

COMMONWEALTH OF KENTUCKY  
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., ) CASE NO. 2006-00197  
AND AMERICAN WATER WORKS COMPANY, )  
INC. FOR APPROVAL OF A CHANGE IN CONTROL )  
OF KENTUCKY-AMERICAN WATER COMPANY )

RESPONSES TO ATTORNEY GENERAL'S  
SECOND REQUEST FOR INFORMATION  
DATED JULY 21, 2006

Item No. 1

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**Witness: Ellen Wolf**

1. RE: Response to OAG 1 – 10. In terms of exercising voting rights, please provide examples of “key issues” for which shareholders of AWW could exercise voting rights. Further, please identify the “key issue” votes by common stock shareholders of the former AWW for the ten-year period preceding RWE’s purchase.

**RESPONSE:**

Shareholders hold general meetings on an annual basis or at fixed times according to the by-laws of the corporation. The primary purpose of these meetings is for shareholders to elect the directors of the corporation. The issues upon which shareholders vote, in addition to the election of the directors, depend on the issues affecting the corporation. The following are examples of the key issues under Delaware law where American Water Works Company, Inc. (“AWW”) shareholders could exercise voting rights:

- approval or disapproval of amendments to bylaws or articles of incorporation;
- approval or disapproval of a merger with another corporation (in most cases);
- approval or disapproval of the sale of all or substantially all of the corporation’s assets;
- approval or disapproval of the voluntary dissolution of the corporate; and
- make nonbinding recommendations about the governance and management of the corporation to the board of directors.

Attached please find key issue notes by former AWW common stock shareholders.

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Item No. 2

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**Witness:** Nick Rowe/Michael Miller

2. RE: Response to OAG 1 – 29 (c). For the period of time 1 January 2003 to present, provide the pertinent minutes and presentation materials for the board meetings as well as any minutes or meetings summaries and presentation material for the capital investment review committee meetings.

**RESPONSE:**

Please see the enclosed CD for the requested minutes and presentations. Item No. 29(c) of the Attorney General's First Request for Information related to the construction plans of KAWC and this response is limited to the scope of that original question. The board meetings cover many topics and the Board of Directors minutes and materials have been redacted for any information not related to the original request. The CIMC minutes contain information for the SE Region operating subsidiaries and have been redacted for information unrelated to KAWC.

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Item No. 3

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Witness: Nick Rowe

3. RE: Response to OAG 1- 30. Provide the third party consultant's report.

RESPONSE:

As stated in the referenced response, the third party consultant's report is currently in draft form and will be submitted as part of the Certificate of Convenience and Necessity case that KAWC plans to file for the new water treatment plant in the Spring of 2007.

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Item No. 4

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Witness: Michael Miller

4. RE: Response to OAG 1 – 49. With regard to applying for Commission approvals required under Case No. 2002-00018, does anyone at Kentucky American Water or anyone on behalf of Kentucky American Water accept this responsibility? If yes, please identify.

RESPONSE:

The conditions in Case No. 2002-00018 cover a wide array of areas of the business. A number of people are responsible for preparing the information required to make the filings related to those conditions. Primarily, Michael Miller and Herb Miller are responsible for obtaining the information for the filings and seeing that the filings are made.

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Item No. 5

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**Witness: Michael Miller**

5. RE: Response to OAG 1 – 49. With regard to the Kentucky River Authority fee, does anyone at Kentucky American Water or anyone on behalf of Kentucky American Water exercise any responsibility for monitoring the fee amount and the collection of this fee amount including the process of reviewing Kentucky American's tariff provisions regarding the collection of the fee? If yes, please identify.

**RESPONSE:**

The KRA fee is not a subject of any of the conditions included in the Order in Case Number 2002-00018, and is not relevant to this proceeding. The KRA fee is being fully addressed in Case Number 2006-00154. The responsibility for this area will be fully addressed in recent discovery requests issued in that case. Michael Miller will be the primary witness responsible for the areas covered by that proceeding.

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SECOND REQUEST FOR INFORMATION  
DATED JULY 21, 2006

Item No. 6

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**Witness:** Michael Miller

6. RE: Response to OAG 1 – 49. With regard to sewer billings performed on behalf of the Lexington-Fayette Urban County Government, does anyone at Kentucky American Water or anyone acting on behalf of Kentucky American Water exercise any responsibility for monitoring the collection of the sewer billing and the remitting of funds to LFUCG? If yes, please identify.

**RESPONSE:**

The sewer billings with LFUCG are not relevant to this proceeding. KAWC has performed extensive analysis of the sewer billings, and continues to work with the LFUCG to resolve this matter. Notwithstanding the previous objection, the intermediate financial analysts at KAWC are responsible.

