

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

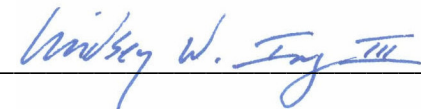
THE JOINT PETITION OF KENTUCKY-)
AMERICAN WATER COMPANY, THAMES)
WATER AQUA HOLDINGS GMBH, RWE)
AKTIENGESellschaft, THAMES WATER)
AQUA US HOLDINGS, INC., AND AMERICAN) CASE NO. 2006-00197
WATER WORKS COMPANY, INC. FOR)
APPROVAL OF A CHANGE IN CONTROL OF)
KENTUCKY-AMERICAN WATER COMPANY)

ORDERING PARAGRAPH 7 REPORT

Pursuant to Ordering Paragraph 7 of the Commission's April 16, 2007 Order in this matter, Joint Petitioners provide the attached decision from the New York Public Service Commission.

Respectfully submitted,

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By: 

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Thames Water Aqua US Holdings, Inc.,
American Water Works Company, Inc., and
Kentucky-American Water Company

CERTIFICATION

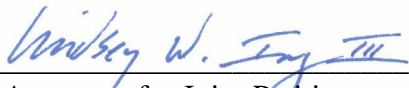
This is to certify that a true and accurate copy of the foregoing has been electronically transmitted to the Public Service Commission on August 15, 2007; that the Public Service Commission and other parties participating by electronic means have been notified of such electronic transmission; that, on August 15, 2007, the original and one (1) copy in paper medium will be hand-delivered to the Public Service Commission, 211 Sower Boulevard, Frankfort, Kentucky 40601; and that on August 15, 2007, one (1) copy in paper medium will be served upon the following via U.S. Mail:

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By 
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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
New York on July 18, 2007

COMMISSIONERS PRESENT:

Patricia L. Acampora, Chairwoman
Maureen F. Harris
Robert E. Curry, Jr.
Cheryl A. Buley

CASE 06-W-0490 - Joint Petition of Thames Water Aqua Holdings GmbH, Thames Water Aqua US Holdings, Inc. and Long Island Water Corp. for approval of the Merger of Thames Water Aqua US Holdings, Inc. with and into American Water Works Co., Inc and the subsequent sale of the shares of Common Stock of American Water Works Co, Inc.

ORDER AUTHORIZING REORGANIZATION
AND ASSOCIATED TRANSACTIONS

(Issued and Effective July 26, 2007)

BY THE COMMISSION:

INTRODUCTION

By petition filed April 25, 2006, Thames Water Aqua Holdings GmbH (Thames GmbH), Thames Water Aqua US Holdings (TWAUSHI), American Water Works Company Inc. (American Water), and Long Island Water Corporation (Long Island Water or the company) have requested approval under Section 89-h of the Public Service Law (PSL) for: 1) the merger of TWAUSHI into American Water, with American Water being the surviving entity; and 2) the sale, after the merger, by Thames GmbH of up to 100% of the shares of American Water in one or more public offerings. The petitioners also submitted a supplement agreeing to additional conditions that we impose upon American Water to reduce Long Island Water ratepayers' exposure to the potential

financial impacts if the initial public offering (IPO) results in lower bond ratings for American Water.

Other than the Commission's approval of the action proposed here, no additional state or local permits or approvals are required, and so a coordinated review under SEQRA is not needed. Our review of the Environmental Assessment Form (EAF) and the petition leads us to conclude, based upon the criteria for determining significance listed in 6 NYCRR § 617.7(c), that there will be no changes to the operation of the existing utilities and infrastructure that will result in significant adverse environmental impacts. Accordingly, we assume lead agency status and issue a notice of determination of non-significance.

In this order, we approve the request to merge TWAUSHI into American Water, with American Water being the surviving entity and the sale by Thames GmbH of up to 100% of the shares of American Water in one or more public offerings, subject to the supplemental conditions filed by the petitioners. This transaction is in the public interest since it will result in American Water being a publicly traded company, which should allow it increased access to capital in the debt and equity markets.

