

**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held July 25, 2007

Commissioners Present:

Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman
Terrance J. Fitzpatrick, Joint Concurring and Dissenting Statement attached
Tyrone J. Christy
Kim Pizzingrilli, Joint Concurring and Dissenting Statement attached

Application of Pennsylvania-American
Water Company for approval of a change in
control to be effected through a public
offering of the common stock of American
Water Works Company, Inc.

A-212285F0136

TENTATIVE OPINION AND ORDER

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BY THE COMMISSION:

Before the Commission for consideration and disposition are the Exceptions of the Pennsylvania-American Water Company (PAWC), the Office of Consumer Advocate (OCA), and the Office of Small Business Advocate (OSBA), filed on June 27, 2007, to the Initial Decision of Administrative Law Judge (ALJ) Louis G. Cocheres, which was issued on June 20, 2007. Reply Exceptions were filed on July 2, 2007, by the Office of Trial Staff (OTS), the OCA and PAWC.

I. HISTORY OF PROCEEDING

PAWC's Application seeking approval for a change in corporate control was filed on May 5, 2006.¹ On June 8 and 9, 2006, respectively, the OSBA and OCA filed Notices of Intervention and Protests. On June 9, 2006, the OTS entered its appearance and filed a Request to Initiate Proceeding. Also on June 9, 2006, a Petition to Intervene was filed jointly by the Utility Workers Union of America, AFL-CIO and the Utility Workers Union of America Local 537 (collectively, UWUA), which was subsequently granted. On July 10, 2006, the Pennsylvania American Water Large Users Group (PAWLUG), an *ad hoc* group of industrial customers, filed a Petition to Intervene in which it explained why good cause existed for seeking to intervene after the deadline set forth in the Commission's Notice. PAWLUG's intervention was not opposed and granted by the ALJ.

On September 18, 2006, a telephonic Public Input Hearing was held. Eight public witnesses testified. On October 16, 2006, the City of Pittsburgh (City) filed a document titled "Late-Filed Petition of City of Pittsburgh To Intervene," which PAWC opposed. The presiding ALJ denied the City's Petition. No exceptions were filed to that action. On December 14, 2006, the ALJ issued a Protective Order to protect confidential information and documents provided by PAWC to the Parties and confidential information contained in testimony and exhibits filed, or to be filed, with the Commission.

The Parties to this proceeding engaged in a collaborative process to address issues raised in their respective testimony and to attempt to resolve their differences. The ensuing negotiations led to a settlement among PAWC, the OTS and the OCA (Settlement), which was embodied in a Joint Petition For Non-Unanimous Settlement

¹ The text of the History of Proceeding was abbreviated from the Procedural History contained in PAWC's Initial Brief.

(Joint Petition) that was filed on December 22, 2006.² Continuing negotiations between PAWC and the UWUA led to an agreement whereby the UWUA joined the Settlement with the addition of terms agreed to by PAWC and the UWUA. Accordingly, a Supplement to the Joint Petition (Supplement) embodying the additional terms was filed on January 26, 2007.³ (A copy of the Supplement is also attached to this Opinion and Order within Attachment A). Although PAWLUG is not a signatory to the Joint Petition or the Supplement, it does not oppose either. As such, the OSBA is the only party that opposes the Settlement.

An evidentiary hearing was held on February 21, 2007. The record was left open for the submission of additional material as discussed during the hearing. The evidentiary record consists of the transcripts from the telephonic Public Input Hearing on September 18, 2006, and Settlement Hearing on February 21, 2007, one Public Input exhibit (Poff) and the various statements and exhibits listed above.⁴

The Initial Decision approving the Joint Petition, with the exception of two paragraphs, was issued June 20, 2007. Exceptions were filed on June 27, 2007, by PAWC, the OCA, and the OSBA. Reply Exceptions were filed by PAWC, OCA and the OTS on July 2, 2007.

² A copy of the Joint Petition is included as Attachment A without copies of maps of proposed construction projects in Mount Pleasant Township (Washington County), Hanover Township (Washington County) and Collier Township (Allegheny County) which were designated Exhibits 1 through 3, respectively. In addition, Statements in Support from PAWC and the OCA are also included.

³ Hereafter, “Joint Petition” will refer collectively to the Joint Petition filed on December 22, 2006, and the Supplement filed on January 26, 2007, unless stated, or the context clearly indicates, otherwise.

⁴ The transcript from the February 21 hearing is not sequentially numbered. As a result, pages 30 through 109 are repeated in each transcript and will be designated, “Input Tr.” and “Settle Tr.,” respectively. There are a total of 241 pages of transcript.

II. DISCUSSION

Before delving into the various issues involved in this contested Settlement, we shall provide a brief description of the transaction and the participants which we believe will serve as a foundation for understanding the background of this proceeding. In its Main Brief, PAWC presented this description:

In March 2006, RWE Aktiengesellschaft (RWE) announced its decision to sell up to 100% of the common stock of American Water Works Company, Inc. (American Water) in one or more underwritten public offerings and, prior to the initial public offering (IPO) of American Water's stock, to merge Thames Water Aqua U.S. Holdings, Inc. (TWAUSHI) with and into American Water (collectively, the Proposed Transaction). Upon completion, the Proposed Transaction will effect a "change in control" of Pennsylvania-American Water Company (PAWC), as defined in the Pennsylvania Public Utility Commission's (PUC or Commission) Statement of Policy at 52 Pa. Code § 69.901. Therefore, on May 5, 2006, PAWC filed the *Application of Pennsylvania-American Water Company For Approval Of A Change In Control To Be Effected Through A Public Offering Of The Common Stock Of American Water Works Company, Inc.* (Application). The parties, the Proposed Transaction and the approvals requested in the Application are more fully described below.

1. The Parties [to the transaction]

PAWC is a regulated public utility organized and existing under the laws of the Commonwealth of Pennsylvania with its principal office located in Hershey, Pennsylvania. PAWC serves approximately 633,000 customers throughout 35 counties in Pennsylvania. PAWC owns, operates and maintains potable water production, treatment, storage and distribution systems furnishing water for residential, commercial, industrial and government users in its service area. PAWC also owns, operates and maintains

collection, pumping and treatment systems for the purpose of furnishing wastewater services in certain areas of south central and northeastern Pennsylvania. PAWC is a wholly-owned subsidiary of American Water (PAWC St. 1, pp. 4-5).

American Water is a corporation organized and existing under the laws of the State of Delaware, with its principal office in Voorhees, New Jersey. American Water owns regulated operating subsidiaries in 18 states, including PAWC. American Water is a subsidiary of TWAUSHI.

TWAUSHI is a corporation organized and existing under the laws of Delaware, with its principal office in Voorhees, New Jersey. TWAUSHI is a wholly-owned subsidiary of Thames GmbH.

Thames GmbH is a foreign corporation organized and existing under the laws of the Federal Republic of Germany, with its principal office in Essen, Germany. Thames GmbH is a wholly-owned subsidiary of RWE and is the holding company for most of RWE's water operations in the United States and other countries.¹

RWE is a foreign corporation organized and existing under the laws of the Federal Republic of Germany, with its principal office in Essen, Germany. RWE is an international utility company with core businesses in the European electricity and natural gas markets.

The current corporate relationships among the foregoing parties are depicted on the organization chart provided as page 1 of Exhibit A to the Application. Page 2 of that exhibit depicts the anticipated corporate relationships after consummation of the Proposed Transaction.

2. The Proposed Transaction

The Proposed Transaction consists of (i) the sale by Thames GmbH of up to 100% of the shares of common stock of American Water and (ii) prior to the IPO of American Water stock, the merger of TWAUSHI with and into American Water.² The shares will be sold, through one or

more public offerings, to a broad group of investors including institutional and retail (e.g., individual) investors. While Thames GmbH desires to sell 100% of American Water's shares in the IPO, it may, depending on market conditions, sell less than all of the shares in the IPO. In that event, the remainder of American Water's shares will be sold in one or more public offerings as soon as reasonably practical after the IPO. The IPO and any subsequent public offerings will be conducted according to the rules for public offerings of stock mandated by the United States Securities and Exchange Commission (SEC) (PAWC St. 2, pp. 2-3; Application, pp. 5-6).

The key participants in an underwritten public offering are: (i) the company in which shares are being sold (in this case, American Water); (ii) the seller of the shares (in this case, Thames GmbH); and (iii) the underwriters (the investment banks that purchase the shares from the seller and resell them to the public) (PAWC St. 2, p. 3; Application, pp. 5-6). A detailed description of the SEC and underwriting processes that must be followed in conducting the IPO and any subsequent offerings of American Water's stock is set forth in PAWC Statement No. 2 (pp. 6-9) and in the Application (pp. 6-8).

¹ The scope of RWE's water operations has been significantly reduced by the sale of London-based Thames Water plc to Kemble Water Ltd., a consortium led by Macquarie Bank's European Infrastructure Funds (PAWC St. 2-R, p. 3, Tr. 74).

² American Water will be the survivor of the merger. Consequently, following the Merger, and at the time of the IPO, Thames GmbH will be the direct parent of American Water and will own all of American Water's common stock.

PAWC M.B. at 1-3 (emphasis in original).

The Company also clearly specified its requested relief, as follows:

3. The Commission Approvals Requested

The Application requests that the Commission: (1) issue a Certificate of Public Convenience under Section 1102 of the Public Utility Code authorizing the Proposed Transaction; (2) relieve PAWC of the filing and reporting requirements set forth in Ordering Paragraphs 6 (d)-(g) of the Commission’s Order entered September 4, 2002 at Docket Nos. A-212285F0096 and A-230073F0004;³ (3) grant such other approvals as the Commission may determine necessary to effect the Proposed Transaction; and (4) terminate and close the proceedings at Docket No. A-212285F0136.

³ Paragraphs 6(d)-(g) pertained to filing and reporting by RWE and, therefore, would have no application following the Proposed Transaction (PAWC St. 1, pp. 13-14).

PAWC M.B. at 4 (emphasis in original) (I.D. at 5 – 7).

A. Legal Standards and Burden of Proof

Subsection 1102(a)(3) of the Public Utility Code (Code) requires an application for a certificate of public convenience for transactions which sell utility assets. 66 Pa. C.S. §1102(a)(3). In order to grant a certificate, Subsection 1103(a) of the Code requires the Commission to find that the application is “necessary or proper for the service, accommodation, convenience, or safety of the public.” 66 Pa. C.S. § 1103(a). (I.D. at 8).

The parties all point to the case of *York v. Pa. PUC*, 449 Pa. 136, 295 A.2d 825 (1972), as the leading case on the subject of defining the standard set forth in Subsection 1103(a). It is well established that the Commission must find the merger “will affirmatively promote the ‘service, accommodation, convenience, or safety of the

public' in some substantial way." *York* at 828. The parties also point to the case of *Popowsky v. Pa. PUC*, 917 A.2d 380 (Pa. Cmwlth 2007) (*Verizon/MCI Merger*), as a reaffirmation by the Commonwealth Court of the *York* merger standards. In *Verizon/MCI Merger*, the Court reversed the Commission's approval of the merger because the Commission failed to perform a state-specific analysis of the potential competitive effects of removing a major telephone competitor from the market. The Commission has interpreted the *York* standard in *Application of UGI Utilities, Inc., UGI Utilities Newco, Inc. and Southern Union Company*, Docket Nos. A-120011F2000, *et al.* (August 18, 2006), 2006 PUC LEXIS 62. In *UGI*, the Commission ruled that, after looking at the positives and negatives, the net effect of the merger or acquisition on all affected parties should benefit the public interest. (I.D. at 8).

The merger cases cited above are completely distinguishable from the case at hand. This case is a divestiture case, not a merger case. We must realize that the United States is part of a global capitalistic economy. Here, a domestic Pennsylvania water and sewer company (PAWC) is owned by a domestic Delaware water and sewer corporation (American Water); which in turn is owned by a domestic Delaware corporation (TWAUSHI); which in turn is owned by a German corporation (Thames GmbH) and which is the holding company for United States and other foreign water companies; which in turn is owned by a German corporation (RWE) which is an international utility with an electric and gas core business. Divestiture can occur for a variety of reasons: the sale could be due to the parent company needing money and deciding to sell a profitable subsidiary; the sale could be due to the parent company wanting to sell a not profitable enough subsidiary (as suggested by the OCA witness); or, the sale could be due to the parent company wanting to adjust its business plan to react to shifting economies in its home market (as suggested by the Company witness); or, there could be some other reason. The point is that not all of these reasons bode well for the utility or its customers and that trying to halt a divestiture could leave the customers in no better position, or even a worse position, than if the divestiture occurred. However, given

that a divestiture must meet the public interest standard, it is conceivable that a divestiture could be in the public interest, even if it was the lesser of two evils. Accordingly, the ALJ did not accept the Courts' interpretation of the statutory standards in merger cases as applicable to divestiture cases. (I.D. at 8 – 9).

Before discussing the OSBA's objections to the individual sections of the Joint Petition, there is one generic argument which can be dismissed summarily. In an apparent effort to use the terminology set forth in the Courts' decisions, the OSBA repeatedly argued that preservation of the *status quo* was insufficient to meet the Courts' standards. The ALJ rejected this position because he believed that the OSBA argument represented a misunderstanding of the *status quo*. According to the ALJ, the OSBA's unstated definition of the status quo was the expected seamless continuation of utility service by PAWC in Pennsylvania. The ALJ found that the OSBA's view of the status quo omitted some important details related to the entire transaction. While this Commission and the PAWC ratepayers may not see any changes to PAWC and the service it renders, both before and after the divestiture, there most certainly are changes. Most particularly, PAWC is currently a subsidiary of American Water Works Company, Inc., which, as noted above, is also a subsidiary of a major international utility conglomerate which, at a minimum, provides electric, gas, wastewater and/or water services on at least two continents. When the divestiture is completed, PAWC will be a subsidiary to American Water. American Water will be the only parent company to PAWC. PAWC will be a subsidiary of a national water and wastewater corporation. After the completion of the transaction, the financial resources immediately available to American Water and PAWC will be limited to national financial institutions. In contrast, currently American Water must compete within its current corporate hierarchy for financial resources in Europe. Under these circumstances, the ALJ found that the completion of the transaction will have altered the *status quo* substantially. Accordingly, the ALJ found that there is no basis for suggesting that the *status quo* will be preserved. (I.D. at 9 – 10).

And finally, as the proponent of a rule or order, PAWC had the burden of proof in this matter pursuant to 66 Pa. C.S. § 332(a).

Any order of the Commission granting an application, in whole or in part, must be based on substantial evidence. *Dutchland Tours, Inc. v. Pa. PUC*, 337 A.2d 922, 925 (Pa. Cmwlth1975). The term “substantial evidence” has been defined by Pennsylvania courts as such relevant evidence as a reasonable mind might accept as adequate to support a conclusion. Included in that standard is the requirement that the applicant must present a preponderance of the evidence. *Samuel J. Lansberry, Inc. v. Pa. PUC*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990) *alloc. den.* 602 A.2d 863 (1992). That is, an applicant must present evidence more convincing, by even the smallest amount, than that presented by the other party. *Se-Ling Hosiery v. Marqulies*, 364 Pa. 45, 70 A.2d 854 (1950). More information is required than a mere trace of evidence or a suspicion of the existence of a fact sought to be established. *Norfolk and Western Ry. v. Pa. PUC*, 489 Pa. 109, 413 A.2d 1037 (1980); *Erie Resistor Corp. v. Unemployment Compensation Bd. of Review*, 166 A.2d 96 (Pa. Super. 1960); *Murphy v. Commonwealth, Dep’t. of Public Welfare*, 480 A.2d 382 (Pa. Cmwlth.1984).

Having reviewed the record, statute, the cases and the briefs, the ALJ found that, on balance, the terms of the Settlement meet the standards set forth in the statute and recommended approval of the Joint Petition with the exception of Paragraphs 17 and 52 regarding the provision of service to portions of Mt. Pleasant and Hanover Townships in Washington County, and Collier Township in Allegheny County. (I.D. at 11).

B. The Settlement

1. Paragraph 42, Settlement Section III – Public Interest Considerations

Paragraph 42 states that:

The Proposed Transaction will result in American Water becoming a publicly-traded company focused on the water and wastewater business in the United States.

a. Positions of the Parties

The OSBA argued that the change in American Water status to publicly owned would not result in a positive or negative impact on the PAWC ratepayers. In its Reply Brief, the OSBA recommended that the Commission should not accept representations which were nothing more than Company opinions about how the European financial markets valued (or devalued) RWE's current corporate structure. (OSBA R.B. at 5 – 6; I.D. at 12).

