

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 LFUCG'S SUPPLEMENTAL
REQUESTS FOR INFORMATION
DATED JULY 21, 2006

Item No. 1

Witness: Jens Gemmecke

1. If the underwriters involved in this transaction will only agree to market the number of shares for which they have obtained purchase commitments, explain whether they could be required to identify and report to the Petitioners if any person or entity is interested in, or intends to acquire, 10% or more of AWW stock (Response to Staff No. 27(c)). If not, explain in detail all legal and other bases for your answer.

RESPONSE:

RWE and American Water Works Company, Inc. ("AWW") can request that the underwriters in the IPO meet certain reporting and information-sharing requirements. RWE and AWW can require the underwriters to (1) offer AWW and RWE transparency with respect to deal progress reports during the marketing process (generally, these updates on the state of the transaction, including the order book, occur on a regular basis throughout the marketing period) and (2) inform AWW and RWE of all new indications, including indications of size, during these updates on the order book.

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Item No. 2

Witness: Ellen Wolf

2. Are the Petitioners willing to agree to immediately report to the Kentucky PSC if any investor acquires a significant interest in AWW as defined by the SEC (Responses to LFUCG No's. 8 and 9).
 - a. Will AWW agree to report to the Kentucky PSC if an institutional investor crosses the 5% threshold, but does not have to report such acquisition within 10 days to the SEC? If not, explain specifically why such a requirement would be unreasonable.

RESPONSE:

AWW cannot agree to immediately report to the Kentucky Commission when an institutional investor (acting as a passive investor) crosses the 5% threshold because, in that event, such investor is not required to immediately report such transaction to the SEC and is allowed to file on a delayed basis. In the absence of a public filing with the SEC, AWW will have no practical way to detect if a shareholder crosses the 5% threshold. It should be noted that if a shareholder crosses the 10% threshold, it is required to file notice of such transaction with the SEC within 10 days after the end of the first month in which such threshold is crossed.

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Item No. 3

Witness: Jens Gemmecke

3. Given that the closing date for the IPO is not known (Response to LFUCG No. 11), do the Petitioners believe that it would be reasonable for the Commission to limit any approval of the Application so as to require that the IPO be closed within a certain period of time after approval or the approval will be void? If so, what period of time would the Petitioners suggest? If the Petitioners believe that such a limitation would be unreasonable, state specifically all reasons why such a requirement would be unreasonable.

RESPONSE:

Joint Petitioners believe that it would be unreasonable to require the IPO to be closed within a certain period of time after approval of the Proposed Transaction by the Kentucky Commission. The ultimate timing of any IPO, particularly one that is subject to multi-jurisdictional regulatory approval, is subject to factors that are outside of the issuer's control. The timing of the proposed AWW IPO is subject to, among other things, the receipt of approvals from other state authorities, the receipt of the SEC's clearance for effectiveness of the eventual registration statement, and favorable market conditions. Approval of the Proposed Transaction without a time limitation will allow RWE to divest itself of its ownership of AWW in an orderly fashion avoiding the need to sell shares at inopportune times for AWW just to meet an arbitrary time deadline. For these reasons, the ultimate timing of the IPO cannot be assured with any certainty and, therefore, attaching an expiration date to the Kentucky Commission's approval of the Proposed Transaction would be unreasonable.

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Item No. 4

Witness: Ellen Wolf/Michael Miller

4. With respect to the refinancing of AWW debt with RWE detailed in the Responses to LFUCG No. 13(a) and Staff No. 21:
 - a. State whether, absent the proposed IPO, the \$24 million note maturing on June 12, 2007, would be replaced by a new note between AWW and RWE. If the answer is "no", provide a detailed explanation.
 - b. State whether the proposed IPO will have an impact on the timing of the refinancing of the \$24 million note. Include in the response an explanation of the refinancing plan for this note should the IPO not be completed by the maturity date of the note, and also explain the benefits and drawbacks of an early call for this note under current market conditions.
 - c. State whether the \$14 million note with an interest rate of 4.75% maturing on March 1, 2014 could be refinanced at a comparable interest rate if recalled early under current market conditions. If not, explain whether the interest rate would likely be higher or lower, and what market interest rate would apply to a similar note under current market conditions.
 - d. State specifically all reasons why the Petitioners' believe it would be unreasonable for the Kentucky PSC to find that any increased costs associated with refinancing the \$14 million note maturing on March 1, 2014, should not be imposed on KAW's customers, given that the sole reason for calling and refinancing this note is RWE's desire to sell off AWW.

