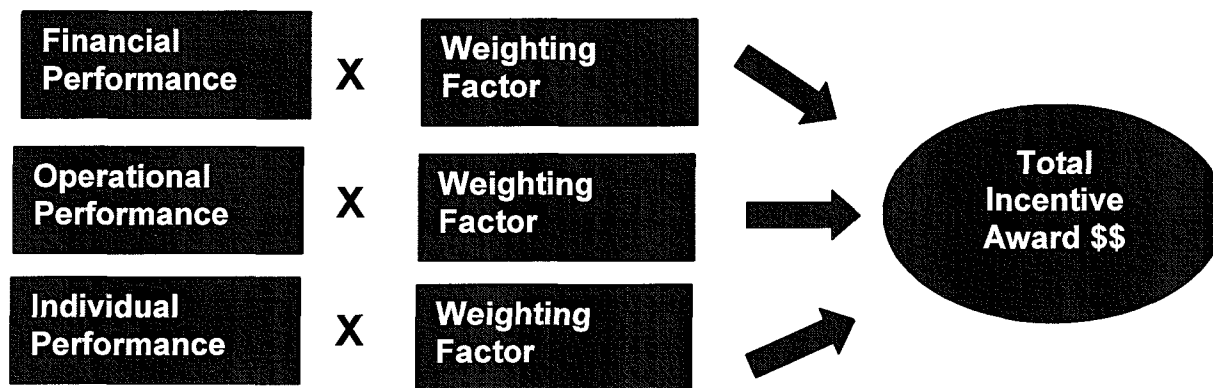
The percentage amounts paid for varying levels of achievement against each KPI should be as follows:

Performance Category	Percent Amounts
• Target not achieved	0 %
• Target partially achieved	25%
• Target largely achieved	75%
• Target fully achieved	100%
• Target exceeded	Up to 120%

Percentages other than these are possible. However, percentages must be expressed in 5% increments (so for example 50% would be a valid scoring, 51% would not). When targets are exceeded a percentage of up to 120% can be defined. This should be used only in cases of exceptional and outstanding performance against KPIs. If an individual received a "too soon to rate" on their PDR they would not be eligible for an AIP award.

How Your Payout Is Determined

At the end of the year, the amount for each component is based on performance against each goal within the component and its relative weighting. Here is a simplified way to think of it.



Target Bonuses

As part of American Water’s alignment with RWE’s incentive processes, the focus of the bonus communication in the future will be on “target bonus.” Target bonus is defined as the bonus paid at 100% for both company and individual awards. This means business plan is achieved for the company and operational element, and the employee has met his/her objectives for the individual element.

It is theoretically possible in the design to generate a combination of company and individual performance that would allow greater bonuses than the agreed maximums. However, the Company will cap the awards at a maximum percentage. The following example will illustrate how the award is calculated.

EXAMPLE:

Regional Employee (other than a Regional Managing Director or their direct report) with an AIP target of 17.3% and 11.5% of their base pay. Example illustrates 100% achievement on each AIP performance component and how it totals each employee’s AIP Target. Since it is possible to exceed 100% of each AIP component the company has established a maximum for plan participants. The “Maximum” column illustrates the maximum award for employee 1 and employee 2. ⁽¹⁾ Meet Business Plan + 100% of personal KPIs met. ⁽²⁾ Maximum is defined as exceeding Business Plan

	60% Financial Component		25% Operational Component	15% Individual Component	AIP Target ⁽¹⁾	Maximum ⁽²⁾
	Value Added	Free Cash Flow I	Operational	Individual		
Emp. 1	5.2%	5.2%	4.3%	2.6%	17.3%	22.5%
Emp. 2	3.5%	3.5%	2.9%	1.7%	11.5%	15.0%

⁽¹⁾ Meet Business Plan + 100% of personal KPIs met

⁽²⁾ Maximum is defined as exceeding Business Plan

Adjustments for uncontrollable events

The financial data included in the appendices has been prepared on the basis of the business plans agreed in 2003, using the assumptions set at that time. As in previous years, the actual results used for assessment will be amended to reflect the impact of events that are not considered to be within the control of local management. Any such amendments will require the explicit approval of the Water Division Finance Director, and where material the Board of RWE Thames Water plc, whose decision will be final. The following items are those most likely to be considered for amendment:

- The impact of movements in foreign exchange rates
- The impact of changes in intra-group recharges
- Disposal/acquisition of businesses not anticipated in the business plan, but subsequently mandated by the Board of Directors

Award Payments

To be eligible to receive an AIP award, you must be actively employed at the end of the plan year for which the award is earned. However, in case of disability, retirement, layoff or death during the plan year, a prorated award based on full months' participation in the plan may be payable. Note that no AIP awards are payable if termination is for cause.

