

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE JOINT PETITION OF KENTUCKY-)	
AMERICAN WATER COMPANY, THAMES)	
WATER AQUA HOLDINGS GMBH, RWE)	
AKTIENGESELLSCHAFT, THAMES WATER)	
AQUA US HOLDINGS, INC., AND AMERICAN)	CASE NO. 2006-00197
WATER WORKS COMPANY, INC. FOR)	
APPROVAL OF A CHANGE IN CONTROL OF)	
KENTUCKY-AMERICAN WATER COMPANY)	

DIRECT TESTIMONY OF ELLEN C. WOLF

June 5 2006

1 **I. INTRODUCTION**

2

3 **Q1. Please state your name and business address.**

4 A1. My name is Ellen C. Wolf. My business address is American Water Works
5 Company, Inc., 1025 Laurel Oak Road, Voorhees, New Jersey 08054.

6

7 **Q2. By whom are you employed and in what capacity?**

8 A2. I am employed by American Water Works Company, Inc. ("American Water") as
9 Senior Vice President and Chief Financial Officer ("CFO"). As CFO, I have primary
10 responsibility for directing and coordinating all company financial objectives and
11 obligations.

12

13 **Q3. Please describe your educational background.**

14 A3. I received a B.A. from Duke University and an MBA from the Wharton School of the
15 University of Pennsylvania.

16

17 **Q4. Please briefly describe your professional background.**

18 A4. I began my career with the accounting firm of Deloitte Haskins & Sells. From 1987-
19 1999, I held various positions with increasing responsibility in corporate accounting,
20 finance, and business development for Bell Atlantic and several of its subsidiaries
21 including Bell Atlantic Enterprises International, Bell Atlantic Mobile, and
22 Bell Atlantic Corporation. From 1999-2003, I was employed by American Water as

1 Vice President and CFO. Just prior to rejoining American Water, I served as
2 Senior Vice President and CFO of USEC, Inc., a global energy company.

3
4 **Q5. What is the purpose of your testimony?**

5 A5. The purpose of my testimony is to describe the parties to the merger of Thames Water
6 Aqua U.S. Holdings, Inc. (“TWAUSHI”) with and into American Water and the sale
7 by Thames Water Aqua Holdings GmbH (“Thames GmbH”)(a 100% owned
8 subsidiary of RWE Aktiengesellschaft (“RWE”)) of up to 100% of the shares of
9 common stock of American Water in one or more public offerings (“the
10 Proposed Transaction”), and to describe the initial public offering process. I will
11 further demonstrate that after the Proposed Transaction American Water, and its
12 affiliate American Water Capital Corp. (“AWCC”), will continue to be in a position
13 to provide the necessary capital for Kentucky American and the other operating
14 subsidiaries comprising the American Water system to meet their commitment to
15 provide high-quality service to customers.

16
17 **II. THE PROPOSED TRANSACTION**

18
19 **Q6. Please describe the Proposed Transaction.**

20 A6. The Proposed Transaction involves two steps. In a first step we will merge
21 TWAUSHI with and into American Water, so that American Water is the surviving
22 corporation. The merger will result in the consolidation of RWE’s American Water
23 related U.S. water assets (including U.S. water assets acquired by RWE through its

1 acquisition of Thames Water plc) into American Water. Thereafter, Thames GmbH
2 will sell up to 100% of the common stock of American Water. The shares will be
3 sold through one or more public offerings to a broad group of investors, including
4 institutional and retail investors. It is the desire of Thames GmbH to sell 100% of the
5 shares in the initial public offering (“IPO”). However, depending upon market
6 conditions, Thames GmbH may initially sell less than 100% of the shares in the IPO.
7 In such case, the remainder of the shares will be sold in one or more subsequent
8 offering(s) as soon as reasonably practicable following the IPO. The IPO and any
9 subsequent public offerings will be conducted according to the rules for public
10 offerings mandated by the United States Securities and Exchange Commission
11 (“SEC”). The process for the IPO and any subsequent public offering is substantially
12 the same, although the timeframe for subsequent public offerings is generally shorter.