RESPONSE:

- a. At maturity, the note will be refinanced. Given RWE's desire to exit the US water business, it cannot be determined whether RWE would refinance notes maturing in 2007. There is no legal obligation for RWE and American Water Capital Corporation ("AWCC") to be parties to that refinancing.
- b. Because this note matures within one year, KAWC would normally consider refinancing options. The timing of the IPO has no direct effect on that consideration.
- c. Joint Petitioners are not aware of any published index that provides forecasted interest rates for bonds maturing in March 2014, and, therefore, Joint Petitioners are not in a position to answer this question.
- d. KAWC and its customers have benefited from the lower debt cost before and after the acquisition of AWW by RWE through the use of AWCC to pool the cash and borrowing requirements of the AWW subsidiaries. This lower debt cost was largely driven by some of the lowest market conditions for debt in at least the last 30 years, the economies of scale associated with larger public offerings (i.e., the impact on issuance costs and interest rates), and to a smaller degree the lower debt cost associated with the improved S&P rating of AWCC after RWE ownership. The benefits associated with AWCC will continue after completion of the Proposed Transaction. All of those benefits listed above are embedded in the current rates charged to the customers of KAWC, which will not change until a rate case is filed by KAWC and new tariffs approved by the Kentucky Commission.

KAWC does not believe that a condition as that proposed in this question is needed or reasonable. KAWC's customers have and will continue to benefit from the favorable market based interest rates and improved credit ratings of AWCC during the RWE ownership period until such time as the Kentucky Commission approves new tariffs for KAWC. Neither RWE, AWCC, nor KAWC promised that those favorable interest rates would continue indefinitely. It is normal for all companies to obtain debt financings subject to call provisions. KAWC has many debt issues with varying interest rates based on the market conditions at the time of issuance. The various debt issues mature (or are called early) routinely, and so long as the replacement debt was determined to be reasonable and based on market conditions at that time, rate recovery has been permitted (KAWC is aware of no instance where the cost of its debt has been determined to be unreasonable). The notes between AWCC and RWE include a call provision at the mutual agreement of the parties, and mandatory redemption if there is a change of ownership of the borrower. It is not reasonable to deny KAWC the opportunity to seek rate recovery for its cost of capital in a future rate proceeding due to the early call of the \$14.0 million note. The customers of KAWC will continue to benefit from the current interest rate on the \$14.0 million note to AWCC until such time

as KAWC seeks a change in its tariffs and a revised tariff is approved by the Kentucky Commission. It is inherently unfair to deny KAWC rate recovery for a market determined cost of debt in a future rate case, particularly in this case where the early call was fully contemplated in the notes supporting that debt, and probably constitutes single-issue ratemaking outside the usual ratemaking process.

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Item No. 5

Witness: Michael Miller/Nick Rowe

5. Refer to the Attachment to Response to LFUCG No. 22. For each employee listed under Status "SC" state the allocation of that employee's time to KAW duties, as opposed to other duties.
- a. For each such employee or position, provide the percentage of the compensation and benefits for that employee or position that was charged to KAW ratepayers in KAW's last rate case before the Commission (Case No. 2004-00103).

RESPONSE:

See the following table.

<u>Name</u>	<u>% to KAWC</u>	<u>% Last Rate Case</u>	<u>Notes</u>
Donna Braxton	89.8%	100%	
Linda Bridwell	67.9%	100%	100 % capitalized
Richard Currey	80.0%	100%	
Susan Lancho	81.8%	100%	Replaced B. Brown
Herbert Miller	76.1%		
Nick Rowe	14.3%	100%	Replaced R. Mundy
Michael Shryock	90.5%		
Donna Taylor	3.5%		
David Whitehouse	97.1%	100%	
Frank Ross	75.7%	100%	

- a. See table above. KAWC does not have readily available the percentage of time of Herbert Miller, Donna Taylor or Michael Shryock charged to management fees in Case Number 2004-00103. The percentage of time charged to KAWC by Herbert Miller and Michael Shryock has not changed significantly, if at all, from the time currently being charged to KAWC. The time charged to KAWC by Donna Taylor has reduced significantly due her current position of report writing for the entire AWW system.

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Item No. 6

Witness: Michael Miller/Nick Rowe

6. Refer to the Response to LFUCG No. 23. For each employee listed whose percentage of time spent on KAW business is less than 100%, state whether such employee's compensation and benefits are paid entirely by KAW.
- a. State whether the Petitioners believe it would be reasonable for the Commission to impose a condition in this proceeding that KAW ratepayers should only be responsible for the compensation and benefits for such employees at the level of time actually spent on KAW business, and that any additional expenses currently included in KAW's rates should be returned to KAW ratepayers through an immediate rate reduction. If not, state specifically all the reasons that the Petitioners believe that such a condition would be unreasonable.

RESPONSE:

No, they are paid by American Water Works Service Company ("AWWSC") and charges are allocated to KAWC under the terms of the agreement between KAWC and AWWSC. Please see the response to Item No. 12 herein.