In its Main Brief, PAWC stressed that the transaction would result in American Water becoming the largest publicly-traded water company in the United States with full access to the domestic financial markets for equity and debt. The Company regards this access as more advantageous than its future ability to enter foreign financial markets as a non-core RWE holding. PAWC succinctly summarized its position, as follows:

Faced with (1) the fact that the European capital markets no longer valued water as a strategic asset of RWE, (2) the need for RWE to focus its resources on its energy business, and (3) the other challenges outlined above, RWE is divesting its water holdings in the U.K and U.S. by selling Thames Water and returning American Water to its status as a U.S.-based, publicly-traded company. Under these circumstances, the IPO of American Water stock will produce a significant affirmative benefit for American Water, its subsidiaries and their customers because, after becoming a public company, American Water will have direct access to

the U.S. capital markets for its funding needs and will not have to compete for capital and management resources as a “non-core” business within a larger foreign energy holding company system

(PAWC St. 2-R, p. 3).

PAWC asserted that when American Water becomes independent of RWE, American Water and PAWC would be better able to focus on the water and wastewater business without the distraction of having to compete for RWE management and financial attention. (PAWC M.B. at 32 – 33; I.D. at 12 – 13).

In its Reply Brief, PAWC pointed to evidence that the new American Water would have independent access to the financial markets which it regarded as a benefit and that the new American Water would be better positioned to raise and deploy capital for needed infrastructure investment. PAWC dismissed the OSBA’s concern that a recent American Water effort to borrow money resulted in a credit rating of A- for the transaction, compared to the established A rating for RWE. The Company attributed the one-notch rating difference to the fact that American Water continued to be a non-core subsidiary of RWE. It added that its review of the financial market at the time of the borrowing revealed, there was no correlation between established credit ratings of other companies in the marketplace and their borrowing costs. (PAWC R.B. at 4 – 7; I.D. at 13).

b. ALJ’s Recommendation

The ALJ agreed with PAWC on this issue, stating that the OSBA introduced no evidence to support its position that RWE incorrectly evaluated the European financial markets. However, the ALJ found that PAWC presented sufficient evidence to support a finding that the European financial markets now view the existing RWE corporate structure as subject to more risk in the energy and gas business and that the water utilities were no longer considered a core business. This information was buttressed by evidence that other

multi-utility conglomerates had already spun off their water utility subsidiaries, including the parent company to Duquesne Light Company in Pennsylvania. The ALJ also agreed that when the transaction is completed, American Water will be better situated as a publicly owned national water and wastewater company to have direct access to the U.S. capital markets for its funding needs and will not have to compete for capital and management resources as a “non-core” business within a larger, foreign, energy holding company system. Accordingly, the ALJ found that having American Water become a publicly-traded company would benefit PAWC and its ratepayers and, therefore, Paragraph 42 to the Settlement is in the public interest. (I.D. at 14).

c. Exceptions

In its third exception, the OSBA avers that the ALJ erred when he found that illusory promises constitute “affirmative benefits” to the public. (OSBA Exc. at 9). The OSBA states that PAWC has represented that the European capital markets will not look favorably on RWE (and, therefore, will not look favorably on American Water) if RWE does not divest American Water. (I.D. at 12-14). However, the OSBA cautions that PAWC’s reading of the European capital markets is no more certain to be correct than it was five years ago when the then merger applicants convinced the Commission of the opposite. (OSBA Exc. at 9).

d. Disposition

We are convinced that removing the need to compete for capital and management resources as a “non-core” business and gaining direct access to the U.S. capital markets for its funding needs will benefit the utility and its customers. Accordingly, the exception of the OSBA is denied and, finding it otherwise reasonable, we adopt the recommendation of the ALJ on this issue.

2. Paragraph 43, Settlement Section III – Public Interest Considerations

Paragraph 43 states that:

The Settlement commits RWE and Thames GmbH to infuse equity capital into American Water to assure that, at the time of the IPO, American Water will have a strong capital structure that included an equity-to-capitalization ratio of not less than 45% common equity. *See* ¶ 29.

a. Positions of the Parties

The ALJ found that this provision is an affirmative public benefit due to the significant equity capital infusion that has already taken place and the guarantee by RWE and Thames GmbH to provide as much equity capital as necessary to achieve at least a 45% equity-to-capitalization ratio. According to the ALJ, PAWC has demonstrated that RWE and the financial markets no longer view American Water as one of RWE's core businesses and that RWE seeks to concentrate its resources on the European electric and gas industries. (PAWC M.B. at 30 – 32; I.D. at 14). PAWC asserted that the equity infusion will ensure that American Water will have a strong capital structure at the time of the IPO, which will provide the basis for a solid investment grade credit rating. (PAWC R.B. at 8; I.D. at 14). The ALJ noted that PAWC, the OCA and the OTS believe that the equity infusion will improve or maintain the “stand-alone” credit quality of American Water and potentially benefit ratepayers through lower capital costs (I.D. at 14 – 15).

The sole opposition to the concept that there is public benefit stemming from Paragraph 43 of the Joint Petition is from the OSBA. The OSBA argues that the equity infusion that “results in American Water's having a functional capital structure does nothing more than maintain the *status quo*” and that it “is the least that ratepayers of PAWC can expect at the conclusion of the proposed transaction.” (OSBA M.B. at 9). As shown above, maintenance of the *status quo* would mean that American Water would

remain a part of RWE's corporate structure and have to compete for capital resources with the favored electric and gas components. (I.D. at 15).

American Water notes that its current corporate credit rating from Standard & Poor's is A-, which is one notch lower than RWE's rating of A. (PAWC St. 2 S at 5; OSBA M.B. at 15; I.D. at 15). PAWC explained that this condition is due to its "change in status from 'core' to 'non-core' within RWE, which exists independently of the proposed IPO and would persist even if the IPO did not occur." (PAWC R.B. at 6; I.D. at 15). PAWC also pointed out that the "stand-alone" credit quality of American Water would not suddenly increase to match that of RWE if the IPO were not to happen. (PAWC R.B. at 6; I.D. at 15). Thus, to maintain the *status quo* would mean that American Water would remain a lower rated and "non-core" business within RWE's capital structure. Additionally, PAWC noted that American Water was recently able to independently borrow funds at rates comparable with its current corporate credit rating (as part of RWE), even though buyers in the capital market are fully aware of the proposed IPO. (PAWC M.B. at 34; I.D. at 15). The current credit rating indicates that the capital markets value American Water's credit quality as an independent company at least as favorably as under the *status quo* even before the proposed equity capital infusion. (I.D. at 15).

b. ALJ's Recommendation

The ALJ found that the equity capital infusion guaranteed by Paragraph 43 of the Joint Petition will produce a capital structure with, as PAWC explains, "more overall equity – and significantly more **common** (emphasis in original) equity – than previously existed for American Water." (I.D. at 15). According to the ALJ, the clear implication is that, for American Water, the *status quo* means that its equity capital ratio is below 45%, which for an independent water utility could negatively affect its credit ratings, increase capital costs, and detrimentally affect ratepayers as noted by the OTS

and OCA. Accordingly, the ALJ found that maintaining the *status quo* is not in the public interest if it means that American Water will have equity capital below the norm for an independent water utility and have to compete for capital as a non-core business within RWE's corporate structure. The ALJ determined that the equity capital infusion will strengthen American Water's stand-alone credit standing and potentially reduce capital costs. (I.D. at 15 – 16).

c. Exceptions

There were no exceptions filed regarding this issue.

d. Disposition

We believe it is in the best interest of American Water, as well as PAWC, to have a strong capital ratio, and the commitment of RWE and Thames GmbH to infuse equity capital into American Water should encourage this important result. Accordingly, finding it otherwise reasonable, we adopt the ALJ's recommendation that Paragraph 43 of the Settlement is in the public interest.

3. Paragraph 44, Settlement Section III – Public Interest Considerations

Paragraph 44 states that:

The Settlement assures the customers of PAWC will be held harmless from any increase in the cost rate for \$80 million of 4.75% debt issued to RWE, through AWCC, that will be retired in advance of its original maturity date. *See ¶ 18.*

PAWC will be held harmless from any increase in the cost rate for \$80 million of 4.75% debt to be refinanced prior to the proposed IPO. PAWC will reflect the

refinanced debt at a coupon rate of 4.75% until March 1, 2014, (the original maturity date) in determining its rate of return for ratemaking purposes. The \$80 million of debt was (pre-refinancing) claimed at a coupon rate of 5.51% for PAWC's last base rate case. (I.D. at 16).

a. Positions of the Parties

The OTS points out that refinancing of debt is a regular corporate occurrence. (OTS M.B. at 13). The OTS also claimed that, given that the loan originated in March 2004, interest rates have risen and any refinancing would likely be at a higher coupon rate than the current 4.75%. (OTS M.B. at 10). Both the OTS and OCA agree that the PAWC customers will benefit from the assurance against the increase in debt costs related to the \$80 million refinancing. (OTS R.B. at 13; OCA M.B. at 37; I.D. at 16).

Opposing the concept of Paragraph 44, the OSBA claimed that:

“[b]ut for the proposed transaction, the \$80 million of debt would not have been retired in advance of its original maturity date” and that the hold harmless provision “does nothing more than maintain the status quo as far as PAWC’s ratepayers are concerned.”

(OSBA M.B. at 10; I.D. at 16 – 17).

b. ALJ’s Recommendation

The ALJ stated that no Party has demonstrated that PAWC would not refinance the \$80 million before 2014, whether or not the proposed IPO is approved. As the OTS noted, and no Party has refuted, refinancing of debt is a common corporate occurrence. PAWC may refinance the debt at any time, and, if it does so, it is under no

obligation to assure ratepayers a coupon rate of 4.75%. In addition, the ALJ found that any refinancing costs would also be recoverable in base rates as part of the cost of capital. Therefore, the ALJ found that the hold harmless assurance, on its own, is an affirmative benefit to ratepayers, regardless of the proposed IPO. (I.D. at 17).

c. Disposition

Exceptions were not filed on this issue. Accordingly, finding the recommendation of the ALJ to be otherwise reasonable, we shall adopt it. To hold the ratepayers harmless against a potential increase in debt cost until 2014 is indeed in the public interest as well as an affirmative benefit to PAWC's ratepayers.

4. Paragraph 45, Settlement Section III – Public Interest Considerations

Paragraph 45 addresses disclosure and reporting requirements which will be applicable to PAWC as follows:

The Proposed Transaction will increase transparency. Following the Proposed Transaction, American Water will be subject to the disclosure requirements of the SEC, the auditing and disclosure requirements of Sarbanes – Oxley and the disclosure and other requirements of the stock exchange on which its shares are traded. In addition, the Settlement commits PAWC to increased levels of reporting to the Commission of financial, creditworthiness, dividend and employment information. *See §§ 27, 28, 32 and 33.*

a. Positions of the Parties

PAWC noted that, as an indirect subsidiary of RWE, American Water's operations are currently not transparent to the public or any party. In addition, PAWC is under no obligation to produce the additional reports required under these provisions. Those reports concern key financial and corporate measures that by their transparency

will provide the public and all parties with the ability to more clearly view PAWC's managerial, corporate and financial performance. (Joint Petition at 9 – 11; I.D. at 17).

The OSBA countered that the transparency only “benefits the investment community and merely maintains the status quo for ratepayers.” The OSBA also argued that “the mere reporting of information, while useful, does not rise to the level of a substantial public benefit.” (OSBA M.B. at 11).

b. ALJ's Recommendation

The ALJ however, found that corporate transparency benefits more than just the investment community. All Parties, including the Commission, that base their actions and regulatory review on information provided by utilities benefit from the more transparent information flow provided by the Sarbanes-Oxley provisions. The additional reports required by PAWC in the Joint Petition enhance that benefit. The ALJ stated that, the reporting of information in and of itself may or may not be a substantial public benefit, but in this case, the information relates to the important matters of corporate governance and financial management effectiveness which was previously unavailable to the public. As such, the ALJ determined that, the transparency provisions outlined in Paragraph 45 of the Joint Petition are an affirmative public benefit because that information would not be publicly available without the proposed IPO and subsequent Joint Petition. (I.D. at 17 - 18).

c. Exceptions

According to the OSBA's third exception, compliance with Sarbanes-Oxley is not an affirmative benefit because, as with Verizon's predicted enhanced deployment⁵ of wireless, there is no evidence that compliance, with Sarbanes – Oxley, is contingent upon approval of the divestiture. (OSBA Exc. at 10).

d. Disposition

Corporate transparency is an important regulatory tool used to monitor many significant activities of Pennsylvania's regulated utilities. In particular, we value the enhanced oversight directly afforded by the Sarbanes-Oxley corporate governance standards. We agree with, and shall adopt, the ALJ's rationale and ultimate conclusion regarding this issue. Accordingly, we shall deny the OSBA's exception on this issue.

5. Paragraph 46, Settlement Section III – Public Interest Considerations

Paragraph 46 addresses recovery of compliance expenses as follows:

Although American Water, as a U.S.-based public company, will have to meet all of the auditing and reporting standards of Sarbanes-Oxley, the Settlement: (a) provides that PAWC will not seek to recover from customers the costs of initial development and implementation of programs and procedures for Sarbanes-Oxley compliance (*see* ¶ 25); and (b) caps the amount of on-going Sarbanes-Oxley compliance costs that PAWC may recover from its customers for a period of three years (*see* ¶ 26).

⁵ In *Popowsky*, Verizon represented that its merger with MCI would result in enhanced deployment of wireless service. However, the Commonwealth Court concluded that the prediction was not an affirmative benefit, in part because enhanced deployment might have occurred even without the merger. *Popowsky*, 917 A.2d at 396. (OSBA Exc. at 10).

a. Positions of the Parties

The OSBA claimed that “the cost of Sarbanes-Oxley compliance would not have been incurred without the proposed transaction” even while acknowledging that PAWC will be implementing the Sarbanes-Oxley provisions regardless of whether the proposed IPO occurs. (OSBA M.B. at 12). The OTS pointed out that PAWC did not explicitly indicate that it would not seek to recover those costs from ratepayers. (OTS R.B. at 12). Both PAWC and the OCA note that the compliance costs are recoverable costs from ratepayers. (PAWC R.B. at 12; OCA R.B. at 9; I.D. at 18 - 19).

b. ALJ’s Recommendation

The ALJ found that this provision is an affirmative public benefit because PAWC claimed: (1) that it will implement many, if not all, of the Sarbanes-Oxley provisions regardless of whether the proposed IPO occurred or not, and, (2) it would have been entitled to seek recovery of the implementation costs. The ALJ stated that by forgoing its entitlement to seek recovery from ratepayers of incurred implementation costs as well as costs exceeding the cap on its allocation of on-going Sarbanes-Oxley compliance costs, the utility provides a clear affirmative public benefit. (I.D. at 18).

c. Exceptions

In its third exception, the OSBA notes that PAWC did not explicitly state that it would seek recovery from ratepayers of the Sarbanes-Oxley compliance costs, even if this transaction is not approved, and pointed out that PAWC also did not explicitly state that it would not seek recovery of those costs. (OSBA Exc. at 10). However, just as with the enhanced deployment of wireless service in *Popowsky*, the OSBA avers that there is no evidence that PAWC’s promise to absorb the compliance

costs will actually give ratepayers something they would not have gotten without the divestiture. (OSBA Exc. at 10 – 11).

d. Disposition

The Sarbanes-Oxley implementation costs are potentially substantial. (PAWC R.B. at 12; I.D. at 18). We agree with the ALJ that by the Company's forgoing its entitlement to seek recovery from ratepayers of incurred implementation costs and those costs exceeding the cap on its allocation of on-going Sarbanes-Oxley compliance costs, it appears that the transaction will provide a clear, affirmative public benefit. Therefore, we shall adopt Paragraph 46 as being in the public interest. Accordingly, we shall deny the OSBA's exception on this issue.

6. Paragraph 47, Settlement Section III – Public Interest Considerations

Paragraph 47 concerns IPO costs and costs associated with compliance with foreign laws:

The Settlement provides that PAWC will not seek to recover from customers the costs of the Proposed Transaction (including the cost of obtaining state regulatory approvals), as detailed in Paragraph 22. The Settlement also provides that PAWC will not seek to recover from customers employee transition costs (early termination, change-in-control payments and retention bonuses) paid as a result of the Proposed Transaction, as detailed in Paragraph 24. Additionally, the Settlement requires that PAWC not bear costs incurred for compliance with foreign laws or regulations necessary to complete the Proposed Transaction. *See* ¶ 23.

a. Positions of the Parties

The OSBA asserted that holding the ratepayers harmless from costs caused by the proposed transaction is not, by definition, a substantial public benefit. (OSBA M.B. at 12; I.D. at 19).

b. ALJ's Recommendation

The ALJ found that while it may be true that these costs would not have occurred but for the proposed IPO transaction, these costs cannot be viewed outside of the context of this proposed transaction. As noted by the OCA, “requiring change-of-ownership costs to be below-the-line is an appropriate and reasonable means of ensuring that the public obtains affirmative benefits from the transaction.” (OCA M.B. at 32; I.D. at 19). PAWC is under no obligation to forgo the change-of-ownership costs. The ALJ believes that the Company’s proposal to forgo these costs is an affirmative benefit because, assuming the transaction is approved, these are legitimate business expenses and costs that are normally collectable from customers. (I.D. at 19).