13
14 As a matter of background, the key participants in an underwritten public offering are
15 the company in which the shares are being sold, referred to as the issuer (in this case,
16 American Water); the seller of the shares (in this case, Thames GmbH); and the
17 underwriters (the investment banks that purchase the shares from the seller and resell
18 them to the public). A more detailed description of the SEC and underwriting process
19 that will need to be followed in conducting the IPO and any subsequent offerings of
20 the shares is found in Section IV below.

1 **III. THE PARTIES**

2

3 **Q7. Please describe the background and business of RWE.**

4 A7. RWE is a stock corporation incorporated and existing under the laws of Germany.
5 RWE's headquarters is in Essen, Germany. RWE is the parent company of a group
6 of companies principally engaged in the business of electric power generation,
7 trading, transmission and distribution of electric power; natural gas and crude oil
8 exploration and production as well as natural gas transmission and distribution; and
9 water related services. RWE ranks among Europe's leading integrated electricity and
10 gas companies. RWE's regional focus stretches mainly from the U.K. to
11 Eastern Europe.

12

13 **Q8. Please describe generally the business and background of Thames GmbH.**

14 A8. Thames GmbH is a corporation incorporated and existing under the laws of Germany,
15 with its headquarters in Essen, Germany. Thames GmbH is a wholly-owned
16 subsidiary of RWE. Thames GmbH is the intermediate holding company for most of
17 RWE's water and wastewater operations. Thames GmbH owns 100% of the shares of
18 TWAUSHI. Thames GmbH does not have any employees of its own.

19

20 **Q9. Please describe the business and purpose of TWAUSHI.**

21 A9. TWAUSHI is a corporation organized and existing under the laws of Delaware and
22 headquartered in Voorhees, New Jersey. It is the intermediate holding company for

1 all of RWE's water businesses in the U.S. and a wholly-owned subsidiary of
2 Thames GmbH and, in turn, the direct parent of American Water.

3
4 **Q10. Could you please describe for us generally the business and background of**
5 **American Water?**

6 A10. American Water is a Delaware corporation headquartered in Voorhees, New Jersey.
7 The principal business of American Water is the investment in and ownership of the
8 common stock of operating water and wastewater utility companies like Kentucky-
9 American Water Company ("Kentucky American") that provide quality water and
10 wastewater services to millions of customers in the United States and three
11 Canadian Provinces. American Water, which is more than 100 years old, and its
12 subsidiaries today have approximately 6,000 employees and provide water,
13 wastewater and other water resource management services to a population of
14 approximately 18 million people in 29 states and in Canada. For nearly 60 years,
15 from 1947 until January 2003, American Water was one of the largest publicly-traded
16 water companies in the United States, with its shares listed on the New York Stock
17 Exchange.

18
19 **Q11. What is the function of AWCC?**

20 A11. AWCC is a direct subsidiary of American Water. The primary function of AWCC is
21 to provide efficient cash management and debt funding for the operating subsidiaries
22 of American Water.

1 **Q12. Will AWCC continue to be a subsidiary of American Water after the conclusion**
2 **of the Proposed Transaction?**

3 A12. Yes. Since its inception in 2000, AWCC has been a subsidiary of American Water.
4 No change will take place in the corporate relationship between American Water and
5 AWCC or between AWCC and Kentucky American as a result of the Proposed
6 Transaction.

7
8 **IV. THE INITIAL PUBLIC OFFERING (“IPO”) PROCESS**

9
10 **Q13. Please describe the IPO process.**

11 A13. The first step in a public offering is the preparation and filing with the SEC of a
12 registration statement. The registration statement for this type of offering (called an
13 “initial public offering” or “IPO,” because no shares of American Water are currently
14 publicly traded) is a lengthy document containing extensive information about the
15 issuer and the offering. This information includes, among other things, the issuer’s
16 audited financial statements, descriptions of its business, financial performance,
17 management and risk factors that investors may consider in deciding to buy the
18 shares. The primary portion of an SEC registration statement is the prospectus, which
19 is the document used to market the offering. The registration statement by law must
20 not contain any untrue statement of a material fact or omit to state any material fact
21 required to be stated therein or necessary to make the statements therein not
22 misleading. The registration statement must also lay out the principal risks involved
23 in investing in the issuer. American Water, Thames GmbH and the underwriters will

1 all have liability under the federal securities laws with respect to the contents of the
2 prospectus.