BACKGROUND

Long Island Water is a regulated waterworks corporation serving approximately 74,500 customers in southwestern Nassau County. The company owns, operates, and maintains water production, treatment, storage, transmission, and distribution plant for residential, commercial, industrial, and government water usage within its service territory. It is a wholly-owned subsidiary of American Water which, in turn, is a wholly owned subsidiary of TWAUSHI. TWAUSHI is a subsidiary of

Thames GmbH. Thames GmbH is a foreign corporation organized under the laws of the Federal Republic of Germany and is a wholly-owned subsidiary of RWE Aktiengesellschaft (RWE). RWE provides electricity, gas, water, and environmental services to residential and business customers, primarily in Europe and North America. In essence, Thames GmbH is the holding company of most of RWE's water operations, both in the United States and in several foreign countries. The existing relationships between the above described firms are summarized in Appendix I.

The petitioners request the authority to merge the operations of TWAUSHI into American Water. Thames GmbH would then sell up to 100% of the shares of American Water in one, or more underwritten public offerings. The relevant projected corporate structure after the proposed transaction is shown in Appendix II. The proposed transaction would result in American Water being a publicly traded company.

Notice of the petition was published in the State Register pursuant to the State Administration Procedure Act §202(1) on October 24, 2006. No comments were received in response to the notice.

DISCUSSION

The Proposed Transaction

The proposed transaction consists of: 1) the merger of TWAUSHI into American Water, with American Water being the surviving entity; and 2) after the merger the sale by Thames GmbH of up to 100% of the shares of American Water in one or more public offerings. RWE seeks to sell American Water and focus on its European operations. The shares will be sold through one, or more, underwritten public offerings to a broad group of investors, including institutional and retail investors. The actual sales price of the shares will be

established when the public offering occurs. Thames GmbH intends to sell 100% of the shares in the IPO but, depending on existing market conditions, may require subsequent offerings to sell all the shares as soon as reasonably practical following the IPO.

As a publicly traded company, American Water would be subject to the federal securities laws and regulations as well as the requirements of the stock exchange where American Water's common shares will be listed. All financial information of American Water and its subsidiaries will have to be reported in accordance with U. S. general accounting principles and Securities and Exchange Commission (SEC) regulations. American Water will also be required to comply with Sarbanes-Oxley (SOX) requirements.

After the proposed transaction, Long Island Water would continue to be a subsidiary of American Water and will continue to be operated by its existing management under its Board of Directors. We do not anticipate any operational changes and, as such, we expect no impact upon Long Island Water's cost of service.

Accounting and Financial Issues

American Water has used American Water Capital Corporation (AWCC) to borrow funds for the benefit of American Water and then loan the funds to its regulated subsidiaries. AWCC's debt consists of corporate loans from its ultimate parent, RWE, and a small amount of debt issued in the capital market. As of December 31, 2005, AWCC's debt consisted of about \$2.6 billion of inter-company debt to RWE. AWCC is currently rated "A-" by Standard & Poor's and Baal by Moody's investor service. If the proposed transaction is approved, all inter-company financial relationships RWE has with American Water and

its subsidiaries will be terminated and all inter-company debt between RWE, American Water, and AWCC will be refinanced. Long Island Water has primarily financed its construction through tax-exempt debt issued through the New York State Environmental Facilities Corporation (EFC) and does not have any outstanding loans provided by AWCC. After the proposed transaction Long Island Water will continue to have access to EFC tax-exempt financing and, while AWCC will remain a financing option, the Company is not anticipated to require financing through AWCC. In addition, it is American Water's intention to capitalize both AWCC and Long Island Water to maintain, at minimum, an investment grade rating.

The company does not seek to recover the costs of the proposed transaction from ratepayers, but will instead fund the cost through RWE and American Water's earnings. As a public company American Water will be required to comply with all SOX requirements. While the start-up costs will not be charged to customers, the Company anticipates charging on-going SOX costs of \$2 million in the first post-IPO year and approximately \$1 million per year thereafter. American Water anticipates that the post-IPO costs will be allocated consistent with Commission approved cost allocation methodologies.