Paragraph 24 of the Settlement provides that these costs may be allocated to PAWC for accounting and tax purposes and also that American Water shall supply a report to the Commission summarizing such costs.

c. Exceptions

The OSBA, in its second exception, states that the ALJ’s adoption of the condition requiring PAWC to absorb the IPO costs, the employee transition costs, and the foreign transaction costs is an error and not an affirmative benefit. (OSBA Exc. at 9). Accordingly, the OSBA states that this condition does not qualify as an affirmative benefit under *Popowsky* because these costs would be incurred only because of the divestiture.

d. Disposition

We believe that PAWC’s willingness to absorb these transaction costs affirmatively benefits its ratepayers and is, therefore, in the public interest. Absent the

Settlement achieved in this proceeding, PAWC would be able to present these costs within a subsequent base rate case for recovery from current ratepayers. As such, we shall deny the OSBA's exception and adopt the recommendation of the ALJ on this issue.

7. Paragraph 48, Settlement Section III – Public Interest Considerations

In Paragraph 48 the Company agreed to:

be a subsidiary of American Water and will continue to be operated by PAWC's local management, under the supervision of PAWC's board of directors. The Settlement provides that PAWC will maintain its corporate office in Pennsylvania, will maintain a substantial local interest representation on its board of directors, and will continue no less than its current level of support for, and involvement in, local and community projects, including funding for PAWC's programs to assist low-income customers. *See §§ 34, 35 and 36.*

a. Positions of the Parties

The OSBA took the position that, based on the Court's comments in the *Verizon/MCI Merger* case, continued local corporate presence and service and funding of low-income programs after the merger were merely the maintenance of the *status quo*. (OSBA M.B. at 12 – 13; OSBA R.B. at 7; I.D. at 20).

The Company countered these arguments by pointing out that the continuation of a strong local presence was a positive benefit. Citing *Joint Application of PECO Energy Company and Public Service Electric and Gas Co.*, Docket No. A-110551F0160 (February 1, 2006) (*PECO/Public Service*), PAWC noted that the Commission had previously concluded that it was not authorized to direct the location of a utility's headquarters and composition of the board of directors or to mandate continued local presence initiatives. Citing *Pa. PUC v. Pennsylvania-American Water Co.*, Docket No. R-00038304, *et al.*, Pa. PUC Lexis 29 (January 16, 2004), PAWC asserted that the

Commission already conceded it cannot mandate levels of charitable giving, community involvement or low-income assistance. (PAWC M.B. at 38 – 39; I.D. at 20).

In its Reply Brief, the Company noted that, in the *PECO/Public Service* case, the Commission concluded that the maintenance of a local corporate headquarters and a local presence on the board of directors, as well as funding and support for local and community projects and low-income customers, were substantial public benefits in merger and acquisition cases. The OCA and the OTS agreed with the arguments offered by the Company. (PAWC R.B. at 12 – 13; OCA M.B. at 35 – 36; OTS M.B. at 12; OTS R.B. at 9 – 10; I.D. at 20 – 21).

b. ALJ’s Recommendation

The ALJ agreed with the Company, the OTS and the OCA. In further clarifying his agreement with the Parties, the ALJ stated that the current maintenance of a local corporate headquarters and a local presence on the board of directors, as well as funding and support for local and community projects and low-income customers are all voluntary gifts from the Company which are not required as part of the rendition of reasonable and adequate public utility service in Pennsylvania. (I.D. at 21) (emphasis in original)). Those gifts could be stopped at any time, including immediately after the completion of the divestiture. The continuation of those gifts should not be confused with the continuation of the *status quo*. That attitude of complacency and expectation fails to recognize the difference between statutory requirements and corporate public relations. The ALJ found that the continuation of these commitments is indeed a substantial public benefit by any criteria. Accordingly, the ALJ found that the commitments made by PAWC are a substantial benefit to all of its customers. (I.D. at 21 – 22).

c. Exceptions

The OSBA excepted to the ALJ’s recommendation on this issue. The basis for the OSBA’s exception is the Commonwealth Court’s finding in *Popowsky*, that Verizon “is the incumbent phone carrier with its lines and facilities in the public right-of-way of the Commonwealth, and it is going to have a corporate presence in Pennsylvania regardless of whether its merger is approved.” *Popowsky*, 917 A. 2d at 396. Likewise, according to the OSBA, PAWC is a certificated water and wastewater utility operating water production, treatment, storage and distribution systems throughout its service territory. Therefore, like Verizon, the OSBA argues that PAWC is going to have a significant presence in Pennsylvania whether or not the transaction in this proceeding is approved. (OSBA Exc. at 11).

d. Disposition

We believe that a corporate presence is more than plant in service, or maintenance crews visible to the public. Corporate presence and public relations, as outlined above, are extremely valuable not only to the utility but to its customers. Additionally, when the utility voluntarily provides funding for community projects and low-income customers, an allegiance is established between the community and the utility. Customer service is much more than the delivery of a commodity. Accordingly, we shall adopt the recommendation of the ALJ regarding this issue and deny the exception of the OSBA.

8. Paragraph 49, Settlement Section III – Public Interest Considerations

Paragraph 49 states that:

The Settlement contains provisions committing PAWC to adequately fund and maintain its treatment, transmission and distribution systems and assuring that PAWC’s customers will

experience no material adverse change in utility service due to the Proposed Transaction. *See §§ 30 and 31.*

Paragraph 30 states:

PAWC and American Water will adequately fund and maintain PAWC's treatment, transmission and distribution systems and supply the service needs of PAWC's customers in accordance with the Public Utility Code and applicable provisions of the Commission's regulations, orders and policy statements including, but not limited to, all water quality, pressure and quality of service standards.

a. Positions of the Parties

The OSBA asserted that these paragraphs reflect the minimum utility obligation without regard to which corporation is the parent company. (OSBA M.B. at 13).

b. ALJ's Recommendation

The ALJ adopted the position of the OSBA on this issue.

c. Exceptions

There were no exceptions filed to this issue.

d. Disposition

The OSBA is correct. All utilities are required to “furnish and maintain adequate, efficient, safe, and reasonable service and facilities” That obligation is not a substantial benefit; it is the law. 66 Pa. C.S. § 1501. Accordingly, we shall adopt the ALJ's recommendation.

9. Paragraph 50, Settlement Section III – Public Interest Considerations

Paragraph 50 states the following:

The Settlement provides that PAWC will pass through to its customers in future rate cases any actual savings from efficiencies gained by the completion of the Proposed Transaction and the continued ownership of PAWC by American Water. *See ¶ 19.*

Paragraph 19 states:

PAWC will pass through to PAWC customers, in future rate cases, any actual savings from efficiencies resulting from the Proposed Transaction and the continued ownership of PAWC by American Water.

a. Positions of the Parties

The OCA optimistically noted that, “[t]o the extent that this assurance lowers rates, it is a consumer benefit that works to support the substantial affirmative public benefit of the” proposed IPO. (OCA M.B. at 37). In other words, according to the OCA, the promise by PAWC to pass on any efficiency savings to customers, even though none can be conclusively identified at this time, is an affirmative public benefit because there is the possibility of rate reductions stemming from potential efficiency savings that would not normally have been available without the proposed IPO. (I.D. at 22).

The OTS explained, “[r]eflection of benefits in future rate proceedings through operating efficiencies has long been the recognized standard in Commission proceedings,” and that, “it is not necessary that the benefit be realized instantaneously.” (OTS R.B. at 7; I.D. at 21 - 22).

At the other end of the spectrum, the OSBA disagrees. It focuses on American Water’s projected cost of debt after the proposed IPO, particularly on the idea

that the proposed IPO will not realize efficiency benefits concerning American Water's cost of debt and that the proposed IPO has, in fact, already caused American Water's credit rating to drop from an A to an A-. (OSBA M.B. at 16). Also, the OSBA argued that, even if "American Water could remain at an 'A' rating after the proposed transaction has been completed, there *still* is no substantial benefit" because "[m]aintaining the status quo does not meet the requirement [of a substantial public benefit]." (OSBA M.B. at 17 (emphasis in original)). The OSBA also contended that PAWC is inconsistent in its view that American Water, as an independent company, will be in a better position to access the capital markets, because in 2002, PAWC and the Commission believed American Water, as part of RWE's corporate structure, would be able to access capital at advantageous rates. As a remedy to what the OSBA perceives as the potential negative effect on American Water's cost of debt due to the proposed IPO, the OSBA asks that the Commission impose a condition proposed by OSBA witness Brian Kalicic, whereby ratepayers would be held harmless from a possible higher debt cost through PAWC employing the lower of American Water or RWE's cost of debt when developing its overall requested rate of return in any future rate proceeding. (OSBA R.B. at 13 – 14; I.D. at 23).

PAWC explained that the difference in corporate credit ratings between RWE and American Water "arose well before the IPO can or will occur" because American Water is no longer seen as a core business of RWE. As PAWC has detailed, and no other party has shown otherwise, RWE no longer desires to be in the water business in either the U.S. or England. Instead, it is going to focus on its European gas and electricity businesses. Again, PAWC, the OCA and the OTS all noted that the separation of American Water from RWE, as well as RWE and Thames GmbH's equity capital commitment holds the potential for more favorable capital market treatment and lower capital costs. (PAWC R.B. at 6 – 9; OCA R.B. at 10; OTS R.B. at 10 – 11; I.D. at 23 – 24).

The OSBA's second contention concerns an alleged inconsistency of PAWC and the Commission's view of the 2002 acquisition of American Water by RWE in comparison to PAWC's view of the proposed IPO. The OSBA noted that, in 2002, the Commission believed the combination of American Water and "the third largest water supplier in the world, RWE," would produce "enhanced financing capabilities" for PAWC. That was a valid statement then, but as PAWC has shown, circumstances have greatly changed, and American Water is better served by separating from RWE. (I.D. at 24).

b. ALJ's Recommendation

The ALJ found that this provision may or may not be in the public interest because the assurance only holds the potential for lower rates in future rate cases filed by PAWC and that the assurance in Paragraph 50 may be illusory if no quantitative savings are ever actually identified in the future. (I.D. at 22).

The ALJ also found that PAWC is not inconsistent in thinking that, given today's circumstances and not those in 2002, American Water's proposed IPO and separation from RWE will better serve the company and ultimately the public. (I.D. at 24).

The ALJ found that there is no inconsistency in PAWC's views of the 2002 and instant transactions because both views are valid given their individual circumstances. RWE is not the same utility holding company today that it was in 2002, due to its divestiture of its Thames Water subsidiary and its new focus on the European gas and electric markets. As PAWC proved, several other European utility companies have also divested their water businesses and abandoned the "strategy of putting water and energy businesses under a single corporate umbrella." (I.D. at 24).

According to the ALJ, the OSBA has not shown that the proposed IPO will lead directly to an increase in PAWC's debt costs. Therefore, the ALJ found that there is no need for any hold harmless condition. Also, as PAWC noted, it is virtually impossible to directly compare the interest rates of debt between two different companies that are issuing debt in different markets at various times under various conditions and at varying terms and maturity. Additionally, RWE will no longer have any substantial holdings in the U.S. or British water utility industry and will have an increased presence in the European gas and electric industries. The ALJ found that debt issued by the new RWE and debt issued by the new American Water cannot be compared credibly. (I.D. at 24 – 25).

c. Exceptions

In its fourth exception, the OSBA asserted that the ALJ erred when he failed to adopt the condition to hold ratepayers harmless if the Company's cost of debt is higher as a result of the proposed transaction. (OSBA Exc. at 11). Despite the Company's long-term forecast, American Water's first issuance of debt on behalf of PAWC since the announcement of the proposed transaction will increase customers' rates unless their "hold harmless" condition is adopted. (OSBA Exc. at 13).

Further, the OSBA asserts that in rejecting the condition, the ALJ found that "[t]he OSBA has not shown that the proposed IPO will directly lead to an increase in PAWC's debt costs. Therefore, there is no need for any hold harmless condition." (I.D. at 24). However, as the ALJ acknowledged, PAWC has the burden of proof in this proceeding under Section 332(a) of the Public Utility Code, 66 Pa. C.S. §332(a). (I.D. at 11). That means that, under *City of York* and *Middletown Township*, PAWC has the burden of proving that the divestiture will produce affirmative benefits on a net basis. The OSBA asserts that PAWC has not proven, and cannot prove, that the divestiture will result in a cost of debt for PAWC's ratepayers which is equal to, or less than, the cost of

debt for which they would be responsible in the absence of the divestiture. (OSBA Exc. at 15).

d. Disposition

As stated above, we believe that it is virtually impossible to directly compare the interest rates of debt between two different companies that are issuing debt in different markets at various times under various conditions and at varying terms and maturity. We also find the exception of the OSBA on this issue to be inconsistent. The OSBA points to the *City of York* and *Middletown Township*, to support the necessity for PAWC to prove that the divestiture will produce affirmative benefits on a net basis. Then the OSBA argues that the Company cannot prove that the cost of debt resulting from the proposed transaction will benefit customers. Even though the cost of debt resulting from the proposed transaction remains speculative, other features of the Settlement provide more quantifiable benefits to PAWC's ratepayers.

We agree with the reasoning of the ALJ on this issue and reject the OSBA's "hold harmless" recommendation. Accordingly, we shall deny the exception of the OSBA on this issue.

10. Paragraph 51, Settlement Section III – Public Interest Considerations

Paragraph 51 states:

The Proposed Transaction will not affect the Commission's regulatory powers with respect to PAWC or the authority of other government agencies as to PAWC's services and facilities. PAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Pennsylvania public utilities.

a. Positions of the Parties

The OSBA asserted that this paragraph is the minimum obligation for utilities operating in the Commonwealth. (OSBA M.B. at 17).

b. ALJ's Recommendation

The ALJ agreed with the OSBA regarding Paragraph 51.

c. Exceptions

No exceptions were filed regarding Paragraph 51.

d. Disposition

All utilities are subject to the Public Utility Code 66 Pa. C.S. §§ 101, *et seq.* and a host of statutes and regulations from other government agencies, *e.g.*, the Department of Environmental Protection and the Department of Revenue. Those obligations are not substantial benefits; they are existing legal requirements. (I.D. at 25). We agree with the OSBA that Paragraph 51 contains the minimum obligations for utilities operating within the Commonwealth.

11. Paragraphs 52, Section III Public Interest Considerations and Paragraph 17 Section II Terms of the Settlement

Paragraph 52 is one of the most controversial parts of the Joint Petition. It reads:

The Settlement provides that PAWC will install, without customer contributions or advances, the Facility Extensions necessary to provide water service in the areas identified in Paragraph 17 that do not have public water supplies and have experienced substantial degradation in the quantity and quality

of their existing on-lot well water sources, as detailed on Exhibits 1, 2 and 3 [maps]. The rate treatment to be afforded PAWC's investment in the Facility Extensions is to be addressed in subsequent base rate proceedings. This provision will result in water service being provided to as many as 750 customers who currently do not have it.

Joint Petition at 15. (Emphasis added.) Paragraph 17, cross-referenced above, adds important details and reads as follows:

PAWC will install the facilities necessary to provide water service in portions of Mt. Pleasant Township (Washington County), Hanover Township (Washington County) and Collier Township (Allegheny County), as such facilities and locations are depicted on the maps to be attached hereto as Exhibits 1, 2 and 3 (the Facility Extensions). PAWC agrees to use best efforts to complete and place in service the Facility Extensions in Hanover and Collier Townships not more than 12 months and the Facility Extensions in Mt. Pleasant Township not more than 24 months from the date that the last state regulatory approval is obtained authorizing the Proposed Transaction. It is understood and agreed that PAWC's installation of the Facility Extensions without customer contributions or advances is being done under the terms of this Joint Petition for purposes of this case only as a part of the compromise necessary to achieve the overall settlement of this proceeding. If, and to the extent that, the installation of the Facility Extensions on the terms set forth herein may represent a variation from the terms of the Company's tariff, the Commission's approval of such variation should be granted as part of its approval of the Settlement and is a condition of the Settlement. It is understood and agreed that: (1) the Commission's approval of the Joint Petition will not constitute a determination at this time that the Company's investment in the Facility Extensions may be included in its rate base; (2) the Company's claim for rate base inclusion of its investment in the Facility Extensions in a subsequent base rate case shall be subject to Commission review in the same manner as the Company's investment in any other property claimed for rate base inclusion; and (3) the Commission's approval of this Joint Petition will not preclude parties from challenging the rate base

inclusion of the Company's investment in the Facility Extensions in a subsequent base rate proceeding.