3

4 Once an initial registration statement has been prepared, it will be filed with the SEC,
5 at which point it will become publicly available on the SEC's web site. We do not
6 anticipate that this initial filing with the SEC will occur before late in 2006, when the
7 state regulatory approval process is well underway. The SEC will then review the
8 initial registration statement. The SEC will provide American Water with initial
9 comments on the filing within four to six weeks, at which point American Water will
10 file an amended registration statement addressing the SEC's comments. (The
11 amended registration statement will also become immediately available on the SEC's
12 web site.) The SEC may have further comments, in which case additional
13 amendments must be filed until all comments are resolved. This review and comment
14 process typically takes between two and three months from the time the initial
15 registration statement is first filed with the SEC.

16

17 After the principal SEC comments have been resolved and the state regulatory
18 approval process has been completed, the marketing process may begin. During the
19 marketing process, the underwriters will distribute a preliminary prospectus to
20 potential investors and schedule a "roadshow," which is a series of group and one-on-
21 one meetings with prospective investors generally spanning approximately two to
22 three weeks. At these meetings, management of American Water will make
23 presentations about the company and answer questions. During the marketing

1 process, the underwriters solicit indications of interest from potential investors in
2 purchasing shares in the offering. Once the marketing process has been completed,
3 American Water will ask the SEC to declare the registration statement effective, and
4 the underwriters and Thames GmbH will agree on the price per share at which the
5 shares will be sold to the public.

6
7 As a technical matter, in an underwritten offering, the underwriters agree to buy the
8 shares from the seller (pursuant to the underwriting agreement) and then in turn agree,
9 usually within a matter of minutes, to resell them to the prearranged purchasers. Both
10 the purchases by the underwriters and the subsequent sales are usually completed on
11 the same day, at the closing of the offering. The closing of the offering, at which the
12 purchases are settled, usually takes place three or four business days after the pricing.
13 At settlement, shares are transferred directly into the names of the investors. On the
14 date of closing, the stock begins regular trading in the public market. In this case, the
15 shares are intended to be listed on the New York Stock Exchange.

16
17 **Q14. Does RWE intend to sell a controlling interest in American Water to any single**
18 **entity?**

19 A14. RWE has no intention of permitting any person or entity to acquire a controlling
20 interest in American Water through the Proposed Transaction. Consequently,
21 American Water is not requesting approval in any state for any individual or group to
22 acquire a controlling interest in American Water in either the IPO or subsequent
23 public offerings. The prospectus pursuant to which the shares will be sold in the IPO

1 will include disclosure about the relevant statutory restrictions and the consequences
2 of a violation.

3
4 **V. PURPOSE AND BENEFITS OF THE PROPOSED TRANSACTION**

5
6 **Q15. Why is RWE seeking to divest itself of American Water and Kentucky
7 American?**

8 A15. RWE has revised its core business focus to be on the European power and energy
9 markets, where historically its roots lie. In the last two years, in order to become a
10 more market-oriented and focused company, RWE had already divested non-core
11 activities such as its environmental business. In order to maintain its position among
12 Europe's leading integrated electricity and gas companies, in response to fierce
13 competition, growing customer needs, and rising costs both for energy production
14 facilities and many other energy production inputs, RWE is forced to concentrate on
15 its power and energy markets. As a result of these developments, RWE's ability to
16 maintain its competitiveness in its core European businesses is proving far more
17 capital intensive than RWE could have predicted when it acquired American Water.
18 Consequently, RWE decided that it intends to sell the water operations of
19 Thames Water in the U.K. and to return American Water to its status as a U.S.
20 publicly-traded company. The Proposed Transaction will allow RWE to focus on its
21 core businesses in its home region, and more importantly for Kentucky American,
22 will allow American Water to focus on its U.S. water and wastewater systems and
23 customers.

1 **Q16. Can you describe a benefit of the Proposed Transaction to American Water, its**
2 **utility subsidiaries and customers?**

3 A16. Yes. The primary benefit of the Proposed Transaction will be to return American
4 Water to its status as a United States publicly-traded company, with all the
5 transparency and ready access to the U.S. public equity and debt capital markets that
6 such a status entails.