In 2003 RWE acquired American Water (Case 01-W-1949) through a subsidiary acquisition company called Apollo Acquisition Corporation (Apollo). After the merger was completed Apollo was merged into American Water. The acquisition occurred at a 2.6 times multiple to the book value of American Water's common equity resulting in the creation of \$3.2 billion of goodwill on American Water's 2005 financial statements.

After the proposed consolidation of TWAUSHI into American Water, the combined entity had a year end 2005 equity

ratio of 28.9% with its \$3.2 Billion of goodwill representing 114% of the common equity balance. While American Water's resultant overall financial profile has been consistent with, at best, a BBB rated company, its low risk business profile and its relationship with RWE has resulted in a rating of A-/Baa1 by S&P and Moody's.

Thames GmbH and RWE have assured Staff that it intends to infuse equity into American Water prior to the IPO. Thames GmbH states that the equity infusion should result in an IPO sale price consistent with at least a targeted 45% common equity ratio for American Water. The company asserts that this should allow American Water to retain its current bond ratings.

In addition, Regulation S-X of the Security and Exchange Act of 1933 requires that if the IPO results in a material adverse change in the financial statements filed prior to the IPO American Water will be required to notify potential buyers. During the one hundred thirty five (135) day evaluation period after the SEC filing requirement if AW determined that there was a likelihood for a material adverse impact on its capitalization as a result of the initial market clearing price of its shares, a goodwill impairment would be recorded reducing American Water's common equity below 45% of total capital and the public would be notified. In this circumstance, Thames GmbH and RWE, in honoring their commitment, would make capital infusions necessary to assure a common equity ratio for American Water of at least 45% at the time of the IPO. Post IPO, American Water's goodwill balance will continue to be subject to an impairment test. Once the IPO takes effect this test will primarily rely on the price of American's Water's common stock in measuring the market valuation of American Water. If the book value of American Water common equity is above the market value, American Water will be required to write-off sufficient

goodwill to equate the market and book value. Recording this goodwill impairment will reduce American Water's equity ratio and its subsequent financial parameters would most likely be impacted.

If the market price after the IPO is materially below American Water's fair value assessment, its equity ratio and subsequent financial parameters would most likely be impacted. As a result, the petitioners filed a supplement to the petition providing additional requirements. The supplement states that if AWCC's bond ratings fall below their current levels within the time period of the lesser of two years from the date the Security and Exchange Commission (SEC) declares the registration statement for the IPO effective, or 60 days after RWE's ownership in American Water is less than 10%, then American Water will file with the Commission a plan addressing the credit quality areas of concern. In addition, American Water acknowledges the Commission's authority to adjust Long Island Water's cost of debt and equity ratio in its current (Case 07-W-0558) or future rate proceedings and to adjust future AFUDC rates to protect ratepayers from the impact of such a downgrading.

Public Interest

Section 89-h of the PSL requires a demonstration that the proposed transaction be in the public interest for it to be approved. The proposed transaction would result in a publicly traded company dedicated and focused on the water and wastewater business in the U.S. In addition, American Water will have direct access to the public debt and equity markets in the U.S. This should provide the company with greater financing options and flexibility to finance the investment in the infrastructure of its utilities. While it is anticipated that Long Island

Water will continue to finance its construction through tax-exempt debt issued through the EFC, the IPO should provide the Company with greater financing options and flexibility. In the event that the IPO results in lower bond ratings for American Water or AWCC, American Water is required to file a plan with the Commission to address the credit quality areas of concern. In addition, the proposed transaction will cause no changes in the operations of American Water or Long Island Water.

Environmental Quality Review

Under the State Environmental Quality Review Act (SEQRA), Article 8 of the Environmental Conservation Law, and its implementing regulations, (6 NYCRR Part 617 and 16 NYCRR Part 7), all State agencies must determine whether the actions they are requested to approve may have a significant impact on the environment. Other than our approval of the action proposed here, no additional State or local permits or approvals are required, and so a coordinated review under SEQRA is not needed. SEQRA (6 NYCRR § 617.6 (a) (3)) requires applicants to submit a completed environmental assessment form (EAF) describing and disclosing the likely impacts of the proposed actions. We have reviewed the submitted SEQRA Part I Short Form EAF submitted by the Petitioner. We assumed Lead Agency Status under SEQRA and conducted an environmental assessment.