Joint Petition at 6-7.

a. Positions of the Parties

In its Main Brief, the OSBA acknowledged that the proposed Facility Extensions were needed to provide potable water to the designated areas. However, OSBA argued that the requirement to install the proposed facilities without customer contributions or advances violated PAWC Tariff Rule 27.1(A) and (D). The OSBA explained that the Parties were aware that the cost of the Facility Extensions exceeded PAWC's calculated contribution. As a result, according to the OSBA, Tariff Rule 27 obligated PAWC to require customer contributions for the difference between PAWC's contribution and the cost of the proposed projects. (OSBA M.B. at 17 – 20; I.D. at 26).

Citing Section 1303 of the Code, 66 Pa. C.S. § 1303, and referencing *Philadelphia Suburban Water Company v. Pennsylvania PUC*, 808 A.2d 1044 (Pa. Cmwlth. 2002) (*Coatesville*), the OSBA indicated that the statute and the Courts did not permit free public utility service because it was illegal. Citing *Middletown Township v. Pa. PUC*, 482 A.2d 674, 682 (Pa. Cmwlth. 1984) (*Middletown*), the OSBA contended that, even if Paragraph 52 was not illegal by the terms of Section 1303, the failure of the projects to benefit all affected parties would undermine any characterization of the projects as a substantial public benefit. The OSBA explained that the proposed projects may benefit up to 750 customers whose incremental revenues would not offset the added capital costs to be borne by the current ratepayers. (OSBA M.B. at 17 – 20; I.D. at 26 – 27).

The OSBA rejected the PAWC assertion that it had the discretion to install mains and other facilities of its own volition within its service territory without regard to the terms of the statute. The OSBA pointed out that Section 65.21 (52 Pa. Code § 65.21) of the Commission regulations required the Company to have a main extension tariff (which were codified as PAWC's Rules 23 and 27), and Section 1303 required the Company to strictly adhere to them. See 66 Pa. C.S. § 1303. The OSBA specified that, even though the Commission Regulations gave PAWC the option to make its customer contribution discretionary, the Company submitted Tariff language (approved by the Commission) which makes the contribution mandatory. (OSBA R.B. at 10 – 13; I.D. at 27 – 28).

In its Main Brief, the Company contested the OSBA's theory that, in order to meet the *York* test, there could be no affirmative public benefit unless the condition of the current customers was improved. PAWC argued that the Commission and the appellate courts had endorsed a wide range of activities which were categorized as affirmative public benefits and which provided no immediate improvements for the current customers, *e.g.*, renewable energy initiatives and funding support for economic development. The Company contended that the provision of quality water was a public benefit and that the proposed projects would make system improvements to the water service for current customers as well. PAWC noted that the basis for the OSBA conclusion was concern for future rate base increases which would be shouldered by existing customers who got no benefit from the proposed projects. The Company emphasized that the Joint Petition left the issue of inclusion in rates unresolved. PAWC believed that it could make capital investments without regard to tariff language. PAWC explained that Tariff Rule 27 set out the minimum contribution (not the ceiling) the Company was required to make for projects it did not wish to initiate. PAWC noted that the Commission Regulations (52 Pa. Code § 65.21(2)) did not **require** the customers to make contributions. PAWC believed that reading Tariff Rule 27 in tandem with the regulation provided the necessary support to permit the proposed projects to go forward. In the alternative, PAWC pointed to Tariff Rule 23.5 regarding

Offsite Development marketing Contracts, as authorizing the system expansion. (PAWC M.B. at 44 – 49; I.D. at 28 – 29).

The OTS did not wholeheartedly endorse this portion of the Joint Petition. It was concerned that any conclusion that these projects were a public benefit could prejudice the parties' positions in future rate cases where the Company would request inclusion of the project costs in rate base. The OTS acknowledged that Paragraph 17 specified that Commission approval of the Joint Petition would not preclude the parties from challenging the project costs in future rate cases. The OTS witness had specifically concluded that any public benefit from the projects was limited to the potential customers in the expansion areas as opposed to all Company ratepayers in general. The OTS asserted that funding issues would be determined in accordance with Commission line extension regulations and Tariff Rule 23 after experienced project costs and expected revenues were considered. Without this information, the OTS believed that it was difficult to label the projects a substantial public benefit as required by the *York* case. The OTS was only willing to recognize that there was a public benefit associated with provision of quality water service to a select group of the state's citizens. (OTS M.B. at 13 – 15; I.D. at 29 – 30).

In its Reply Brief, the OTS clarified its position. It contended that, if the projects were to be evaluated without the other provisions of the Joint Petition, it would be difficult to conclude they were a substantial public benefit. However, viewing the projects as part of the overall settlement, the OTS noted that initially the Company had assumed all risk associated with the provision of service to these needy customers. The OTS was willing to accord at least negligible benefit to the addition of more customers to form a broader base to absorb related service costs. (OTS R.B. at 13 – 14; I.D. at 30). The OTS concluded, as follows:

Public policy concerns must be an integral part of the
evaluation of the worthiness and impact of this particular

project. Viewed as a total entity within the Joint Petition, the project provides a benefit that should be included in the resolution of this proceeding. Adequate protections are in place to hold the balance of the Company's ratepayers harmless and the public policy considerations far outweigh any perceived shortcomings.

(OTS R.B. at 14).

The OCA argued that neither the Code nor the Commission regulations required the Company to charge for main extensions. The OCA believed that, while the Company had the right to demand contributions, it had agreed to forego that right in order to provide a public benefit which met the legal standard. (OCA M.B. at 19 – 23; I.D. at 31).

The OCA contended that the Company tariff did not prevent it from providing service without customer contributions. Referring specifically to Rule 27.1, the OCA asserted it did not apply because there was no *bona fide* service applicant requesting service which was a prerequisite to the application of the Rule. Noting that the proposed projects were all within the Company's existing certificated service territory, the OCA argued PAWC had the authority to voluntarily extend its lines anywhere within its territory. Arguing in the alternative, the OCA posited that the regulation gave the Company the discretion to require or not require contributions and, to the extent that the Tariff Rule only required contributions, it was preempted by the regulation. (OCA M.B. at 23 – 26; I.D. at 31).

The OCA asserted that the *Coatesville* case was distinguishable because *Coatesville* concerned an indirect method of providing free utility service in lieu of a tariffed rate for a specified service (fire hydrant fees) in violation of the statute, whereas the Joint Petition concerned a tariff which set the minimum (but not the maximum) investment per customer that the Company was required to make in a main extension project. The OCA continued that approval of Paragraph 17 would result in new customers paying the tariffed

rates for service. There would be no free or discounted service, and the new customers would be added to the ratepayer population responsible for all system costs. (OCA M.B. at 27 – 28; I.D. at 32).

The OCA pointed out that the Commission has the authority to waive Tariff Rule 27 if it did not adversely affect the substantive rights of a Party. The OCA explained that the rights of the Parties were expressly preserved by delaying the issue of recovery of the project costs until those costs were at issue in a base rate case. The OCA theorized that, given the preservation of rights, the Commission could waive Tariff Rule 27, if it believed the Rule was applicable. (OCA M.B. at 28 – 29; I.D. at 33).

Citing passages from the Pennsylvania Supreme Court in *Popowsky v. Pa. PUC* 589 Pa. 605, 910 A.2d 38 (2006), *affirming Popowsky v. Pa. PUC* 853 A.2d 1097 (2004), the OCA claimed that the Court referred to a utility's right to demand customer contributions, but did not specify that a utility was required to demand contributions in all circumstances. (OCA M.B. at 29 – 31; I.D. at 33).

The OCA concluded by asserting that Paragraph 17 provided a substantial affirmative benefit to the public because public health depended on the availability of quality water service and because the Company was willing to provide quality water service at its initial, sole expense to three communities which needed the service but had a history of being unable to make contributions. (OCA M.B. at 31; I.D. at 33).

The OCA agreed that the *Middletown* case set forth the proposition that the merger must provide substantial affirmative benefits for the public, as a whole, and not just those customers involved in the application proceedings. The OCA pointed out that the OSBA witness conceded that current customers would not be affected because there would be no change in tariffed rates unless the costs were approved in a subsequent rate case. In addition, customers added as a result of the system extensions would immediately start to

pay tariffed rates and would experience the same rate changes after a rate case was completed. The OCA distinguished the *Middletown* case by noting that there would have been actual harm to some customers if the application had been approved. The OCA regarded Paragraph 17 as evidence of the Company's commitment to serve prospective customers in need of service which the OCA regarded as a benefit to both new and current customers. (OCA R.B. at 6 – 8; I.D. at 34).

b. The ALJ's Recommendation

After reviewing the briefs, record, statute, regulations and cases cited, the ALJ found that under the holding of the *Coatesville* case Paragraphs 17 and 52 of the Joint Petition are violative of Section 1303 of the Code and must be deleted from the Settlement. (I.D. at 34).

The ALJ has recommended that the non-unanimous Settlement be adopted except for Paragraphs 17 and 52,⁶ which provide that Pennsylvania American Water Company (PAWC) will install, without customer contributions or advances, facilities necessary to provide water service in portions of Mt. Pleasant and Hanover Townships in Washington County, and Collier Township, Allegheny County. There was agreement among all parties that these areas do not have public water supplies and that the residents of those townships have experienced substantial degradation of their on-lot well water sources. (PAWC Exc. at 4).

The ALJ concluded that the named paragraphs were violative of Section 1303 of the Public Utility Code, 66 Pa.C.S. § 1303, which requires public utilities to

⁶ Paragraph 17 is PAWC's commitment to expand its distribution system. Paragraph 52 explains why that commitment is in the public interest and constitutes a substantial public benefit. PAWC Exceptions at 2 fn.2.

adhere to the provisions of their tariffs. The ALJ interpreted PAWC's Tariff Rule 27 as mandating customer contributions for main extensions. The ALJ found further that Tariff Rule 27 required both a minimum and maximum contribution to be made to main extension projects. (I.D. at 35).

The ALJ's analysis began with litigation history which, in his view, makes it impossible to classify these projects as anything other than main extension projects. The Company and the OCA litigated three complaint cases: *Parks, et al. v. PAWC*, Docket Nos. C-00015377, *et al.* (August 8, 2003) (*Parks*); *Morra v. PAWC*, Docket No. C-00014733, (February 2, 2004) (*Morra*); and *Township of Collier v. PAWC*, Docket No. C-20016207 (April 29, 2004) 2004 Pa. PUC LEXIS 26 (*Collier Township*). Ultimately, the Commission's Opinion and Order in the *Parks* case was appealed and affirmed by the Commonwealth and Pennsylvania Supreme Courts. *Popowsky v. Pa. PUC*, 589 Pa. 605, 910 A. 2d 38 (2006); *Popowsky v. Pa. PUC*, 853 A. 2d 1097 (Pa. Cmwlth. 2004). The complaint cases concerned the three projects described in Paragraphs 17 and 52, respectively. In each case, the complainants and the OCA wanted the PAWC to construct the main extensions with no contributions or advances from the customers. In each case, the Commission, and later the appellate courts, concluded that: (1) if the customers applied for service, Rule 27 would apply; (2) the construction costs would exceed the Company's contribution; (3) the Commission could not force the Company to pay the construction costs by itself; (4) the Commission's main extension regulations were valid; and (5) public need for the facilities was insufficient to justify waiving the regulations or the tariff. (I.D. at 34 – 35).

The ALJ agreed with the OSBA that Rule 27 is authorized by, and consistent with, the Commission's main extension regulations. 52 Pa. Code § 65.21. The regulation gave the utility the opportunity to decide whether or not to mandate customer contributions. PAWC exercised that opportunity by mandating contributions. Rule 27.1 (A)(2). In addition, PAWC specified the formula by which the "Company contribution"

would be calculated. Rule 27.1 (D)(2). According to the ALJ, PAWC does not have unfettered discretion to invest in main extension projects nor does it have unfettered discretion in managing its own affairs. The whole purpose of tariffs is to impose limitations on many aspects of the Company's conduct. If PAWC had chosen not to mandate customer contributions, its tariff would also have been consistent with the regulation. However, by specifying the formula, PAWC locked in both the customer and its own contributions for each project. In other words, the ALJ concluded that the formula sets forth both the minimum and maximum contribution PAWC can make to the projects. (I.D. at 35).

The ALJ stated that in the Joint Petition there are no *bona fide* service applicants. However, prospectively, the ALJ asserted that completion of the projects will convert those who would have been bona fide service applicants into ordinary applicants for service with no main extension fees involved. (I.D. at 36).

Second and contrary to the OCA's representation, the new customers would, in fact, be receiving free service because the OCA overlooked the definition of the "service" which includes "facilities." 66 Pa. C.S. § 102. The whole purpose of Paragraph 17 was to make PAWC, initially, solely responsible for building millions of dollars of facilities (main extensions) with no guarantee of reimbursement. The new customers would then avoid paying contributions or advances which other customers with similar problems would be assessed. The ALJ concluded that this was an attempt to circumvent the Tariff Rule 27, thereby violating Section 1303 by directly or indirectly giving free service only to a subgroup of similarly situated customers. (I.D. at 36).

Third, the ALJ found that postponing the decision on project cost responsibility to a future rate case would not remedy the violation. The ALJ also stated that the *Coatesville* case has already decided that the worst case scenario for the

Company, *i.e.*, the project costs are rejected from rate base and become shareholder expenses, is illegal. (I.D. at 36).

And finally, the ALJ concluded that any reliance on Tariff Rule 23.5, related to Offsite Development Marketing, is misplaced. By its own terms, it applies to offsite development marketing contracts. The ALJ concluded that the OSBA was correct. He found that nothing in the record gave any indication that the projects in Paragraph 17 (which speaks in terms of Facility Extensions without customer contributions or advances) were in anyway related to Rule 23.5. The Rule terminology is not applicable to the facts of this case. Accordingly, the ALJ found that Paragaraphs 17 and 52 are unacceptable and cannot be approved. (I.D. at 36 – 37).

c. Exceptions

PAWC excepts to the ALJ's conclusion that Paragraphs 17 and 52 violate Rule 27 of the Company's Tariff or Section 1303 of the Public Utility Code. (PAWC Exc. at 3).

In its Exceptions, PAWC argues convincingly that its Tariff Rule 27 is applicable only when a customer applies for service to be provided by facilities that the company has not already committed to install. PAWC buttresses its argument by citing Tariff Rule 27:

The Company will extend existing distribution mains for a Bona Fide Service Applicant *making application* for water service . . . under, and pursuant to, these Rules and Regulations

PAWC Exceptions at 5 (emphasis added).

PAWC explains that if the OSBA's view were to prevail, every time PAWC contemplated installing a new main for any reason (*e.g.*, to connect a new supply source or interconnect separate systems), it would first have to determine whether any new customers could receive service from that main and seek a contribution under Rule 27 before the installation could begin. For that reason, according to PAWC, the application of Rule 27 is properly restricted to those instances where an applicant seeks the installation of facilities PAWC would not otherwise install. (PAWC Exc. at 6).

PAWC also states that the ALJ wrongly assumes that it does not have authority to expand its distribution system except to the extent that it can find a provision of its tariff that permits it to do so. Pennsylvania appellate courts have long held that utilities have the inherent power to install facilities and expand their systems as they determine necessary and appropriate:

Accordingly, this Court cannot acquiesce in the Commission's exercise of powers when such powers have not been provided by the legislature. This conclusion is buttressed by our Supreme Court, which has held that the PUC, in non-ratemaking cases, is without authority to disapprove "the expansion or extension" of existing facilities. In so doing, it reasons "that such a decision is in the discretion of company management." *Duquesne Light Co. v. Upper St. Clair Township*, 377 Pa. 323, 337, 105 A.2d 287, 293 (1954); *Lower Chichester Township v. Pa. P. U. C.*, 180 Pa. Superior Ct. 503, 119 A.2d 674 (1956).

Philadelphia Electric Co. v. Pa. PUC, 455 A.2d 1244, 1248 (Pa. Cmwlth 1983), rev'd on

other grounds *sub nom.*, *Pa. PUC v. Philadelphia Electric Co.*, 501 Pa. 153, 460 A.2d 734 (1983).⁷ (PAWC Exc. at 6 – 7).

Simply stated, there is nothing in PAWC’s tariff that operates as a prior constraint on its inherent power to install facilities, including the expansion of its distribution grid, in the manner it sees fit to provide service to residents within its franchise area. (PAWC Exc. at 7).