7
8 **Q17. Please elaborate further on the benefits that Kentucky American will derive**
9 **from American Water's status as a publicly-traded company.**

10 A17. As a publicly-traded company, American Water will become subject to the federal
11 securities laws and regulations as well as the requirements of the stock exchange
12 where American Water's common shares will be listed. Specifically, such laws and
13 regulations will impose obligations on American Water related to financial reporting,
14 accounting, internal controls, general business disclosure, corporate governance,
15 executive compensation reporting, issuance of securities and related financial and
16 business matters. American Water will be required to file annual, quarterly and
17 current reports (relating to certain business events) with the SEC, and certain
18 American Water investors will be required to make filings disclosing their
19 American Water shareholdings (including, under certain circumstances, the purpose
20 of acquiring such shareholdings). All financial information of American Water and
21 its subsidiaries will have to be reported in accordance with U.S. generally accepted
22 accounting principles ("GAAP") and SEC regulations. The annual consolidated
23 financial statements of American Water will be required to be audited. In addition,

1 all filings with the SEC will be made immediately available on the SEC's web site,
2 not only to investors, but to the public at large. American Water will also be required
3 to comply with the extensive requirements imposed as a result of the federal
4 Sarbanes-Oxley legislation. These requirements relate to, among other things,
5 internal controls over financial reporting and an external audit of management
6 assessment of such controls, corporate officer certification of financial and other
7 information, corporate governance requirements, and enhanced and expedited
8 disclosure (particularly with respect to certain financial information).

9
10 **Q18. Will American Water's status as a publicly-traded company benefit customers?**

11 A18. Yes. American Water's status as a publicly-traded company will increase the
12 accessibility and level of information available to customers with regard to
13 American Water and its subsidiaries. Customers will further benefit from the
14 confidence that American Water is subject to the rules and restrictions governing
15 public companies. Customers will also have the opportunity to invest in
16 American Water through the purchase of its common stock.

17
18 **Q19. Is Sarbanes-Oxley compliance a result of the Proposed Transaction?**

19 A19. It is not a direct result of the Proposed Transaction. However, our implementation of
20 it will be accelerated as a result of the Proposed Transaction. Sarbanes-Oxley
21 compliance is mandated for United States publicly traded companies. Also it
22 becomes a key area of interest for a number of state regulators, banks, financial
23 institutions and other sources of debt which also require Sarbanes-Oxley like controls

1 on privately held companies. However, there are legal, accounting and other costs
2 inherent in compliance. These costs are required to be incurred by American Water
3 pursuant to federal law. Accordingly, American Water, like other utilities, will need
4 to recover these costs in the future.

5
6 **Q20. Are there other benefits related to being a public company that will be derived**
7 **from the Proposed Transaction?**

8 A20. Yes. As a publicly-traded company, American Water will be able to raise capital
9 through its access to public equity and debt capital markets in the U.S. Raising
10 capital to replace aging infrastructure and to comply with ever more stringent water
11 quality standards is a primary challenge facing the water and wastewater industry in
12 the U.S. The U.S. Environmental Protection Agency (“EPA”) estimates that up to
13 \$1 trillion may be necessary for the industry to meet these challenges over the next
14 20 years. American Water’s status as a publicly-traded company will help ensure that
15 American Water and its utility subsidiaries have ready, cost-effective capital available
16 to meet such needs.

17
18 **Q21. Can you describe some of the other positive features associated with the**
19 **Proposed Transaction?**

20 A21. American Water will control its own destiny and no longer have to compete for
21 management attention and financial support with the other divisions within a large
22 international corporate structure that is focused on energy.

1 **Q22. Are there intangible benefits of American Water no longer being owned by a**
2 **foreign company?**

3 A22. Yes. American Water will be focused on the water and wastewater markets in the
4 U.S. and dedicated to maintaining a high level of service at just and reasonable rates.
5 Although American Water always considered its association with RWE to be
6 positive, some parties, including some of our customers, have had concerns about
7 foreign ownership of their water company by a large foreign energy conglomerate.
8 Returning American Water to U.S. publicly-traded status with a U.S. focus will
9 alleviate any lingering concerns about foreign ownership
10

11 **Q23. Do you expect a material change in American Water's financial characteristics**
12 **after the Proposed Transaction?**