The proposed action is the approval of the merger of a private water company known as Thames Water Aqua US Holdings (TWAUSHI) into American Water Works Company Inc. (American Water) with American Water being the surviving entity and after the merger the sale by Thames Water Aqua Holdings GmbH (Thames GmbH) of up to 100% of the shares of American Water into one or more public offerings. The proposed action does not meet the definition of either Type 1 or Type 2 actions that are contained

in 6 NYCRR §§ 617.4, 617.5, and 16 NYCRR § 7.2, so it is classified as an "unlisted" action requiring SEQRA review. After review of the EAF and the petition, we conclude that, based upon the criteria for determining significance listed in 6 NYCRR § 617.7(c), that there will be no changes to the operation of the existing utilities and infrastructure that will result in significant adverse environmental impacts.

We determine that the action proposed in the petition will not have a significant impact on the environment and adopt a negative declaration pursuant to SEQRA. Because no adverse environmental impacts were found, no Public Notice Requesting Comments is required or will be issued. A Notice of Determination of Non-Significance for this unlisted action is attached. The completed EAF will be retained in the Commission files.

CONCLUSION

We find that the proposed transaction to merge TWAUSHI into American Water, with American Water being the surviving entity and to conduct a sale by Thames GmbH of up to 100% of the shares of American Water in one or more public offerings will not impair or jeopardize service to the public and is in the public interest.

The Commission Orders:

1. Pursuant to Section 89-h of the Public Service Law, the petition of Thames Water Aqua Holdings GmbH (Thames GmbH), Thames Water Aqua US Holdings (TWAUSHI), American Water Works Company Inc. (American Water), and Long Island Water Corporation regarding the merger of TWAUSHI into American Water, with American Water being the surviving entity, and the sale, after the merger, by Thames GmbH of up to 100% of the shares of American Water in one or more public offerings, is approved.

2. Within ten days of the date of closing, American Water shall file with the Director of the Office of Accounting, Finance, and Economics all filings made to the Securities and Exchange Commission related to the Initial Public Offering.

3. As discussed in the body of this Order, if either Moody's or Standard & Poor's downgrade the credit rating of American Water or American Water Capital Corporation existing as of the date of the issuance of this order, American Water will file with the Commission within sixty (60) days after notification from Moody's or Standard & Poor's of the downgrade a document setting forth American Water management's plans to address in a timely manner the credit quality areas of concern set forth in the downgrade notification.

4. American Water shall submit a letter to the Secretary of the Commission within ten days of the issuance of this Order, indicating whether or not it unconditionally accepts the requirements and conditions in this Order. In the event the American Water fails to provide said letter, the Commission may revoke or modify this Order.