If you become eligible to join the AIP during a plan year, any payout for that year will be prorated to reflect the number of full months you participated in the plan.

Awards are usually determined and paid in cash as soon as practical after RWE's release of financial results. Payments will be made by the end of the first quarter of the following year. Appropriate taxes will be withheld from awards.

The American Water Board reserves the right to determine whether incentives are payable to any individual or group of individuals. The Board may withhold all incentive payments in exceptional circumstances, such as failing to reach minimum financial goals. Individuals with poor performance will not be eligible to receive an incentive award.

Rewarding Achievement

Our AIP goals are challenging, but with your focus and contributions and effective teamwork, they can be achieved. Remember, your individual results do matter; our overall performance is the collective results of all AIP participants.

It's important that you clearly understand your goals, how we're performing against the goals, and how the AIP works so you know how you personally affect our performance. Be sure to talk to your manager or your local HR representative if you have questions.

This brochure describes the 2004 American Water Annual Incentive Plan. The Plan Administrator, whose decisions will be final and binding, will determine interpretations of the Plan. The Company reserves the right to amend, modify, or discontinue the Plan during the plan year or at any time in the future. Participation in the Plan does not convey any commitment to ongoing employment. If there are any differences between the information contained here and the Plan Document, the Plan Documents will govern.

AMERICAN WATER WORKS COMPANY, INC.

LONG-TERM INCENTIVE PROGRAM 2002 ADMINISTRATIVE GUIDELINES

I. ADMINISTRATION

The Long-Term Incentive Program (the "Program") will be administered by the Compensation and Management Development Committee (the "Committee") of the Board of Directors of American Water Works Company, Inc. (the "Company") pursuant to the terms and conditions of the 2000 Stock Award and Incentive Plan.

II. ELIGIBLE PARTICIPANTS

Executives and other key associates of the Company who are designated from time to time by the Committee, based on the recommendation by the President of the Company, will be eligible for Program awards. The receipt of an award will not confer upon any participant the right to continued employment or the right to receive any additional awards. Eligible participants for 2002 Program awards will be limited to executives in Levels One and Two and selected executives in Levels Three and Four. The Committee may add a participant to performance cycles in progress so long as at least one year remains in the performance cycle, in which case the participant will be entitled to a pro rata award for such performance cycle based on a target award level established by the Committee.

III. PROGRAM AWARDS

Since the merger agreement between the Company and RWE prohibits the grant of stock options and restricted stock, the 2002 Program awards will consist entirely of Performance Share Units.

IV. PERFORMANCE SHARE UNITS

Performance Share Units for 2002 will be based on achievement of performance goals from January 1, 2002 through December 31, 2004 (the "2002-2004 Performance Cycle") as described below.

Target values will be established by the Committee for each participant based on a percentage of salary midpoint in effect at the beginning of the performance cycle, and such target values will not be adjusted during the performance cycle for changes in salary midpoints, promotions or otherwise. Target values are divided by the fair market value of Company Common Stock at the beginning of the 2002-2004 Performance Cycle to determine the target number of Performance Share Units awarded to a participant. (Fair market value for this purpose will be based on the average of the closing prices during the 20-day trading period consisting of the last ten trading days in December 2001 and the first ten trading days in January 2002.) The actual number of Performance Share Units earned by a participant will be based on the Company's achievement of cumulative net income during the 2002-2004 Performance Cycle in accordance with the Net Income Matrix set forth on Exhibit A.

The President of the Company will report to the Committee regarding actual performance as soon as practicable following the conclusion of each performance cycle. The Committee will determine the extent to which the performance goals have been met and the actual number of Performance Share Units earned in accordance with the Net Income Matrix set forth on Exhibit A.

It is anticipated that the Company's merger with RWE will be consummated prior to the expiration of the 2002-2004 Performance Cycle, in which case the number of earned Performance Share Units will be paid 100% in cash at or as soon as practicable after the closing based on the RWE merger closing price (currently \$46) for each Performance Share Unit earned, subject to proration. If the 2002-2004 Performance Cycle expires on 12/31/2004 and at a time when the Company is not prohibited from issuing restricted stock, 50% of the Performance Share Units earned will be paid in cash (based on the fair market value of Company Common Stock at the end of the 2002-2004 Performance Cycle), and the remaining 50% will be paid in restricted shares of Company Common Stock as soon as practicable after the end of the performance cycle. (Fair market value at the end of the 2002-2004 Performance Cycle will be based on the average of the closing prices during the 20-day trading period consisting of the last ten trading days in December 2004 and the first ten trading days in January 2005.) Shares of restricted stock will vest after three years of continued future employment following the grant date, subject to 100% accelerated vesting upon a change in control event, termination of employment due to death or disability, termination of employment following the date on which the participant is eligible promptly thereafter to commence receiving retirement benefits from the Company ("Retirement"), or involuntary termination of employment without cause. The Committee may, in its discretion, provide for the deferral of any component of the award and the terms and conditions thereof.