13 A23. No. There should not be a material change to American Water's financial
14 characteristics as a result of the Proposed Transaction. The proposed transaction will
15 change our ownership structure from a single shareholder to multiple shareholders,
16 and American Water will raise its financing capital in the public markets. Aside from
17 the merger of Elizabethtown Water Company and The Mount Holly Water Company
18 with and into New Jersey-American Water Company, Inc., we expect that there will
19 be no material changes in revenues or expenses, the balance sheet will remain solid,
20 there will be an ongoing emphasis on service and water quality, the role of
21 Kentucky American as a valued corporate citizen will continue, and the strong
22 commitment to investing the capital required to appropriately maintain operations
23 consistent with a fair regulatory treatment will be continued. Additionally, dividend

1 payments to American Water will continue only when such dividends do not impair
2 Kentucky American's ability to provide high quality service to its customers.

3
4 **Q24. How will AWCC be impacted by the Proposed Transaction?**

5 A24. The impact on AWCC is two-fold: Currently, AWCC receives its debt from RWE.
6 RWE receives its capital from the European capital markets. In the future, the source
7 of any new capital for AWCC will be directly from the debt capital markets as
8 opposed to from RWE. AWCC will also need to refinance any debt with RWE that
9 matures after the Proposed Transaction. As of December 31, 2005, the total amount
10 of AWCC borrowings from RWE is \$2,438,586,000 of which \$2,030,286,000 will
11 become due under ordinary course of business terms and conditions between
12 June 2006 and June 2007. In addition, as of December 31, 2005 \$408,300,000 of
13 long-term debt will be called by RWE, as allowed by the terms of the loans, prior to
14 its maturity. Thirty-Eight Million Dollars (\$38,000,000) of those long-term
15 borrowings provide funding to Kentucky American as of December 31, 2005. To the
16 extent required, a separate financing petition will be submitted to the Commission for
17 approval for any replacement financing.

18
19 **Q25. Are there any other financing activities contemplated at AWCC?**

20 A25. Yes. Other than the refinancing which occurs in the ordinary course of business,
21 AWCC is in the process of refinancing its short-term credit facilities with RWE,
22 which are in the process of being replaced with stand-alone AWCC short-term credit
23 facilities.

1

2 **Q26. How will AWCC refinance its debt?**

3 A26. AWCC will again access the U.S. public and private debt capital markets to meet the
4 financing needs of the regulated utility subsidiaries of American Water. While
5 refinancing costs post transaction will vary according to market conditions, we are
6 seeing evidence that the capital debt market is very receptive to a publicly-traded,
7 post RWE ownership American Water. Of note, for the current replacement of the
8 \$550MM RWE revolving credit facility to AWCC, we have requested expressions of
9 interest for a new \$800MM facility for AWCC. We received offers totaling more
10 than \$2 billion at a cost roughly in line with the current RWE facility.

11

12 **Q27. How will American Water be capitalized following the IPO?**

13 A27. American Water's goal is to have a debt to equity ratio in the range of 45% to 55%
14 debt and to 55% to 45% equity like components in its total capitalization structure.
15 Thus, American Water's Balance Sheet will include debt instruments, common
16 equity, and may include convertible debt, preferred stock and other instruments that
17 may be considered equity equivalents (none of which will result in a controlling
18 interest in the company). As is common practice in transactions such as this, the
19 exact composition of the balance sheet will depend on market conditions.

20

21 **Q28. What will be the credit rating of AWCC after the Transaction, and what is the**
22 **impact of the transaction on the cost of capital to Kentucky American?**

1 A28. A credit rating is the opinion of the credit rating entity of the overall general
2 creditworthiness of a company based on an analysis of relevant risks considering both
3 qualitative and quantitative factors. Among the qualitative factors that are considered
4 are a company's competitiveness and growth prospects, the caliber of its
5 management, the industry's regulatory framework and how it applies to the company.
6 Quantitative analysis metrics frequently utilized include ratios such as Funds from
7 Operations to Total Debt, Pretax Coverage Ratios and Total Debt to Total Capital.

8
9 American Water's strategy post transaction is to retain its senior management, which
10 have experience in the industry and with the various ratings agencies. Also, post
11 transaction, American Water's Debt to Equity structure will be similar to water
12 utilities which have Investment Grade ratings (Debt = 45-55%, Equity = 55-45%).