PAWC also asserts that Rule 27 should be read in *pari materia* with the Commission’s line extension regulations, which make it clear that the utility-required investment is the minimum a utility can be forced to invest, not a ceiling on the amount it is permitted to invest. In fact, the Commission’s Order approving the final regulations expressly rejected the Independent Regulatory Review Commission’s recommendation that customer advances should be made mandatory when project costs exceed the utility’s minimum required investment. The Commission held that, when a *bona fide* service applicant applied for service, utilities should be allowed to construct main extensions without customer contributions and without having to obtain a waiver of the regulations or any other prior Commission approval:

However, it was not our intention to limit the utility’s ability to fund more of the line extension costs if, for legitimate business reasons, the utility desires to do so. . . . However, changing the minimum requirement to a hard and fast rule would mean that companies wishing to be more generous would have to seek a waiver of the rule and, in our judgment, make this regulation unnecessarily burdensome and

⁷ The Supreme Court upheld the fundamental point made by the Commonwealth Court in the passage quoted above: “The Public Utility Code does not expressly grant the PUC general authority over the siting and construction of all utility plants. Nor does it require PUC approval for expansion of all facilities, the discretion of the company’s management over such matters being generally beyond the PUC’s power to supersede. *Duquesne Light Co. v. Upper St. Clair Township*, 377 Pa. 323, 337, 105 A.2d 287, 293 (1954).” 460 A. 2d at 737.

inflexible. . . . Realistically, these companies would probably not bother, and it is the bona fide service applicant which would end up paying more as a result.

Revised Final Order – Final Rulemaking Re: Line Extensions – 52 Pa. Code §§ 65.21, 65.22, Docket No. L-00930098 (October 7, 1996), 27 Pa. Bulletin 799, 802. (PAWC Exc. at 8).

PAWC also asserts that the Initial Decision errs in alleging that new customers served from facilities installed pursuant to Paragraph 17 would receive “free service” if they are not required to pay a customer contribution. Unlike the situation presented in *Coatesville (Philadelphia Suburban Water Company v. Pa. PUC*, 808 A.2d 1044 (Pa. Cmwlth. 2002), upon which the Initial Decision relies, customers served from facilities installed under Paragraph 17 will pay PAWC’s tariff charges for the water service they receive. Moreover, because the ratemaking implications of Paragraph 17 would be considered in a subsequent base rate case (as Paragraph 17 expressly provides), the Commission retains its authority and discretion to design rates that balance the benefits and burdens of the main installations between PAWC’s existing customers and those served from the Paragraph 17 facilities. In other words, simply because customers served from the Paragraph 17 facilities would not pay an up-front customer contribution does not mean they would be absolved from bearing their fair share of the revenue requirement those facilities will impose. This is much different from the situation presented in *Coatesville* where the Commonwealth Court found that the terms of the acquisition agreement between the utility and the municipality effectively granted the latter free public fire protection “in perpetuity.” (PAWC Exc. at 9 – 10).

PAWC proposes to revise its Tariff Rule 27 to provide that main extensions and Special Utility Service facilities (as defined in Rule 27) can be installed without a customer contribution where a substantial public need exists, the public health and safety may be compromised by the absence of a public water supply, and the Commission

grants its prior approval. The requirement of prior Commission approval makes the Commission the final arbiter of when the revised tariff language would apply and gives it the final word on whether similarly situated bona fide service applicants are receiving similar treatment under the rule. This proposal beneficially defines the Commission's discretion to permit a utility to waive its tariff provisions in response to a pressing public need.

The OCA states, in its Exceptions, that it does not agree with the ALJ's finding that PAWC's existing tariff requires or even contemplates mandatory customer contributions in aid of construction (CIAC) in the case of a utility's voluntary expansion of service. As stated by the OCA, the PAWC tariff establishes the formula for determining the minimum investment that can be required of PAWC if and when the Company decides to require a customer contribution. (OCA MB at 26). There is no requirement under the Commission's regulations, asserts the OCA, that a utility must seek a customer contribution in all cases where such a contribution is permitted. Indeed, the Commission explicitly rejected such a mandatory requirement when it promulgated its line extension regulation found at 52 Pa. Code § 65.21. (OCA Exc. at 4 – 5). The OCA continues that it fully supports PAWC's proposed revision to Tariff Rule 27, and urges the Commission to approve the proposed revision. (OCA Exc. at 4).

d. Disposition

We agree with the Exceptions filed by PAWC and with the OCA, to the extent consistent with the following discussion. Furthermore, we believe that *Parks, Morra and Collier Township* are factually distinguishable from the instant case because there is not an existing application for an extension of service, as occurred in each of the cited cases. It is clear that PAWC's Tariff Rule 27 applies only in an *application for a main extension*. If the Company's proposed revision to Tariff Rule 27 is made (as we

have granted, pending final outcome of this Tentative Order) this factual distinction from *Parks, Morra, and Collier Township* will be made clear, as will the Commission's authority as final arbiter.

Also, we believe that PAWC correctly concludes that Rule 27 is properly restricted to those instances where an applicant seeks the installation of facilities that PAWC has not already committed to install. There is nothing in its tariff that operates as a prior constraint on its inherent power to install facilities, including the expansion of its distribution system in the manner that it sees fit to provide service to residents in its franchise area. (PAWC Exc. at 5-6).

Accordingly, we shall grant the exceptions on this issue filed by PAWC and the OCA to the extent discussed and shall reverse the finding of the ALJ to remove Paragraphs 17 and 52 from the Settlement. Therefore, we adopt the revision of Tariff Rule 27 which reads as follows:

(F) Where substantial public need exists and the public health and safety may be compromised by the absence of a public water supply in a portion of the Company's authorized service territory, the Company, subject to the Commission's prior approval, may install main extensions and Special Utility Service facilities without the payment of the Customer Contribution that would otherwise be required under subparagraphs (A)(3) and (D)(2), respectively of this Rule 27.1.

12. Paragraph 53, Section III Public Interest Considerations

Paragraph 53 states:

Litigation and associated costs will be significantly reduced by approval of the Settlement. The Settlement resolves

a number of important and potentially contentious issues. The administrative burden and associated costs to litigate these matters to conclusion among the joint Petitioners will not have to be incurred.

a. Positions of the Parties

The OSBA argued that the Joint Petition did not save litigation costs, but rather created them. The OSBA asserted that the Paragraph had no value to the ratepayers and was not a substantial public benefit. (OSBA M.B. at 20-21).

b. ALJ's Recommendation

The ALJ noted that no party responded to the OSBA's comments. The ALJ stated that, normally, in an uncontested settlement, this language would unquestionably be true because litigation would have halted when the settlement was signed. In this instance, litigation continued, albeit at a likely reduced level. However, nothing on the record verifies what costs would have been or what they actually were. As such, the ALJ found that there is no evidence of a positive or negative impact on the public interest.

c. Exceptions

No exceptions were filed to this issue.

d. Disposition

While the litigation of this Application was shortened to some degree, it is not possible to quantify with any certainty any associated savings or its impact upon the public interest. Accordingly, finding the ALJ's recommendation to be otherwise reasonable, it is adopted.

13. Paragraph 54, Section III Public Interest Considerations

Paragraph 54 states as follows:

The Joint Petitioners arrived at the Settlement terms after conducting extensive discovery and engaging in in-depth discussions. The Settlement terms constitute a carefully crafted package representing negotiated compromises on the issues addressed herein. Thus, the Settlement is consistent with the Commission’s rules and practices encouraging negotiated settlements. (see 52 Pa. Code § § 5.231, 69.391, 69.401).

Paragraph 54 represents that the Settlement occurred after extensive discovery and long discussions which led to a compromise and that settlements are encouraged by the Commission’s regulations.

a. Positions of the Parties

The OSBA called the Paragraph “legalese”. (OSBA M.B. at 21).

b. ALJ’s Recommendation

The ALJ agreed with the OSBA regarding this paragraph. (I.D. at 37).

c. Exceptions

No exceptions were filed regarding this issue.

d. Disposition

We concur with the ALJ and find that it has neither a positive nor negative impact on the public interest.

C. Miscellaneous

1. Supplement to the Joint Petition

As indicated previously, the Supplement was added to the Settlement when PAWC was able to come to an agreement with the UWUA. The Supplement included assurances that: (1) for three years after the transaction, PAWC would not reduce the Company workforce more than 5% without notice to the Commission and the UWUA; (2) American Water would continue to fund existing pension funds in accordance with the Employee Retirement Income Security Act (ERISA) and the Pension Protection Act of 2006; (3) PAWC would not attempt to recoup any pension contribution shortfall arising prior to the transactions from its customers; (4) for one year after the transaction, PAWC would retain at least 90% of all collectively bargained for individuals employed by PAWC on January 1, 2007; and (5) PAWC and its successors would honor all terms and conditions of the existing collective bargaining agreements. (I.D. at 37 – 38).

a. Positions of the Parties

The OSBA dismissed all of these terms as preservation of the *status quo*, which the OSBA did not regard as a substantial benefit. (OSBA M.B. at 21 – 22; I.D. at 38).

The Company regarded the commitments agreed to in the Supplemental Settlement as substantial public benefits. PAWC explained that it was not currently

subject to any commitment to maintain any particular level of employees. Similarly, it had no obligation to give the assurances about the adequacy of pension funding and limiting its options for recovery of possible pension funding shortfalls. The Company argued that its employees were members of the public. And, to the extent that the employees received a benefit from the transaction, the public also received one. (PAWC R.B. at 13 – 14; I.D. at 38).

The OTS also noted that, but for the Supplement, the Company had no obligation to maintain its staffing levels at any particular minimum. The OTS regarded the commitments to retain 90% of the January 1, 2007 staff levels for a one-year period following the completion of the transaction and for a three-year period to give the Commission and the UWUA notice of an intention to reduce staffing levels by more than 5% as positive benefits. The OTS stressed that, in order to perform proper service, the utility was required to maintain an operational workforce. (OTS M.B. at 12; OTS R.B. at 9 – 10; I.D. at 38 – 39).

The OCA also agreed that it was a public benefit for the Company to commit for a three-year period to provide advance notice to the Commission and the UWUA of any planned reduction of more than 5% to staffing levels. The OCA, like the OTS, explained that PAWC had no such previous obligation to provide this notice. (OCA M.B. at 34 – 35; I.D. at 39).

b. ALJ's Recommendation

Regarding the Supplemental Settlement, the ALJ found that it revealed several instances where PAWC made commitments for which it had no legal obligation, and found these to be in the public interest.

c. Exceptions

There were no exceptions filed to this issue.

d. Disposition

We concur with the ALJ that the Supplemental Settlement is in the public interest. However, we believe that it is important to clarify and condition our approval of the Supplemental Settlement. We emphasize that in paragraph number six (6) of the Supplemental Settlement, PAWC has agreed:

For one year following the occurrence of the IPO, staffing levels for collectively bargained employees will not drop below 90% of the number of collectively bargained individuals employed by PAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis). Likewise, for one year following the occurrence of the IPO, staffing levels for all employees (union and non-union collectively) will not drop below 90% of the number of individuals employed by PAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis).

The Company's Joint Application filed on December 14, 2001, at Docket No. A-212285F0096, provided in Section 5.09(e) of the Agreement and Plan of Merger among RWE Akteingesellschaft, Thames Water Aqua Holdings GMBH, Apollo Acquisition Company and American Water Works Company, Inc. dated September 16, 2001 that:

Subject to Applicable Law and Judgments and obligations under Collective Bargaining Agreements, Parent shall, or shall cause the Surviving Corporation to, provide to the Retiree Group (as defined below), without adverse amendment, the post-retirement medical and life insurance benefits as in effect immediately prior to the Closing Date (at the same levels, and at the same cost (if any), as in effect immediately prior to the Closing Date), provided to the Company Employees who are not covered by a Collective Bargaining Agreement and their dependents as set forth in the

retiree medical plan listed in Section 3.01(k)(i) of the Company Disclosure Schedule (the “Retiree Medical Plan”). The “Retiree Group” means each Company Employee who is not (or was not while employed) covered by a Collective Bargaining Agreement and who, as of the Closing Date, (i) is either retired under the terms of the Retiree Medical Plan as in effect on the date hereof or (ii) has satisfied all applicable eligibility requirements (under the terms of the Retiree Medical Plan as in effect on the date hereof) necessary to commence receiving benefits if his or her employment were terminated at the Effective Time.

This Term, regarding Non – Collective Bargaining Agreement employees, was approved by Commission Order entered September 4, 2002, and PAWC, its successor, and its parent, American Water Works, is bound to honor the provisions of this Term.

Additionally, pursuant to paragraph seven (7) of the Supplemental Settlement PAWC has agreed:

To honor all terms and conditions of the existing collective bargaining agreements between PAWC and the applicable local union of the Utility Workers Union of America (the Collective Bargaining Agreements) through the termination dates of those agreements. Any successor to PAWC will assume the Collective Bargaining Agreements and all obligations thereunder through the termination dates of those agreements.

In addition to the Settlement Term stated above, regarding current employees covered by the currently effective collective bargaining agreements, we also expect PAWC, its successor, or its parent company, to commit that it or they will not diminish, reduce, terminate, or otherwise adversely affect the pension, health care, welfare, or life insurance benefits plans of PAWC’s already retired employees or their

dependents, including employees who were designated as management employees, as the date of their retirement.

Our approval of the instant Application is conditioned upon the Company's acceptance of these Terms. We therefore shall direct the Parties to this proceeding to respond in writing within twenty days of entry of this Tentative Opinion and Order regarding the above stated conditions. If no comments are filed within that twenty day period, this Tentative Opinion and Order shall become final by operation of law.

2. Signatories

We note that both the Joint Petition (Paragraph 29) and the Supplement (Paragraph 5) contain agreements by the parent corporations of PAWC to take specific actions. For instance, in Paragraph 5 of the Supplement American Water agreed to fund the pensions in accordance with certain statutes. However, American Water is not a party to the proceeding and not a signatory to the Joint Petition or the Supplement. A representative of PAWC signed both documents. Given that PAWC is a subsidiary of American Water and the other parent corporations/companies, we are willing to accept its signature as an agent of its parent(s). We hasten to add that these proceedings did not take place without input from American Water. Indeed, Ms. Wolf, Senior Vice President and Chief Financial Officer of American Water testified in the proceeding, *inter alia*, about the adequacy of funding for the pension plans. (I.D. at 39).

III. CONCLUSION

Based upon our review of the record developed in this proceeding, the main briefs, reply briefs, exceptions and reply exceptions, we conclude that, with the exception of the condition related to the Supplemental Agreement, as described above, that the Settlement meets the standards set forth in the Code. 66 Pa. C.S. § 1103(a). More specifically, we find that the Application to complete the Proposed Transaction, as modified by the Joint Petition, the Supplement and the condition outlined above, is necessary or proper for the service, accommodation, convenience, or safety of the public. Accordingly, we shall direct that the Secretary issue a Certificate of Public Convenience pursuant to Section 1102(a)(3) of the Code, after comments are received and a final order is entered or after twenty days from the entry date of this Tentative Opinion and Order, which authorizes the Proposed Transaction, as conditioned above, to go forward. In addition, the Commission's Opinion and Order, entered September 4, 2002, at Docket Nos. A-212285F0096 and A-230073F0004 shall be modified so as to relieve PAWC of the filing and reporting requirements set forth in Ordering Paragraphs 6 (d)-(g).

THEREFORE,

IT IS ORDERED:

1. That the Exceptions filed by Pennsylvania-American Water Company on June 27, 2007, are granted, consistent with this Tentative Opinion and Order.
2. That the Exceptions filed by the Office of Consumer Advocate, on June 27, 2007, are granted, consistent with this Tentative Opinion and Order.
3. That the Exceptions filed by the Office of Small Business Advocate, on June 27, 2007, are denied, consistent with this Tentative Opinion and Order.

4. That the Initial Decision of Administrative Law Judge Louis G. Cocheres is modified, consistent with this Tentative Opinion and Order.

5. That the Joint Petition For Non-Unanimous Settlement, dated December 22, 2006, is hereby approved to the extent consistent with this Tentative Opinion and Order. A copy of the Joint Petition is attached hereto, as Attachment A, except for the maps related to the Facility Extensions designated in Paragraphs 17 and 52.

6. That the Supplement To The Joint Petition For Non-Unanimous Settlement, filed by letter dated January 26, 2007, is hereby conditionally approved to the extent consistent with this Tentative Opinion and Order. A copy of the Supplement is attached hereto as Attachment A.

7. That the Parties to this proceeding shall have twenty (20) days beyond the entry date of this Tentative Opinion and Order to comment in writing, regarding the adoption of Section 5.09(e) of the Agreement and Plan of Merger among RWE and Akteingesellschaft, Thames Water Aqua Holdings GMBH, Apollo Acquisition Company and American Water Works Company, Inc. as a condition precedent to the Commission's approval of the instant Application.

8. That the Application of Pennsylvania-American Water Company for Approval of a Change in Control to be Effected Through a Public Offering of the Common Stock of American Water Works Company, Inc., as Modified by the Joint Petition For Non-Unanimous Settlement, dated December 22, 2006, and the Supplement To The Joint Petition For Non-Unanimous Settlement, as conditioned by this Tentative Opinion and Order, filed by letter dated January 26, 2007, at Docket No. A-212285F0136, is tentatively approved.