In the event of termination of employment of a participant during a performance cycle due to death, disability, or Retirement, awards will be calculated at the end of the performance cycle based on actual performance and will be paid on a pro-rated basis, provided the participant has been an associate for at least one year during the performance cycle.

Upon a change in control event, all awards that have been earned by participants will immediately vest and all restrictions applicable to the awards will immediately expire. In addition, for the performance cycles not yet concluded at the time of a change in control event, pro rata awards for each of those performance cycles (based on the greater of the award values earned for performance calculated through the quarter ending prior to the change in control event or target values) will be paid to each participant as soon as practicable, and such payments will be made 100% in cash.

V. PERFORMANCE CYCLE GOALS

Performance cycle goals will be established by the Committee based on recommendations by the President of the Company. Goals for the 2002-2004 Performance Cycle will be based on the Company's cumulative net income as set forth on Exhibit A.

VI. **DIVIDEND EQUIVALENTS**

A contingent shares ledger account will be established for each participant. Reflected in that ledger account, retroactive to 1/1/2002, will be a number of shares of Company Common Stock equal to the number of Performance Share Units that are earned by the participant. Dividends paid on these earned shares during the 2002-2004 Performance Cycle will be accumulated as if reinvested during the performance cycle in additional shares of Company Common Stock on the dividend payment date. The shares accumulated in this ledger account by virtue of dividend reinvestment will be added to the Performance Share Units earned by a participant in connection with the participant's 2002 Program award.

VII. **HOW THE PROGRAM WORKS**

An example of how the Program will work is set forth on Exhibit B.

EXHIBIT A

NET INCOME MATRIX

2002 Cumulative Net Income (a)		Award Achievement
<u>\$ Millions</u>	<u>% Achievement</u>	<u>% of PSUs Earned (b)</u>
[Less than \$182	Less than 95%	0%
\$182.0	95%	50%
\$191.7	100%	100%
\$201.0]	105%	150%

- (a) Net income to be calculated excluding nonrecurring items; in particular, expenses relating to the RWE transaction will not be included in the calculation. Committee discretion to adjust net income goals for impact (positive or negative) of acquisitions and divestitures or other unusual items. Quarterly net income goals to be referenced in the event of a change in control prior to 12/31/2002 are as follows:

<u>2002*</u>	
Q1	<u>\$26.7</u>
Q2	<u>\$55.2</u>
Q3	<u>\$67.9</u>
Q4	<u>\$41.9</u>

- (b) Interpolate between results. Upon a change in control, the percentage of PSUs earned cannot be less than 100% of target, subject to proration based on the portion of the performance cycle completed up to the change in control date.

*Pre-Citizens

ILLUSTRATION OF 2002 LONG-TERM INCENTIVE PROGRAM

Determination of Target Performance Share Units

Participant's Salary Grade Midpoint (1/1/02)	\$159,300
Participant's Target Award	\$23,895 (15% of salary grade midpoint)
Beginning AWK stock value ^(a)	\$42.06
Target Number of PSUs	568 PSUs (\$23,895 ÷ \$42.06)

Hypothetical Results:

Percentage of PSUs Earned ^(b)	120%
RWE Closing Date	June 30, 2003
Pro Rata Award Percentage	50% (one-half of 2002-2004 cycle)

Calculation of Award:

Target Number of PSUs	568
Percentage of PSUs Earned	<u>x 120%</u>
	682
Pro Rata Award Percentage	<u>x 50%</u>
	341
Ending AWK stock value	<u>x \$46</u>
Total Award	<u>\$15,686^(c)</u>

- (a) Average of last ten trading days in December 2001 and first ten trading days in January 2002.
- (b) Based on actual cumulative net income through quarter ended immediately prior to RWE closing compared to target cumulative net income for such period. Upon a change in control, the percentage of PSUs earned cannot be less than 100% of target, subject to proration.
- (c) Paid in cash at or promptly following the RWE closing.