- a. No condition of this nature is appropriate or reasonable. Such a condition would effectively be a classic example of retroactive and single issue ratemaking. The cost of service of a utility is constantly changing and to suggest the rates of KAWC based on the single issue and retro ratemaking concepts referenced in this question without looking at all the other changes in the KAWC cost of service is inappropriate, unreasonable, and not supported by Kentucky Commission practice. Changes in the KAWC cost of service should appropriately be addressed in a general rate filing which is not relevant to or the subject of this proceeding.

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Item No. 7

Witness: Nick Rowe

7. In their Response to LFUCG No. 53, the Petitioners refer to their Response to Attorney General No. 30, which references a third-party analysis of the cost of the Bluegrass Water Supply Commission's proposed solution to the water supply issues, and the cost and scope of KAW's proposed water treatment plant. Provide a complete copy of this analysis.

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. 8

Witness: Michael Miller

8. State whether the Petitioners believe that it would be unreasonable for the Commission to impose a condition as suggested in LFUCG No. 54. If so, state specifically all of the reasons why the Petitioners believe that such a condition would be unreasonable.

RESPONSE:

KAWC has not changed its position from that indicated in the response to Item No. 54 of the LFUCG's First Request for Information. In addition, please see the response to Item No. 4 herein.

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Item No. 9

Witness: Michael Miller

9. State whether the Petitioners believe that it would be unreasonable for the Commission to impose a condition in this proceeding similar to the condition restricting payments of dividends adopted in Case No. 2002-00018. (LFUCG No. 57) If so, state specifically all of the reasons that the Petitioners believe that such a condition would be unreasonable.

RESPONSE:

KAWC has not changed its position indicated in the response to Item No. 57 of the LFUCG's First Request for Information. KAWC operated without such a condition prior to the purchase of AWW by RWE and sees no reason to continue that condition once KAWC returns to the corporate structure that existed prior to RWE ownership of AWW. KAWC is not aware of any other utility in Kentucky where such a restriction is imposed. KAWC has stated it has no intentions of changing its long-standing dividend policy, however, circumstances in the future may dictate a change in the dividend policy as prudent and warranted in order to maintain the appropriate capital structure for KAWC. KAWC would suggest that it should be free to make such business decisions subject to review in an appropriate future rate case proceeding if a change in policy is necessary.

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Item No. 10

Witness: Michael Miller

10. Do the Petitioners agree that no costs related to setting up processes and systems for SEC compliance will be charged to KAW ratepayers? (Response to Attorney General No. 44) If not, explain what costs the Petitioners recommend be charged to KAW ratepayers, the basis for the recommendation and the projected amounts of such costs.

RESPONSE:

As stated in the response to Item No. 44 of the Attorney General's First Request for Information, Joint Petitioners agree that no costs related to setting up processes and systems for SEC compliance will be charged to KAWC ratepayers.

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Item No. 11

Witness: Michael Miller

11. Is it the intent or belief of any of the Petitioners that the findings in this case should impact: (a) the pending appeal of the last rate (PSC Case No. 2004-00103); (b) the water supply deficit case (PSC Case No. 2001-00117); or (3) a future rate case? If so, provide a detailed response as to how and in what ways.

RESPONSE:

- (a) The appeal of Case No. 2004-00103 should stand on its own merits.
- (b) Joint Petitioners do not intend nor is it their belief that this proceeding should impact Case No. 2001-00117. That case will proceed on its own course, and KAWC and AWW have indicated their commitment to providing a solution to the source of supply deficit of KAWC. KAWC believes that a rate filing moratorium in this proceeding would create financial difficulties for KAWC with attendant consequences to its customers and should not be a condition placed on KAWC in this proceeding.
- (c) Joint Petitioners do not intend nor do they believe it appropriate that the findings in this proceeding should impact KAWC's ability to file a future rate case. It is important that KAWC seek adjustment of its rates if its circumstances warrant such a decision. It is critical that KAWC be a financially strong entity if it is to continue to attract the significant capital needed to address its replacement of aging infrastructure, meet regulatory mandates, solve the source of supply deficit, and meet its other service obligations. KAWC believes it is not in the best interest of its customers if it is forced to operate with unacceptable financial results and is impaired in its ability to seek recovery of its cost of service and a fair return on its investments as part of the findings in this case.

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Item No. 12

Witness: Michael Miller

12. Describe the allocations (percentages) for distribution of costs to KAW for services performed under any agreement with AWW, and provide supporting documentation of the same, including copies of the agreement(s). Will the proposed transaction result in any changes to these allocations? If so, list all such changes.

RESPONSE:

Charges to KAWC are allocated from AWWSC under the agreement dated January 1, 1989 which is attached hereto. Where possible, employees of AWWSC charge their hours directly to each subsidiary for which they perform work. If the function being performed is common to all subsidiaries or to a group of subsidiaries, those costs are allocated based on the number of customers of each subsidiary in relation to the total customers in the formula group. The current formulas for the AWW regulated subsidiaries are also attached hereto.

There are no anticipated changes to the AWWSC formulas as a result of the Proposed Transaction.