9. That, if this Tentative Opinion and Order becomes final by operation of law, the Secretary shall issue a Certificate of Public Convenience approving the Application, as modified, and authorizing a change in control of the Pennsylvania-American Water Company to be effected by: (i) the merger of Thames Water Aqua US Holdings, Inc., with and into American Water Works Company, Inc., the parent of the Pennsylvania-American Water Company; and (ii) the sale by Thames Water Aqua Holdings GmbH of up to 100% of the common stock of American Water Works Company, Inc. through one or more public offerings.

10. That, upon receipt of notice from the Pennsylvania-American Water Company within thirty (30) days from the completion of the public offerings of the common stock of American Water Works Company, Inc., the Commission's Opinion and Order, entered September 4, 2002, at Docket Nos. A-212285F0096 and A-230073F0004 shall be modified so as to relieve Pennsylvania-American Water Company of the filing and reporting requirements set forth in Ordering Paragraphs 6 (d)-(g).

11. That, upon receipt of notice from the Pennsylvania-American Water Company within thirty (30) days from the completion of the public offerings of the common stock of American Water Works Company, Inc., the record at Docket No. A-212285F0136 shall be marked closed by the Secretary.

BY THE COMMISSION,

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: July 25, 2007

ORDER ENTERED: August 22, 2007

Attachment A

Joint Petition for Non-Unanimous Settlement

Among: PAWC, the OTS and the OCA

Supplement to the Joint Petition for Non-Unanimous Settlement

Among: PAWC, the OTS, the OCA, the UWUA, AFL-CIO and the Utility
Workers Union of America Local 537

Statements in Support of the Joint Petition for Non-Unanimous Settlement

PAWC, the OCA,

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**APPLICATION OF PENNSYLVANIA-
AMERICAN WATER COMPANY FOR
APPROVAL OF A CHANGE IN
CONTROL TO BE EFFECTED
THROUGH A PUBLIC OFFERING OF
THE COMMON STOCK OF AMERICAN
WATER WORKS COMPANY, INC.** :

DOCKET NO. A-212285F0136

RECEIVED

DEC 22 2006

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

JOINT PETITION FOR NON-UNANIMOUS SETTLEMENT

This Joint Petition for Non-Unanimous Settlement (Joint Petition) is submitted by Pennsylvania-American Water Company (PAWC or the Company), the Office of Trial Staff (OTS) and the Office of Consumer Advocate (OCA) (collectively, the Joint Petitioners). The Pennsylvania-American Water Large Users Group (PAWLUG), which is not a party to the Joint Petition, has indicated that it does not oppose it.

The terms and conditions set forth in this Joint Petition represent a settlement (Settlement) that resolves all issues among the Joint Petitioners pertaining to the above-captioned Application. The Joint Petitioners aver that the Settlement is in the public interest and, therefore, request that the Pennsylvania Public Utility Commission (Commission) (1) issue a final order approving this Joint Petition, including all terms and conditions contained herein, without modification; (2) issue a Certificate of Public Convenience under Section 1102 of the Public Utility Code authorizing the transaction for which approval is sought in the above-captioned Application; (3) grant such other approvals as the Commission may determine necessary to effect such transaction; and (4) terminate and close the proceedings at the above-referenced docket.

In support of their request, the Joint Petitioners state as follows:

1-PH/2548690.3

I. BACKGROUND

1. This proceeding was initiated by the filing on May 5, 2006 of the *Application Of Pennsylvania-American Water Company For Approval Of A Change In Control To Be Effected Through A Public Offering Of The Common Stock Of American Water Works Company, Inc.* (the Application).

2. The change-in-control transaction comprehended by the Application consists of (i) the sale by Thames Water Aqua Holdings GmbH (Thames GmbH) of up to 100% of the shares of common stock of American Water Works Company, Inc. (American Water) in one or more underwritten public offerings; and (ii) prior to the closing of the initial public offering of American Water stock (IPO), the merger of Thames Water Aqua US Holdings, Inc. (TWAUSHI) with and into American Water, with American Water being the surviving corporation (collectively, (i) and (ii) are referred to as the Proposed Transaction). American Water intends that its publicly issued stock will be listed on the New York Stock Exchange. A detailed description of the Proposed Transaction and of the IPO process is set forth in Paragraph Nos. 16-23 of the Application.

3. American Water is a Delaware corporation. It is the parent of PAWC and a direct subsidiary of TWAUSHI. TWAUSHI is a Delaware corporation. It is the parent of American Water and a direct subsidiary of Thames GmbH. Thames GmbH is a corporation organized and existing under the laws of the Federal Republic of Germany. It is the parent of TWAUSHI and a wholly-owned subsidiary of RWE Aktiengesellschaft (RWE). RWE is a corporation organized and existing under the laws of the Federal Republic of Germany, where its shares are publicly traded. Descriptions of the parties to the Proposed Transaction are set forth in Paragraph Nos. 10-15 of the Application.

4. In the Application, PAWC requested that the Commission issue a certificate of public convenience evidencing its approval under Section 1102 of the Public Utility Code (66 Pa. C.S. § 1102), as interpreted by its Policy Statement at 52 Pa. Code § 69.901, and under such other statutory and regulatory authority the Commission deems applicable, of the change in control of PAWC that would be effected through the Proposed Transaction.

5. PAWC notified its customers of the filing of the Application by bill inserts. PAWC also served copies of the Application on the OTS, the OCA, the OSBA and all active parties to its last base rate proceeding.

6. On May 27, 2006, the Commission caused notice of the filing of the Application to be published in the *Pennsylvania Bulletin*, which allowed interested parties until June 12, 2006 to file protests and petitions to intervene.

7. On June 8 and 9, 2006, respectively, the OSBA and OCA filed Notices of Intervention and Protests. On June 9, 2006, the OTS entered its appearance and filed a Request to Initiate Proceeding with respect to the Application. Also on June 9, 2006, a Petition to Intervene was filed jointly by the Utility Workers Union of America, AFL-CIO and the Utility Workers Union of America Local 537 (collectively, UWUA), which was subsequently granted. On July 10, 2006 PAWLUG filed a Petition to Intervene in which it explained why good cause existed for seeking to intervene after the deadline set forth in the Commission's Notice. PAWLUG's Intervention was not opposed and, therefore, was granted. On October 16, 2006, the City of Pittsburgh (City) filed a document titled "Late-Filed Petition of City of Pittsburgh To Intervene," which PAWC opposed. By his Initial Decision issued November 21, 2006, the Administrative Law Judge denied the City's Petition. No exceptions were filed to that Initial Decision.

8. The Commission assigned this matter to Administrative Law Judge Louis G. Cocheres to conduct hearings and issue an Initial Decision. On July 26, 2006, a Prehearing Conference was held in Harrisburg at which various procedural matters were addressed, including establishing a schedule for filing testimony, hearings and briefing. These rulings were confirmed in Prehearing Order No. 2, which was issued on August 9, 2006.

9. Commencing shortly after the Application was filed, the parties engaged in extensive discovery. To date, the Applicant has responded to approximately 133 interrogatories and requests for production of documents, which provided substantial additional information about the Proposed Transaction and other issues of interest to the parties.

10. In accordance with the schedule established at the Prehearing Conference, on August 4, 2006, PAWC served PAWC Statement Nos. 1 and 2, the direct testimony of Daniel W. Warnock and Ellen C. Wolf.¹

11. On September 18, 2006, a telephonic public input hearing was held. In addition, on September 29, 2006, direct testimony was served by the OTS, OCA, OSBA and UWUA consisting of the following:

¹ Mr. Warnock is the President of PAWC, and Ms. Wolf is Senior Vice President and Chief Financial Officer of American Water.

<u>Party</u>	<u>Statement Designation</u>	<u>Witness</u>	<u>Accompanying Exhibits/Schedules</u>
OTS	OTS Statement No. 1	Robert Plonski	OTS Exhibit No. 1
OCA	OCA Statement No. 1	Scott J. Rubin	OCA Schedules SJR-1 through SJR-15
OCA	OCA Statement No. 2	J. Randall Woolridge, PhD.	Exhibit Nos. JRW-1 through JRW-6
OSBA	OSBA Statement No. 1	Brian Kalcic	N/A
UWUA	Exhibit UWUA-1	Robert Potochny	Exhibit Nos. UWUA-2 through UWUA-9
UWUA	Exhibit UWUA-10	Sam Weinstein	Exhibit Nos. UWUA-11 and UWUA-12

12. On November 2, 2006, PAWC served PAWC Statement Nos. 1-R, 2-R and 3-R, the rebuttal testimony of Mr. Warnock, Ms. Wolf and David R. Kaufman,² respectively, as well as Exhibit No. 1-A, accompanying Mr. Warnock's testimony, and Exhibit Nos. 2-A and 2-B, accompanying Ms. Wolf's testimony.

13. On November 29, 2006, surrebuttal testimony was served by the OTS, OCA and OSBA consisting of the following:

<u>Party</u>	<u>Statement Designation</u>	<u>Witness</u>	<u>Accompanying Exhibits/Schedules</u>
OTS	OTS Statement No. 1-SR	Robert Plonski	OTS Exhibit No. 1
OCA	OCA Statement No. 1-S	Scott J. Rubin	OCA Schedules SJR-16 and SJR-17
OCA	OCA Statement No. 2-S	J. Randall Woolridge, PhD.	Exhibit No. JRW-7
OSBA	OSBA Statement No. 2	Brian Kalcic	N/A

² Mr. Kaufman is the Director of Engineering for the Southeast Region of American Water Works Service Company Inc. (the Service Company). PAWC is within the Southeast Region of the Service Company.

14. On December 14, 2006, Administrative Law Judge Cocheres issued a Protective Order to protect confidential information and documents provided by PAWC to the parties and confidential information contained in testimony and exhibits filed, or to be filed, with the Commission.

15. The parties to this proceeding engaged in a collaborative process to address the Application and the issues raised by the parties in order to resolve their differences. Those negotiations ultimately led to the Settlement among the Joint Petitioners set forth herein.

II. TERMS OF THE SETTLEMENT

The Terms of the Settlement are as follows:

16. The Commission will issue to PAWC a Certificate of Public Convenience evidencing its approval, under Section 1102(a)(3) of the Public Utility Code and the Commission's Statement of Policy at 52 Pa. Code §69.901, of the change in control of PAWC to be effected by (i) the merger of TWAUSHI with and into American Water, the parent of PAWC; and (ii) the sale by Thames GmbH of up to 100% of the shares of common stock of American Water in one or more public offerings. The Commission shall also grant such other approvals, if any, that the Commission deems necessary for the Proposed Transaction to be lawfully consummated.

17. PAWC will install the facilities necessary to provide water service in portions of Mt. Pleasant Township (Washington County), Hanover Township (Washington County) and Collier Township (Allegheny County), as such facilities and locations are depicted on the maps to be attached hereto as Exhibits 1, 2 and 3 (the Facility Extensions). PAWC agrees to use best efforts to complete and place in service the Facility Extensions in Hanover and Collier Townships not more than 12 months and the Facility Extensions in Mt. Pleasant Township not

more than 24 months from the date that the last state regulatory approval is obtained authorizing the Proposed Transaction. It is understood and agreed that PAWC's installation of the Facility Extensions without customer contributions or advances is being done under the terms of this Joint Petition for purposes of this case only as a part of the compromise necessary to achieve the overall settlement of this proceeding. If, and to the extent that, the installation of the Facility Extensions on the terms set forth herein may represent a variation from the terms of the Company's tariff, the Commission's approval of such variation should be granted as part of its approval of the Settlement and is a condition of the Settlement. It is understood and agreed that: (1) the Commission's approval of the Joint Petition will not constitute a determination at this time that the Company's investment in the Facility Extensions may be included in its rate base; (2) the Company's claim for rate base inclusion of its investment in the Facility Extensions in a subsequent base rate case shall be subject to Commission review in the same manner as the Company's investment in any other property claimed for rate base inclusion; and (3) the Commission's approval of this Joint Petition will not preclude parties from challenging the rate base inclusion of the Company's investment in the Facility Extensions in a subsequent base rate proceeding.

18. On March 1, 2004, PAWC obtained \$80 million of debt financing from American Water Capital Corporation (AWCC) with a maturity date of March 1, 2014 and at a coupon rate of 4.75% (the 4.75% Debt Issue). Prior to the Proposed Transaction and, therefore, in advance of its original maturity date, the 4.75% Debt Issue will be repaid by PAWC. The parties agree that (1) in determining its rate of return for ratemaking purposes, PAWC will reflect the debt issued for the purpose of repaying the 4.75% Debt Issue at a coupon rate of 4.75% until March 1, 2014; and (2) the parties will support the Commission's approval of PAWC's recording

regulatory assets and liabilities for accounting purposes to properly record the retirement of the 4.75% Debt Issue and provide the same effective rate to customers on the replacement debt through March 1, 2014 as if the 4.75% Debt Issue had not been retired until that date.

19. PAWC will pass through to PAWC customers, in future rate cases, any actual savings from efficiencies resulting from the Proposed Transaction and the continued ownership of PAWC by American Water.

20. The payment for American Water stock will not be recorded on PAWC's books.

21. The divestiture of American Water by RWE and Thames GmbH will not affect the accounting and ratemaking treatment of PAWC's excess deferred income taxes.

22. PAWC will not seek recovery from its customers of the costs of the Proposed Transaction, which are comprised of the Securities and Exchange Commission (SEC) registration fee, the National Association of Securities Dealers' (NASD) (or a successor organization's) filing fee, the stock exchange listing fee, legal fees and expenses of the Proposed Transaction, accounting fees and expenses of the Proposed Transaction, printing and engraving fees and expenses for the registration statement, Blue Sky fees and expenses, transfer agent fees and expenses, and legal fees for the state regulatory approval process. American Water will supply a report to the Commission summarizing such costs, including the amount of such costs allocated to PAWC, if any, within one year from the date of the Commission's Order in this case or, if the sale by Thames GmbH of the common stock of American Water occurs more than one year after the date of the Order, within sixty days of the date of the sale.

23. PAWC will not bear any costs incurred to comply with any law, regulation, standard, or practice of the United Kingdom, Federal Republic of Germany, or European

Community necessary to complete the Proposed Transaction.

24. PAWC will not seek recovery from its customers of any early termination costs, change in control payments, or retention bonuses paid to an employee of PAWC, American Water or the Service Company as a result of the Proposed Transaction. However, nothing contained in the Settlement will prohibit such costs from being allocated to PAWC for accounting and tax purposes. American Water will supply a report to the Commission summarizing such costs, including the amount of such costs, if any, allocated to PAWC within one year from the date of the Commission's Order in this case or, if the sale by Thames GmbH of the common stock of American Water occurs more than one year after the date of the Order, within 60 days of the date of the sale.

25. PAWC will not seek recovery from its customers of the costs for the initial development and implementation of programs and procedures necessary for compliance with the Sarbanes-Oxley Act of 2002 (Pub. L. No. 107-204, 116 Stat. 745) (Sarbanes-Oxley).

26. For a period of three years from the date of the Order, PAWC will not seek to recover from its customers more than its allocated share, as calculated under the existing agreement between the Service Company and PAWC, of \$1 million per year (adjusted annually for inflation) for additional audit costs for Sarbanes Oxley compliance.

27. Commencing after the IPO of American Water's stock and continuing for a period of three years thereafter, PAWC will file with the Commission, or provide the appropriate SEC website address for the Commission to access electronically, the following: American Water's quarterly reports on SEC Form 10-Q, American Water's annual reports to its shareholders, American Water's annual audit report, and PAWC's annual audit report.

28. For a period of three years commencing on the date of the IPO, PAWC will report to the Commission any downgrading of the bonds of American Water, AWCC or PAWC within 30 days of the public notification to American Water, AWCC or PAWC, respectively, of such downgrading and, where available, will provide a copy of the report of the rating agency relating to the downgrading.

29. Prior to the IPO of American Water's stock, RWE and Thames GmbH will infuse equity capital into American Water sufficient to establish a capital structure for American Water at the time of such IPO that includes an equity-to-capitalization ratio no lower than 45% common equity. American Water will file with the Commission and serve upon the Joint Petitioners a balance sheet as of the quarter ended immediately preceding the initial public offering.

30. PAWC and American Water will adequately fund and maintain PAWC's treatment, transmission and distribution systems and supply the service needs of PAWC's customers in accordance with the Public Utility Code and applicable provisions of the Commission's regulations, orders and policy statements including, but not limited to, all water quality, pressure and quality of service standards.

31. Customers of PAWC will experience no material adverse change in utility service due to the Proposed Transaction.

32. PAWC will notify the Commission before making a dividend that is more than 75% of net income.

33. For a period of three years from the date of the Commission Order in this case (and after it has first notified PAWC employees), PAWC will notify the PUC of a planned

reduction of 5% or more in PAWC's workforce.