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Item No. 7

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Witness: Jens Gemmecke

7. RE: Response to LFUCG 1 – 7. In the event that less than 100% of the shares are sold, (1) who has control over the unsold shares including control over the decision as to when to put the shares up for sale, and (2) will RWE retain any control or ownership interest in AWW in the event that less than 100% of the shares are sold?

RESPONSE:

- 1) Thames GmbH will retain control of unsold shares and will retain control as to when its shares will be put up for sale.
- 2) Through its ownership of Thames GmbH, RWE will retain any indirect control or ownership that might result to the extent that less than 100% of the shares are sold. It is not known at this time how long Thames GmbH will retain ownership of the shares not sold through the IPO, but it is the intent of Thames GmbH/RWE to sell all of those shares. Timing will depend on market conditions.

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Item No. 8

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**Witness:**

8. RE: Private Offering Testing (e.g. Presentation to Angelfish, Overview of Divestiture Process, November 17, 2005, page 4). Please provide the state-by-state review of the regulatory climate for each jurisdiction in the Southeast Region.

**RESPONSE:**

There is no reference to "state-by-state review of the regulatory climate" on page 4 of the referenced document.



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SECOND REQUEST FOR INFORMATION  
DATED JULY 21, 2006

Item No. 9

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**Witness: Jens Gemmecke**

9. Concerning response to Staff 1-15, Standard and Poor's presentation of 11/5/05, page 14. Please describe in detail and quantify the "required investments and associated risks" that are referred to concerning AWW.

**RESPONSE:**

The need for significant capital investment in the US water utility industry is a well-known concern. It affects all water utilities regardless of form of ownership. The US EPA has estimated that, over a 20-year period, necessary capital investments for the US water utility industry will be \$277 billion. For wastewater utilities, the estimated necessary investment will be \$388 billion. In order to meet its obligations for systems owned and operated by AWW subsidiaries, it will be necessary for AWW and its subsidiaries to make significant investments.

Some of the risks attendant to such investments are an impact on the free cash flow of the business as well as competition for the capital from other divisions in the RWE system. Please also see page 17 of attachment to the response to Item No. 15(b) of the Commission Staff's First Request for Information.

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SECOND REQUEST FOR INFORMATION  
DATED JULY 21, 2006

Item No. 10

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Witness: Jens Gemmecke

10. Concerning response to Staff 1-15, Standard and Poor's presentation of 11/5/05, page 17. Please describe in detail the meaning of the phrases "Quality/Networks USA" and "Post Projection Period" as used on this page. In particular, describe the types of capital expenditures that RWE contemplates totaling €0.9 billion in this category, and over what period of time that investment is anticipated.

RESPONSE:

The "post-projection period" refers to the period after the 2005 – 2009 horizon. The €0.9 billion (\$1 billion) was a generic assumption of what AWW needs to invest. "Quality/Networks USA" refers to the investment required to maintain systems necessary to serve customers.

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SECOND REQUEST FOR INFORMATION  
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Item No. 11

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**Witness: Jens Gemmecke**

11. Concerning response to Staff 1-15, Standard and Poor's presentation of 11/5/05, page 19. How would the separation of AWW from RWE result in a "higher return on equity through leverage."

**RESPONSE:**

This effect will only take place at Thames. AWW itself is not affected.

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SECOND REQUEST FOR INFORMATION  
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Item No. 12

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**Witness: Jens Gemmecke**

12. Concerning response to Staff 1-15, Moody's presentation of March 2006, page 29. It states that RWE is considering the option of selling AWW to a "group of long-term financial investors." Is this still under consideration? If not, when did this cease to be an option? If so, please describe the status of RWE's pursuit of this option and the expected schedule for knowing whether this option will be pursued.

**RESPONSE:**

The selling to long-term financial investors ceased to be an option on March 21, 2006.

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Item No. 13

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**Witness: Ellen Wolf**

13. Concerning, Goldman Sachs presentation of 4/19/06, page 22. It states that one of the "capital structure considerations" is for a minimum credit rating of Baa1 / BBB+.
- a. Will AWW's initial financing be designed to achieve a Baa1 / BBB+ credit rating?
  - b. How does this compare to the current credit ratings of AWW and American Water Capital Corp.?
  - c. Please quantify the likely change in interest rates as a result of the difference between the current credit rating and a Baa1 / BBB+ credit rating.
  - d. When does AWW expect to have a final financing plan in place?
  - e. Do the Joint Applicants expect the Commission to approve the proposed transaction before the final financing plan is known? If so, would the Joint Applicants agree to conditions that require AWW to achieve a particular credit rating and/or capital structure?