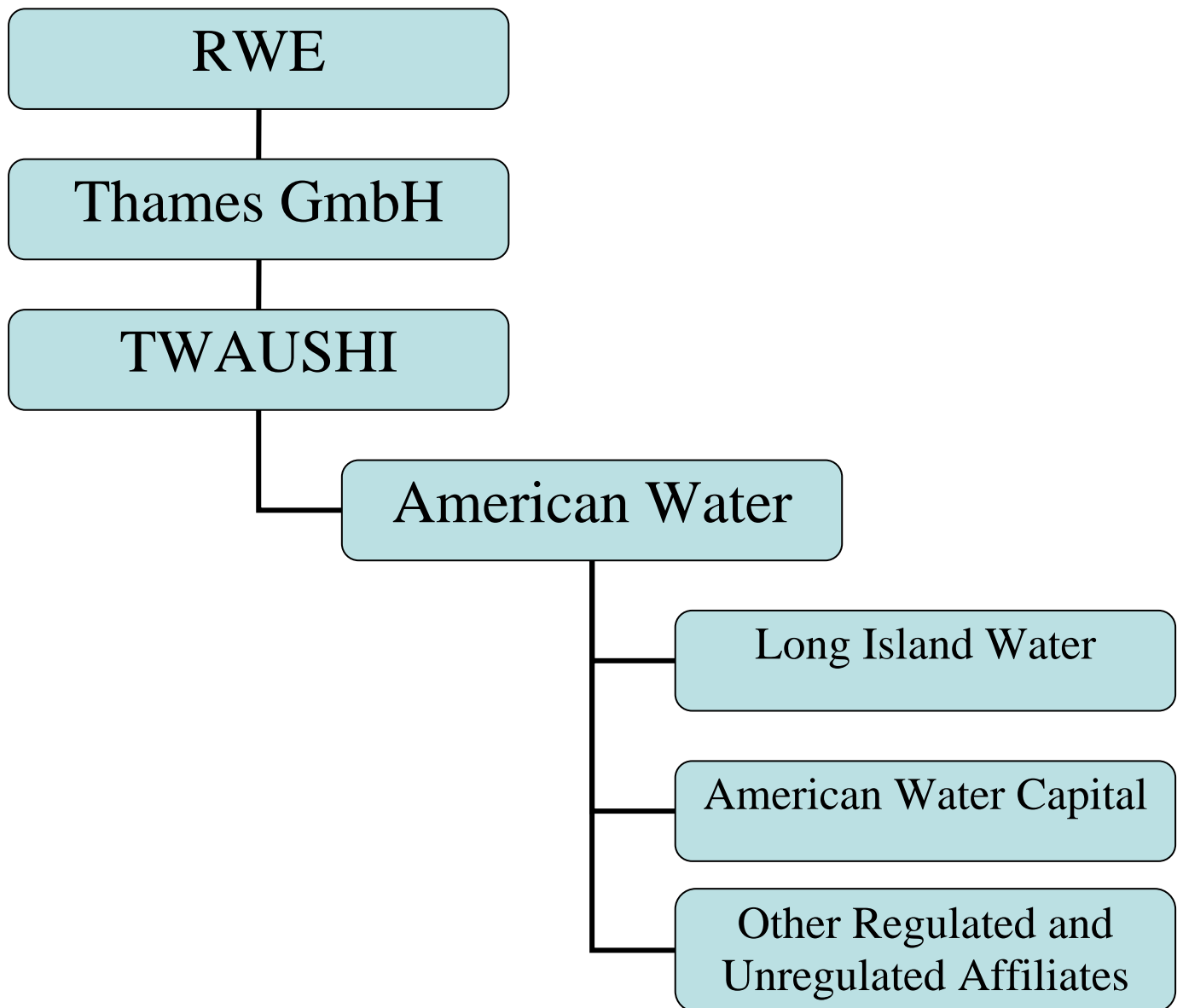
5. This proceeding is continued.