34. PAWC will maintain its corporate offices in Pennsylvania.

35. PAWC will maintain a substantial "local interest" representation on its Board of Directors.

36. PAWC will continue no less than its current level of support for and involvement in local and community projects, including continued funding for PAWC's low-income program to assist low-income residential customers with their water bills.

37. In its Order granting approval of the Proposed Transaction, the Commission will direct that, upon completion of the initial public offering of American Water's common stock, PAWC will be relieved of the filing and reporting requirements set forth in Ordering Paragraphs 6(d) – (g) of the Commission's Order entered September 4, 2002 at Docket No. A-212285F0096, which approved the acquisition of American Water by RWE.

38. The Settlement is conditioned upon the Commission's approval of the terms contained herein without modification. If the Commission rejects the Settlement, the Settlement automatically will terminate and be null and void. If the Commission, in approving the Settlement, should modify any terms of the Settlement or add any conditions (including any conditions relating to the issues resolved herein), any Joint Petitioner may elect to withdraw from the Settlement by filing a notice of withdrawal with the Commission's Secretary and serving a copy thereof upon all Joint Petitioners by facsimile, electronic mail or overnight delivery service within five business days of the entry of the Commission's Order. If the Settlement is not approved, the Joint Petitioners reserve their respective rights to continue the litigation of this proceeding, including, but not limited to, the submission of briefs to the Administrative Law

Judge. In addition the Joint Petitioners reserve their respective rights to submit testimony and other evidence and file briefs in support of the Settlement and in response to issues pursued by non-settling parties.

39. The completion of the initial public offering of the common stock of American Water constitutes a condition precedent to the terms of the Settlement set forth in Paragraphs 17 through 37, above. Once the initial public offering has occurred, the Settlement and its terms shall be implemented and enforceable notwithstanding the pendency of a petition for reconsideration or a legal challenge to the Commission's approval of the Joint Petition and Settlement unless such implementation and enforcement of the Settlement is stayed or enjoined by the Commission, another regulatory agency or a court having jurisdiction over the matter.

40. The Settlement resolves with prejudice all issues related to the Application and precludes the Joint Petitioners from asserting contrary positions in derogation of this Settlement with respect to any issue addressed herein during any subsequent litigation against PAWC provided, however, that this Settlement is made without admission against or prejudice to any factual or legal positions which any of the Joint Petitioners may assert in (a) the subsequent litigation of this proceeding in the event that the Commission does not issue a final, non-appealable Order approving this Settlement without modification; or (b) any proceeding involving another Pennsylvania utility. This Settlement is determinative and conclusive of all of the issues addressed herein and constitutes a final adjudication as to the Joint Petitioners of the matters thereof.

41. All Joint Petitioners shall support the Settlement and make reasonable and good faith efforts to obtain approval of the Settlement by the Commission and any Courts. In furtherance of this commitment, the Joint Petitioners agree to submit to the Administrative Law

Judge Statements in Support of the Settlement within five business days of the filing of this Joint Petition.

III. PUBLIC INTEREST CONSIDERATIONS

The Joint Petitioners submit that this Settlement is in the public interest and should be approved in full for the following reasons:

42. The Proposed Transaction will result in American Water becoming a publicly-traded company focused on the water and wastewater business in the United States.

43. The Settlement commits RWE and Thames GmbH to infuse equity capital into American Water to assure that, at the time of the IPO, American Water will have a strong capital structure that includes an equity-to-capitalization ratio of not less than 45% common equity. *See* ¶ 29.

44. The Settlement assures that the customers of PAWC will be held harmless from any increase in the cost rate for \$80 million of 4.75% debt issued to RWE, through AWCC, that will be retired in advance of its original maturity date. *See* ¶ 18.

45. The Proposed Transaction will increase transparency. Following the Proposed Transaction, American Water will be subject to the disclosure requirements of the SEC, the auditing and disclosure requirements of Sarbanes-Oxley and the disclosure and other requirements of the stock exchange on which its shares are traded. In addition, the Settlement commits PAWC to increased levels of reporting to the Commission of financial, creditworthiness, dividend and employment information. *See* ¶¶ 27, 28, 32 and 33.

46. Although American Water, as a U.S.-based public company, will have to meet all of the auditing and reporting standards of Sarbanes-Oxley, the Settlement: (a) provides that

PAWC will not seek to recover from customers the costs of initial development and implementation of programs and procedures for Sarbanes-Oxley compliance (*see* ¶ 25); and (b) caps the amount of on-going Sarbanes-Oxley compliance costs that PAWC may recover from its customers for a period of three years (*see* ¶ 26).

47. The Settlement provides that PAWC will not seek to recover from customers the costs of the Proposed Transaction (including the cost of obtaining state regulatory approvals), as detailed in Paragraph 22. The Settlement also provides that PAWC will not seek to recover from customers employee transition costs (early termination, change-in-control payments and retention bonuses) paid as a result of the Proposed Transaction, as detailed in Paragraph 24. Additionally, the Settlement requires that PAWC not bear costs incurred for compliance with foreign laws or regulations necessary to complete the Proposed Transaction. *See* ¶ 23.

48. PAWC will continue to be a subsidiary of American Water and will continue to be operated by PAWC's local management, under the supervision of PAWC's board of directors. The Settlement provides that PAWC will maintain its corporate office in Pennsylvania, will maintain a substantial local interest representation on its board of directors, and will continue no less than its current level of support for, and involvement in, local and community projects, including funding for PAWC's programs to assist low-income customers. *See* ¶¶ 34, 35 and 36.

49. The Settlement contains provisions committing PAWC to adequately fund and maintain its treatment, transmission and distribution systems and assuring that PAWC's customers will experience no material adverse change in utility service due to the Proposed Transaction. *See* ¶¶ 30 and 31.

50. The Settlement provides that PAWC will pass through to its customers in future rate cases any actual savings from efficiencies gained by the completion of the Proposed

Transaction and the continued ownership of PAWC by American Water. *See* ¶ 19.

51. The Proposed Transaction will not affect the Commission's regulatory powers with respect to PAWC or the authority of other government agencies as to PAWC's services and facilities. PAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Pennsylvania public utilities.

52. The Settlement provides that PAWC will install, without customer contributions or advances, the Facility Extensions necessary to provide water service in the areas identified in Paragraph 17 that do not have public water supplies and have experienced substantial degradation in the quantity and quality of their existing on-lot well water sources, as detailed on Exhibits 1, 2 and 3. The rate treatment to be afforded PAWC's investment in the Facility Extensions is to be addressed in subsequent base rate proceedings. This provision will result in water service being provided to as many as 750 customers who currently do not have it.

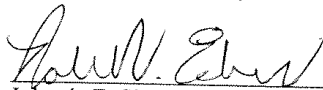
53. Litigation and associated costs will be significantly reduced by approval of the Settlement. The Settlement resolves a number of important and potentially contentious issues. The administrative burden and associated costs to litigate these matters to conclusion among the Joint Petitioners will not have to be incurred.

54. The Joint Petitioners arrived at the Settlement terms after conducting extensive discovery and engaging in in-depth discussions. The Settlement terms constitute a carefully crafted package representing reasonable negotiated compromises on the issues addressed herein. Thus, the Settlement is consistent with the Commission's rules and practices encouraging negotiated settlements (*see* 52 Pa. Code §§ 5.231, 69.391, 69.401).

IV. CONCLUSION

WHEREFORE, the Joint Petitioners, intending to be legally bound, respectfully request that the Commission: (1) approve this Joint Petition, including all terms and conditions contained herein, without modification; (2) issue a Certificate of Public Convenience under Section 1102 of the Public Utility Code authorizing the Proposed Transaction; (3) grant such other approvals as the Commission may determine necessary to effect the Proposed Transaction; and (4) terminate and mark closed the proceedings at Docket No. A-212285F0136.

Respectfully submitted,



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Robert V. Eckenrod
Prosecutor
Richard A. Kanaskie
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For the Office of Consumer Advocate

DATED: December 22, 2006

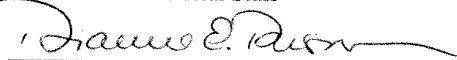
IV. CONCLUSION

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DATED: December 22, 2006

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For Pennsylvania-American Water
Company

IV. CONCLUSION

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Respectfully submitted,

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For the Office of Consumer Advocate

DATED: December 22, 2006

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**APPLICATION OF PENNSYLVANIA- :
AMERICAN WATER COMPANY FOR :
APPROVAL OF A CHANGE IN :
CONTROL TO BE EFFECTED : DOCKET NO. A-212285F0136
THROUGH A PUBLIC OFFERING OF :
THE COMMON STOCK OF AMERICAN :
WATER WORKS COMPANY, INC. :**

CERTIFICATE OF SERVICE

I hereby certify that I have served true and correct copies of the Joint Petition for Non-
Unanimous Settlement upon the persons and in the manner indicated below.

VIA HAND DELIVERY

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VIA FEDERAL EXPRESS

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Counsel for Pennsylvania-American Water
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Dated: December 22, 2006

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January 26, 2007

VIA FEDERAL EXPRESS

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RECEIVED

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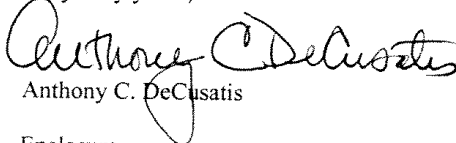
PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: **Application Of Pennsylvania-American Water Company For Approval Of A
Change In Control To Be Effected Through A Public Offering Of The Common
Stock Of American Water Works Company, Inc.
Docket No. A-212285F0136**

Dear Secretary McNulty:

Enclosed are an original and three copies of the **Supplement To The Joint Petition for Non-
Unanimous Settlement** (Supplement) filed in the above-captioned matter on behalf of
Pennsylvania-American Water Company, the Office of Trial Staff, the Office of Consumer
Advocat, the Utility Workers Union of America, AFL-CIO and the Utility Workers Union of
America Local 537. An additional copy of the Supplement and an additional copy of this letter
are also enclosed to be date-stamped and returned to us in the stamped, self-addressed envelope
provided. As evidenced by the Certificate of Service attached to the original and each copy of
the Supplement, that document was served on all parties to the above-captioned proceeding and
the presiding Administrative Law Judge.

Very truly yours,


Anthony C. DeCusatis

Enclosure

cc: Per Certificate of Service

Philadelphia Washington New York Los Angeles San Francisco Miami Pittsburgh Princeton Chicago
Palo Alto Dallas Harrisburg Irvine Boston London Paris Brussels Frankfurt Beijing Tokyo

1-PH/2552818.1

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**APPLICATION OF PENNSYLVANIA- :
AMERICAN WATER COMPANY FOR :
APPROVAL OF A CHANGE IN :
CONTROL TO BE EFFECTED : DOCKET NO. A-212285F0136
THROUGH A PUBLIC OFFERING OF :
THE COMMON STOCK OF AMERICAN :
WATER WORKS COMPANY, INC. :**

**SUPPLEMENT TO
THE JOINT PETITION FOR NON-UNANIMOUS SETTLEMENT**

This Supplement to the Joint Petition For Non-Unanimous Settlement (Supplement) modifies the Joint Petition For Non-Unanimous Settlement (Joint Petition) filed on December 22, 2006, by: (1) adding terms; and (2) including the Utility Workers Union of America, AFL-CIO and the Utility Workers Union of America Local 537 (collectively, UWUA) as parties to the non-unanimous settlement (Settlement) of the above-captioned proceeding.

I. BACKGROUND

1. On December 22, 2006, Pennsylvania-American Water Company (PAWC), the Office of Trial Staff (OTS) and the Office of Consumer Advocate (OCA) filed the Joint Petition to resolve all issues among them pertaining to the above-captioned Application.
2. From and after the filing of the Joint Petition, PAWC and UWUA indicated to the other parties and to the Administrative Law Judge that discussions were on-going to reach a settlement on matters of interest to UWUA.
3. As a result of continuing negotiations with UWUA, an agreement was reached whereby the UWUA would join the Settlement with the addition to the Joint

Petition of the terms agreed to by PAWC and UWUA (Additional Terms). Accordingly, this Supplement is being filed to include the Additional Terms in the Joint Petition and to add UWUA to the Joint Petition as a Joint Petitioner. (Hereafter, "Joint Petitioners" shall refer, collectively, to PAWC, OTS, OCA and UWUA.)

II. ADDITIONAL TERMS OF THE SETTLEMENT

The Additional Terms of the Settlement hereby added to the Joint Petition are as follows:

4. Paragraph 33 of the Joint Petition is amended by adding "and, if applicable, the Utility Workers Union of America, AFL-CIO" following "... PAWC will notify the PUC" so that Paragraph 33 will now read:

For a period of three years from the date of the Commission Order in this case (and after it has first notified PAWC employees), PAWC will notify the PUC and, if applicable, the Utility Workers Union of America, AFL-CIO of a planned reduction of 5% or more in PAWC's work force.

5. AWW will continue to fund the pension plans of the union and non-union employees of PAWC in compliance with the Employee Retirement Income Security Act (ERISA) and the Pension Protection Act of 2006 (PPA). PAWC will not seek to recover from its customers any increased pension funding expense or other costs that would be incurred to remedy any violation of ERISA's minimum funding requirements during RWE's ownership if it should be determined that any such violation has occurred. Neither AWW nor PAWC is aware of, nor do they believe that, any such violation has occurred.

6. For one year following the occurrence of the IPO, staffing levels for collectively bargained employees will not drop below 90% of the number of collectively bargained individuals employed by PAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis). Likewise, for one year following the occurrence of the IPO, staffing levels for all employees (union and non-union collectively) will not drop below 90% of the number of individuals employed by PAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis).

7. PAWC agrees to honor all terms and conditions of the existing collective bargaining agreements between PAWC and the applicable local union of the Utility Workers Union of America (the Collective Bargaining Agreements) through the termination dates of those agreements. Any successor to PAWC will assume the Collective Bargaining Agreements and all obligations thereunder through the termination dates of those agreements.

III. PUBLIC INTEREST CONSIDERATIONS

The Joint Petitioners submit that the Additional Terms are in the public interest and that the Settlement, including the Additional Terms, should be approved in full for the reasons set forth in the Joint Petition and for the following additional reasons:

8. The Additional Terms resolve issues of concern to UWUA pertaining to collectively bargained employees.

9. The Additional Terms provide added assurances concerning the adequacy of funding of union and non-union pension plans in compliance with ERISA and the PPA. The Additional Terms also: (1) provide that PAWC will not seek to recover from

its customers any additional pension funding expense or other costs resulting from any violation of ERISA's minimum funding requirements during RWE's ownership if it should subsequently be determined that any such violation may have occurred; and (2) provide assurances that neither AWW nor PAWC is aware of any such violations or believes that any such violations have occurred.

10. The Additional Terms provide an objective metric to maintain minimum employee staffing levels for one year following the IPO. This provision complements other terms of the Joint Petition in which PAWC committed to adequately fund and maintain its system (§ 30) and assured that customers will experience no material adverse change in utility service due to the Proposed Transaction (§ 31).

11. The Additional Terms provide further assurance that PAWC will honor existing collective bargaining agreements.

IV. CONCLUSION

WHEREFORE, the Joint Petitioners, intending to be legally bound, respectfully request that the Commission: (1) approve the Joint Petition, including all terms and conditions contained in the Joint Petition and this Supplement, without modification; (2) issue a Certificate of Public Convenience under Section 1102 of the Public Utility Code authorizing the Proposed Transaction; (3) grant such other approvals as the Commission may determine necessary to effect the Proposed Transaction; and (4) terminate and mark closed the proceedings at Docket No. A-212285F0136.

Respectfully submitted,


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For the Office of Consumer Advocate

DATED: 1/23/07



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For Pennsylvania-American Water
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Elaine Lippmann
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For the Utility Workers Union of
American, AFL-CIO and Utility Workers
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IV. CONCLUSION

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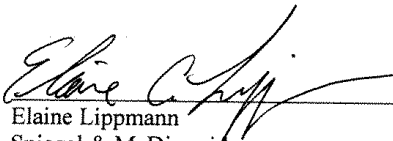
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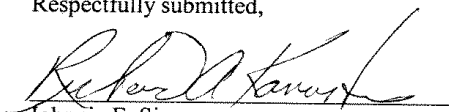
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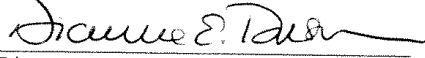
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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**APPLICATION OF PENNSYLVANIA- :
AMERICAN WATER COMPANY FOR :
APPROVAL OF A CHANGE IN :
CONTROL TO BE EFFECTED : DOCKET NO. A-212285F0136
THROUGH A PUBLIC OFFERING OF :
THE COMMON STOCK OF AMERICAN :
WATER WORKS COMPANY, INC. :**

CERTIFICATE OF SERVICE

I hereby certify that I have served true and correct copies of the Supplement To The Joint
Petition For Non-Unanimous Settlement upon the persons and in the manner indicated below.