**RESPONSE:**

- a. Assuming timely rate relief, a rate of return similar to the average in the water industry, and a debt to total capital ratio in the range of 45% to 55%, no change is anticipated in the current credit rating.
- b. American Water Capital Corporation's current unsecured debt ratings are Baa1 by Moody's and A- by Standard and Poor's.
- c. Any difference in interest rates will be dictated by market conditions existing at the time of refinancing.
- d. Prior to the Proposed Transaction.

- e. Yes. Petitioners expect the Commission to approve the Proposed Transaction before the final financing plan of AWW is known. No. No conditions are necessary.

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Item No. 14

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Witness: Jens Gemmecke

14. Concerning Goldman Sachs presentation of 5/2/06, page 13. Please quantify and explain in detail the concern with the "high level of capital expenditure spending" that is needed for AWW.

RESPONSE:

Joint Petitioners cannot speak for what concerns Goldman Sachs has concerning the above matter.

The need for significant capital investment in the US water utility industry is a well-known concern. It affects all water utilities regardless of form of ownership. The US EPA has estimated that, over a 20 year period, necessary capital investments for the US water utility industry will be \$277 billion. For wastewater utilities, estimated level of investment needed will be \$388 billion.

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Item No. 15

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**Witness: Ellen Wolf**

15. Concerning Goldman Sachs presentation of 5/2/06, page 13. Please quantify and explain in detail the concern with AWW's "underfunded pension and OPEBs, coupled with a low pension funding ratio."

**RESPONSE:**

Joint Petitioners cannot speak for what concerns Goldman Sachs has concerning the above matter.

For pension plans, AWW's funding policy is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974 (ERISA). The value of the funded portion of the Plans is a function of the fair value of those assets which rise and fall due to temporary market conditions.

AWW also maintains Postretirement Benefit Plans (OPEBs) which are partly funded and provide varying levels of medical and life insurance to eligible retirees.

For further clarification, attached please find the Notes to the audited 2004 American Water Works consolidated financial statements as they pertain to Pension and Other Postretirement Benefits.



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Item No. 16

---

Witness: Ellen Wolf

16. Concerning Goldman Sachs presentation of 5/2/06, page 23. This page indicates that a 100% IPO would provide proceeds of approximately \$4.3 billion. If that is the case, and if equity represents 45% to 55% of AWW's capital structure (Ms. Wolf's testimony, page 16), then it would imply total debt between \$3.5 billion and \$5.2 billion, compared to AWCC's existing debt of less than \$3 billion. Concerning this:
- a. Are these figures accurate? If not, please explain why not.
  - b. Please provide a financing plan for the issuance of between \$3.5 billion and \$5.2 billion of debt.

RESPONSE:

- a. No, while the mathematics is correct, AWW is not impacted by the ultimate (cash) proceeds that RWE will receive.
- b. No definitive plan currently exists for the AWW refinancing.

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Item No. 17

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**Witness:**

17. Concerning response to AG 1-45, RWE Supervisory Board minutes of 11/4/05, page 4. On this page it states that "rises in efficiency [at AWW] were not implemented as planned." Please specifically describe the increases in efficiency that were planned, delineate when they should have been implemented, and explain why they were not implemented.

**RESPONSE:**

Joint Petitioners do not understand the question because Item No. 45 of the Attorney General's First Request for Information refers to accounting conversion costs.

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Item No. 18

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**Witness:**

18. Concerning response to AG 1-45, RWE Supervisory Board minutes of 11/4/05, page 8. On this page, it states: "In connection with the discussions about the most recent planning by American Water's management, it had become clear to him that leakage problems in the US would tend to worsen in future. For instance, the share of water production in New Jersey that is lost by leakage had risen from 15% to currently 18%. The comparable value for Pennsylvania stood at 30%. While replacing Thames Water's entire pipe system would take 125 years at the current renewal rate, the corresponding figure for American Water was over 200 years. The reason for this extraordinarily high value was that American Water, across a period of several years, had not met regulatory stipulations in various US states. In part, this was due to insufficient investment by American Water in the previous 10 years prior to RWE acquiring its holding. In view of this renewal backlog, there ought to be no investment restraint in dealing with these defects. The elimination of major deviations from regulators' stipulations is likely to last into the year 2008." Concerning this:
- a. Please provide comparable loss figures for KAWC.
  - b. Has KAWC experienced a similar level of "insufficient investment"?
  - c. What is the current renewal rate for the replacement of KAWC's pipe system?

**RESPONSE:**

Joint Petitioners do not understand the question because Item No. 45 of the Attorney General's First Request for Information refers to accounting conversion costs.