13
14 As I previously noted, a credit rating (and ultimately the costs of debt and capital), are
15 dependent on a multitude of factors, including Funds from Operations (FFO) metrics,
16 which themselves are a direct product of timely and fair treatment in the regulatory
17 process.

18
19 Given American Water's plan for Debt to Equity levels at par with water utilities, and
20 assuming a rate of return similar to the average in the industry, we would not expect
21 to see a change in American Water's Cost of Capital.

22

1 **Q29. Please explain the Proposed Transaction's impact on management of American**
2 **Water.**

3 A29. The senior management of American Water and of Kentucky American consists of
4 high-caliber executives with the experience and ability to operate water and
5 wastewater services. American Water's board of directors and management team will
6 take the Company through the IPO process, and assure continued provision of safe
7 and reliable utility service during and after the IPO process. The highly qualified
8 local management team will continue to operate the local business. At the time of the
9 IPO, and thereafter, the board of directors of American Water will meet the
10 requirements for boards of public companies. The board will consist of experienced
11 individuals who, in the aggregate, possess the capabilities and experience appropriate
12 for the board of a large, publicly-owned multi-state water utility. Federal securities
13 laws and stock exchange rules also require, following completion of the Proposed
14 Transaction, that the board have a majority of independent directors and that the
15 audit, compensation and nominating committees consist entirely of independent
16 directors.

17
18
19 **Q30. Will the Proposed Transaction affect the financial capabilities of**
20 **Kentucky American in any negative manner?**

21 A30. No. As a result of the Proposed Transaction, Kentucky American will continue to be
22 a wholly-owned subsidiary of American Water and will continue to have a financial
23 profile similar to that which currently exists. The activities of Kentucky American

1 will remain the same, and the cash generated from operating activities will not be
2 impacted by the Proposed Transaction.

3
4 **Q31. After the Proposed Transaction, will AWCC continue to access the debt capital**
5 **markets to loan funds to Kentucky American to finance its investments in its**
6 **water distribution network, and fund its working capital needs?**

7 A31. Yes. After the Proposed Transaction, AWCC will continue to support Kentucky
8 American under the provisions of the Agreement for Services approved by this
9 Commission by an Order dated July 21, 2000, in Case 2000-189. There will be no
10 changes made to this agreement as a result of the Proposed Transaction. Through the
11 aggregation of borrowing requirements on both short-term and long-term debt,
12 Kentucky American and its affiliates can borrow amounts that will enable them to
13 obtain more advantageous terms than had they borrowed from the market
14 individually. Combined borrowing power increases the efficiencies of borrowing
15 operations and lowers the cost thereof (i.e., bank fees, legal fees, rating costs, SEC
16 registration costs, and others).

17
18 **Q32. Will American Water and AWCC be capable of supporting the financing needs**
19 **of Kentucky American after the Proposed Transaction?**

20 A32. Yes. American Water will retain its solid balance sheet. American Water and
21 AWCC will have access to the Investment Grade Debt Markets and American Water
22 will have access to the Capital Markets as well. These markets provide sufficient
23 depth to cover the financing needs of Kentucky American but its enormous capital

1 needs in the next five years can best be satisfied if it becomes a more attractive
2 financial investment. An average return of 4.0% for the last 3 years is not consistent
3 with a financial healthy company. Such a return makes it difficult and costly to raise
4 the capital necessary to serve the interests of the ratepayers and investors.

5
6 **Q33. Are there anticipated changes in Kentucky American's rate structure**
7 **attributable to the reorganization?**

8 A33. No. This transaction will have a minimal impact on Kentucky American.
9 Kentucky American will continue to operate under its current existing tariffs and rate
10 structure until such time as these tariffs and rate structure are modified in accordance
11 with established law and regulation.

12
13 **Q34. Are there any anticipated changes in Kentucky American's capital structure?**

14 A34. No, other than such changes that might occur in the ordinary course of business.

15
16 **Q35. Are there anticipated changes in Kentucky-American's cost of service**
17 **attributable to the Proposed Transaction?**

18 A35. No. The transaction is anticipated to have minimal impact on the cost of service of
19 Kentucky American. Changes in the cost of service after the Proposed Transaction
20 will be the result of changes in the general business and economic conditions in
21 Kentucky.

22 **Q36. Does this conclude your direct testimony?**

23 A36. Yes.