VIA ELECTRONIC MAIL AND FEDERAL EXPRESS

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Anthony C. DeCusatis
Counsel for Pennsylvania-American Water
Company

Dated: January 26, 2007

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

APPLICATION OF PENNSYLVANIA-AMERICAN WATER COMPANY FOR APPROVAL OF A CHANGE IN CONTROL TO BE EFFECTED THROUGH A PUBLIC OFFERING OF THE COMMON STOCK OF AMERICAN WATER WORKS COMPANY, INC. :
: **DOCKET NO. A-212285F0136**
:

**STATEMENT OF
PENNSYLVANIA-AMERICAN WATER COMPANY
IN SUPPORT OF THE JOINT PETITION
FOR NON-UNANIMOUS SETTLEMENT**

On December 22, 2006, Pennsylvania-American Water Company (PAWC or the Company), the Office of Trial Staff (OTS) and the Office of Consumer Advocate (OCA) (collectively, the Joint Petitioners) filed with the Pennsylvania Public Utility Commission (PUC or Commission) a *Joint Petition For Non-Unanimous Settlement* (Joint Petition) of the above-captioned proceeding. The Joint Petition contains a statement of the factual background and procedural history of this case, and the *Application Of Pennsylvania-American Water Company For Approval Of A Change In Control To Be Effected Through A Public Offering Of The Common Stock Of American Water Works Company, Inc.* (Application), filed on May 5, 2006, contains a detailed description of the transaction for which approval is requested (the Proposed Transaction). This Statement in Support is filed pursuant to Paragraph 41 of the Joint Petition.

The settlement embodied in the Joint Petition (Settlement) was achieved only after an extensive investigation of the Application and the Proposed Transaction, which included substantial discovery and the submission of direct, rebuttal and surrebuttal testimony. In addition, over a period of several weeks, the parties engaged in discussions and negotiations about the terms of the Settlement.

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The Joint Petition (¶¶ 42-54) contains a detailed explanation of the reasons why the Joint Petitioners believe that the Settlement is in the public interest, satisfies the standards for issuance of a certificate of public convenience and should be approved. In addition, the Company advances the reasons set forth herein as further support of those points.

In the Application, and as described therein as part of the Proposed Transaction, PAWC has requested the Commission's approval, evidenced by a certificate of public convenience, of a change in control to be effected through the public offering of the common stock of its parent, American Water Works Company, Inc. (American Water). Upon the initial public offering (IPO) of American Water stock, American Water will be a publicly-traded, New York Stock Exchange-listed water company that is focused on the water and wastewater business in the United States. At the time of and after the Proposed Transaction, American Water is expected to be the largest publicly-traded water company in the United States. As a publicly-traded company, American Water will be better positioned to focus on maintaining, developing and growing the water and wastewater businesses of its subsidiaries and on the needs of its customers and employees.

The Proposed Transaction will provide American Water with access to the public equity and debt capital markets in the United States and, thereby, maintain and enhance its ability to finance necessary investment in the infrastructure of its subsidiaries, including PAWC. Unlike conditions that prevailed before RWE acquired American Water, the United States' capital markets today see greater potential in "pure-play" domestic water utilities.

Throughout this proceeding, witnesses for PAWC have emphasized that American Water will have a sound financial structure containing between 45% and 55% equity. *See* PAWC Statement 2, p. 15. As further support for these representations, the Settlement (¶ 29) includes a

firm commitment that, prior to IPO of American Water stock, RWE and Thames GmbH will infuse equity capital into American Water as necessary such that, at the time of the IPO, American Water's capital structure will have a common equity-to-total-capitalization ratio containing no less than 45% common equity. With this capital structure, American Water can maintain a strong investment grade credit rating. Additionally, this commitment addresses concerns expressed by certain witnesses, such as OCA witness Rubin, regarding the capital structure, financial strength and creditworthiness of American Water after the Proposed Transaction.

The Settlement also contains a term (§ 18) that assures PAWC's customers will be held harmless from any increase in the cost rate for \$80 million of 4.75% debt issued by PAWC to RWE through American Water Capital Corporation (AWCC), which will be retired in advance of the IPO. This commitment addresses, and resolves, the one issue identified in OTS witness Plonski's surrebuttal testimony (OTS Statement 1-SR) that remained unresolved after the submission of PAWC's rebuttal testimony.

The Proposed Transaction will substantially increase the transparency of American Water because, as a publicly-traded company, it will be subject to the disclosure requirements of the Securities and Exchange Commission, the auditing and disclosure requirements of the Sarbanes-Oxley Act of 2002 and the disclosure and other requirements of the stock exchange on which its shares are traded. Increased transparency and more extensive disclosure and reporting promote the public interest and are a significant benefit to customers, as evidenced by the recommendations and conclusions set out in the Bureau of Audits' report issued in August 2002 at Docket No. D-02SPS013 titled *Review Of Corporate Governance Controls And Audit-Related Practices Pertaining To The Financial Reporting Process*. See OTS Exhibit 1-SR, Schedule 4

and PAWC Statement 2-R, p. 20. Additionally, the terms of the Settlement include commitments by PAWC to increased levels of reporting to the Commission of financial (§ 27), creditworthiness (§ 28), dividend (§ 32) and employee staffing (§33) information. These are reporting requirements that do not currently exist by statute, regulation or Commission order and would not be imposed absent PAWC's commitment, under the terms of the Settlement, to assume those obligations.

Under the terms of the Settlement, PAWC has agreed to forego recovery of a variety of significant costs that it otherwise could have claimed in future base rate proceedings. These include initial implementation costs for Sarbanes-Oxley compliance (§ 25), the costs of the Proposed Transaction (including the costs of obtaining state regulatory approval) (§§ 22 and 23), and certain employee transition costs (§ 24). Additionally, PAWC has agreed to cap the amount of additional audit costs for Sarbanes-Oxley compliance that it may recover from customers for a period of three years (§ 26). This cap is a restriction that would not be imposed absent PAWC's agreement.

PAWC has committed, as part of the Settlement terms, to keep a strong local presence in the communities it serves by maintaining its corporate office in Pennsylvania (§ 34), preserving a substantial local interest representation on its board of directors (§ 35) and continuing no less than its current level of support for, and involvement in, local and community projects, including funding for PAWC's programs to assist low-income customers. These commitments create obligations on PAWC's part that would not exist absent its agreement to the terms of the Settlement.

As part of the Settlement, PAWC has agreed to install, without customer contributions or advances, facilities necessary to provide water service in areas identified in the Joint Petition

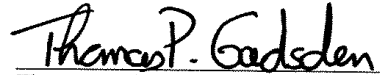
(Exhibits A, B and C) that do not have public water supplies and have experienced substantial degradation in the quality and quantity of their existing on-lot water sources. These installations would not be made on the terms specified in the Joint Petition absent PAWC's agreement to the terms of the Settlement.

As explained in the Application (¶ 39), Section 1103(a) of the Public Utility Code (66 Pa. C.S. §1103(a)) provides that a certificate of public convenience evidencing the Commission's approval under Section 1102 (66 Pa. C.S. §1102) shall issue only upon a showing that granting such approval is "necessary or proper for the service, accommodation, convenience, or safety of the public." In *York v. Pa. P.U.C.*, 449 Pa. 136, 295 A.2d 825, 828 (1972), the Pennsylvania Supreme Court interpreted Section 1103(a), as applied to a request for approval of a utility merger, to require the applicants to demonstrate that the proposed merger "will affirmatively promote the 'service, accommodation, convenience, or safety of the public' in some substantial way."

PAWC submits that the Proposed Transaction will create substantial public benefits that fully satisfy the requirements of Section 1103(a) as interpreted by the Pennsylvania Supreme Court. The public benefits inherent in the completion of the Proposed Transaction on the terms stated in the Application and supported by the direct and rebuttal testimony of PAWC have been enhanced by the additional terms set forth in the Joint Petition. Furthermore, the terms of

the Settlement are consistent with, and affirmatively promote, the public interest. Accordingly, the Joint Petition should be approved without modification.

Respectfully submitted,



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Dated: January 2, 2007

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**APPLICATION OF PENNSYLVANIA- :
AMERICAN WATER COMPANY FOR :
APPROVAL OF A CHANGE IN :
CONTROL TO BE EFFECTED : DOCKET NO. A-212285F0136
THROUGH A PUBLIC OFFERING OF :
THE COMMON STOCK OF AMERICAN :
WATER WORKS COMPANY, INC. :**

**STATEMENT IN SUPPORT
OF THE OFFICE OF CONSUMER ADVOCATE**

I. INTRODUCTION

The Office of Consumer Advocate (OCA) submits this statement in support of the Joint Petition For Non-Unanimous Settlement (Settlement) filed on December 22, 2006 in this proceeding. The OCA submits that this Settlement is in the public interest and is in accord with the law and Commission policy.

The Settlement is a compromise; it does not encompass all of the specific recommendations proposed by the OCA in its litigation position. Reasoned compromises form the basis of nearly all settlements, and the terms of this Settlement reflect this process. Through participating in the settlement process, the OCA sought to ensure that substantial affirmative benefits would accrue to Pennsylvania ratepayers. In its entirety, the Settlement is in the public interest, and therefore, the Commission should approve the Settlement without modification.

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II. BACKGROUND

On May 5, 2006, Pennsylvania-American Water Company (PAWC) filed an application for approval of a change in control of the American Water Works Company (AWW) through a public offering of the common stock of AWW. The proposed transaction consists of the sale by Thames Water Aqua Holdings GmbH (Thames) of up to 100% of the shares of common stock of AWW and the merger of Thames with and into AWW.

In response to the May 27, 2006, notice of the filing published in the Pennsylvania Bulletin, the OCA timely filed a Notice of Intervention and Protest on June 9, 2006. The Office of Small Business Advocate filed a Notice of Intervention and Protest and the Office of Trial Staff entered its appearance and filed a Request to Initiate Proceeding on June 9, 2006. Also on June 9, 2006, the Utility Workers Union of America, AFL-CIO, and the Utility Workers Union of America Local 537 (collectively, UWUA), filed a Joint Petition to Intervene. On July 10, 2006, the Pennsylvania American Water Large Users Group (PAWLUG) submitted a late-filed Petition to Intervene which was not opposed. On October 16, 2006, the City of Pittsburgh (City) also submitted a Late-Filed Petition of City of Pittsburgh To Intervene, which PAWC opposed, and the ALJ denied.

The Commission assigned Administrative Law Judge Louis G. Cocheres to conduct hearings and issue an Initial Decision in this matter. On July 26, 2006, ALJ Cocheres conducted a Prehearing Conference to address procedural matters including the litigation schedule. In accord with that schedule, PAWC served PAWC Statement Nos. 1 and 2 -- the direct testimony of Daniel W. Warnock and Ellen C. Wolf, respectively, on August 4, 2006.

On September 18, 2006, ALJ Cocheres conducted a telephonic public input hearing for the purpose of gathering the testimony of PAWC ratepayers and members of the public affected

by the proposed transaction.

On September 29, 2006, The OCA timely filed direct testimony consisting of OCA Statement No. 1 of Scott J. Rubin with Schedules SJR-1 through SJR-15, and OCA Statement No. 2 of J. Randall Woolridge, Ph.D. with Exhibit Nos. JRW-1 through JRW-6.

On November 29, 2006, the OCA timely filed surrebuttal testimony consisting of OCA Statement No. 1-S of Scott J. Rubin with Schedules SJR-16 and SJR-17, and OCA Statement No. 2-S of J. Randall Woolridge, Ph.D. with Exhibit No. JRW-7.

On December 14, 2006, Administrative Law Judge Cocheres issued a Protective Order.

II. STATEMENT IN SUPPORT

This Settlement, as with all settlements, is the product of compromise. Nevertheless, any settlement agreement proposing that the acquisition proceed must ensure that substantial affirmative public benefits result from the acquisition. City of York v. Pa. Pub. Util. Comm'n, 449 Pa. 136, 295 A.2d 825 (1972). The OCA submits that the entire Settlement provides a substantial affirmative benefit, and in addition, provides commitments and requirements that might not have been achieved through further litigation. Accordingly, the OCA respectfully requests that the Commission approve the Joint Petition.

Through settlement discussions, the OCA addressed its concerns directly with PAWC and American Water Works Company (AWW). While the OCA will discuss each provision of the Settlement in its Brief in Support, the OCA includes a brief description here of the ratepayer benefits provided by the Settlement:

- **Needed Facility Extensions** -- PAWC will install, without customer contributions or advances, facility extensions necessary to provide water service to certain areas that do not have public water supplies and have experienced substantial degradation in the quantity and quality of their existing on-lot well

water source. Under the Settlement, this facility extension does not constitute a determination that the investment may be included in the Company's rate base in a subsequent base rate proceeding.

- **Ratepayer Debt Financing Protection** -- Regarding \$80 million of debt financing at a coupon rate of 4.75% that must be refinanced because of the transaction, PAWC will reflect the debt issued for the purpose of repaying the 4.75% debt issue at a coupon rate of 4.75% until March 1, 2014. This will provide the same effective rate to customers on the replacement debt through March 1, 2014 as if the 4.75% debt issue had not been retired until that date, and will avoid finance cost increases for ratepayers on this debt.
- **Efficiency Savings** -- PAWC will pass through to PAWC customers, in future rate cases, any actual savings from efficiencies resulting from the Proposed Transaction and the continued ownership of PAWC by American Water.
- **No Deferred Income Tax Impact** -- The divestiture of American Water by RWE and Thames GmbH will not affect the accounting and ratemaking treatment of PAWC's excess deferred income taxes.
- **No Recovery of Transaction and Transition Costs** -- PAWC will not seek to recover from ratepayers the costs of the transaction and transition costs, and will detail these costs to the Commission to ensure that they are not included in future rates.
- **No Recovery of European Law Compliance Costs** -- PAWC will not bear any costs incurred to comply with any European legal requirements, standards or practices.
- **Sarbanes-Oxley Cost Recovery Limits** -- PAWC will not recover initial development and implementation costs necessary for compliance with the Sarbanes-Oxley Act of 2002, and will not recover for three years more than its allocated share of a \$1 million per year limit for additional audit costs for Sarbanes Oxley compliance.
- **Additional Financial Reporting** -- For three years, PAWC will provide the Commission with electronic access to the following: AWW's quarterly reports on SEC Form 10-Q, AWW's annual reports to its shareholders, American Water's annual audit report, and PAWC's annual audit report. PAWC is not under an affirmative obligation to transmit this information to the Commission otherwise.
- **Monitoring of Bond Performance** -- For three years, PAWC will inform the Commission of downgrade of the bonds of AWW, American Water Capital or PAWC within 30 days of its notification of these events, and will provide supporting documentation.

- **Equity Capital Infusion** -- Prior to the IPO, RWE and Thames GmbH will infuse equity capital into AWW sufficient to establish a capital structure that includes an equity-to-capitalization ratio no lower than 45% common equity, and will provide reporting on this infusion as of the quarter ended immediately preceding the initial public offering.
- **Assurance of Adequate Funding** -- PAWC and AWW will adequately fund and maintain PAWC's treatment, transmission and distribution systems and supply the service needs of PAWC's customers in accordance with the Public Utility Code and applicable regulations.
- **Dividend Limit Notification** -- PAWC will notify the Commission before making a dividend that is more than 75% of net income.
- **Employment Level Monitoring** -- For a period of three years from the date of the Commission Order in this case, PAWC will notify the PUC of a planned reduction of 5% or more in PAWC's workforce.
- **Local Presence** -- PAWC will maintain its corporate offices in Pennsylvania and will maintain a substantial "local interest" representation on its Board of Directors.
- **Local and Community Support** -- PAWC will continue to maintain, at a minimum, its current level of support for and involvement in local and community projects, including continued funding for PAWC's low-income program to assist low-income residential customers with their water bills.

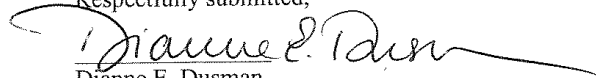
The OCA points out that these are highlights from the Settlement and not an exhaustive list. The OCA will discuss all the aspects of the Settlement in detail in its Brief in Support. Nevertheless, the OCA submits that these terms and conditions, taken as a whole, constitute a substantial affirmative public benefit.

In addition to these considerations, the OCA would point out that the Settlement contains no language limiting the Parties' ability to challenge future rate or tariff filings made by PAWC – even regarding most issues addressed in this Settlement. To this end, the Settlement resolves issues raised in the record that is before the Commission in this docket at this time, and does not limit the Parties' rights in future filings. The OCA would make clear, however, that it

does not intend to challenge the facility extensions contemplated by this Settlement beyond a normal prudence review.

Taken together, all these terms and conditions achieve significant service, rate and financial assurances to the benefit of ratepayers and the public. The OCA submits, therefore, that the ALJ and the Commission should adopt the terms of the Settlement as being in the public interest.

Respectfully submitted,



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Dated: December 22, 2006

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