By the Commission,

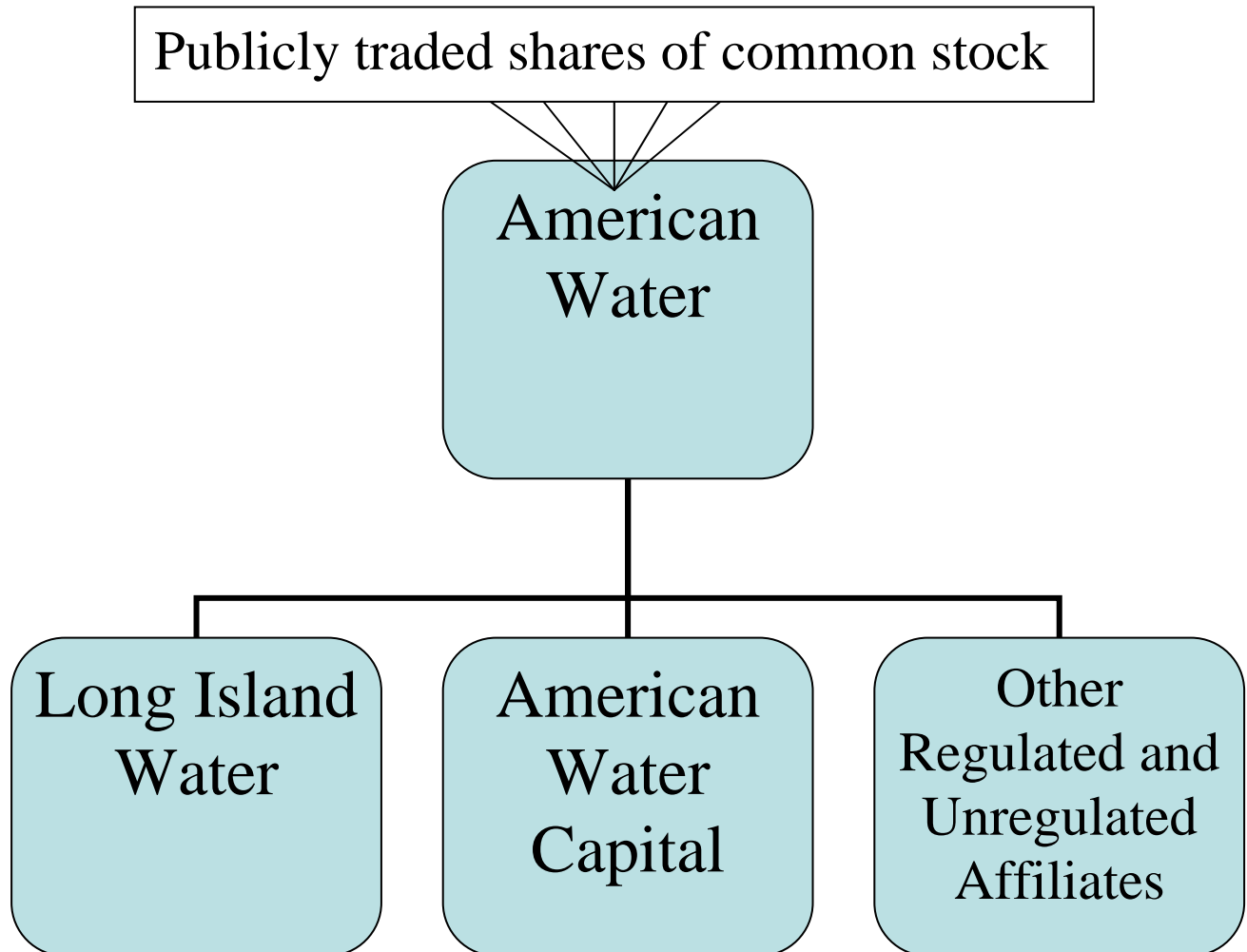
(SIGNED)

JACLYN A. BRILLING
Secretary

Current Organizational Chart



Organizational Chart after the Proposed Transaction



STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 06-W-0490 - Joint Petition of Thames Water Aqua Holdings GmbH, Thames Water Aqua US Holdings, Inc. and Long Island Water Corp. for the approval of the Merger of Thames Aqua US Holdings, Inc. with and into American Water Works Co., Inc. and the subsequent sale of the shares of Common Stock of American Water Works Co., Inc.

NOTICE OF DETERMINATION OF NON-SIGNIFICANCE

NOTICE is hereby given that an Environmental Impact Statement will not be prepared in connection with the approval by the Public Service Commission, for approval of the Merger of Thames Aqua US Holdings, Inc. with and into American Water Works Co., Inc. and the subsequent sale of the shares of Common Stock of American Water Works Co., Inc. Based upon our determination in accordance with Article 8 of the Environmental Conservation Law, that such action will not have a significant adverse effect on the environment. The approval of this action is an Unlisted Action as defined under 6 NYCRR Section 17.7(c).

Base upon our review of the record, the approval of the Merger of Thames Aqua US Holdings, Inc. with and into American Water Works Co., Inc. and the subsequent sale of the shares of Common Stock of American Water Works Co., Inc. with no changes to the operation of the water facilities and delivery infrastructure that will result in significant adverse environmental impacts. The address of the Public Service Commission, the lead agency for purposes of the Environmental Quality Review of this project is Three Empire State Plaza, Albany, New York 12223-1350. Questions may be directed to Richard H. Powell at (518) 486-2885 or to the address above.

JACLYN A. BRILLING
Secretary