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The following debt and preferred stock with mandatory redemption requirements were retired through extinguishments, optional redemption or payment at maturity in 2007:

| Company | Type | Interest Rate | Maturity | Amount (in thousands) |
|---|---|---|---|---|
| *Long-term debt:* | | | | |
| American Water Capital Corp | Senior notes-fixed rate | 6.87% | 2011 | $ 28,000 |
| American Water Capital Corp | RWE notes-fixed rate | 4.00%-6.05% | 2007-2034 | 465,300 |
| American Water Capital Corp | RWE redemption notes-fixed rate | 5.72% | 2009 | 1,750,000 |
| Various Subsidiaries | Senior notes-fixed rate | 7.25%-8.75% | 2007-2028 | 101,531 |
| Various Subsidiaries | Miscellaneous | 0%-10.06% | 2007-2034 | 114,340 |
| *Preferred stock with mandatory redemption requirements* | | | | |
| American Water Works Company, Inc. | RWE preferred stock-fixed rate | 5.90% | 2012 | $ 1,750,000 |
| Various Subsidiaries | | 4.60%-8.88% | 2007-2019 | 388 |
| Total extinguishments, retirements & redemptions | | | | $ 4,209,559 |

From time to time and as market conditions warrant, we may engage in long-term debt retirements via tender offers, open market repurchases or other viable alternatives to strengthen our balance sheets.

### *Credit Facilities and Short-Term Debt*

The components of short-term debt were as follows:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| | (in thousands) | |
| Revolving credit line | $ 437,000 | $ — |
| Commercial paper, net of discount | — | 169,267 |
| Book-overdraft | 42,010 | 42,198 |
| Lines of credit | — | 9,049 |
| Total short-term debt | $ 479,010 | $ 220,514 |

AWCC has entered into a $10.0 million committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2009 unless extended and is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on either the prime rate of PNC Bank, N.A. or the applicable LIBOR for the term selected plus 200 basis points. In addition, there is a fee of 25 basis points charged quarterly on the portion of the commitment that is undrawn. As of February 23, 2009, December 31, 2008 and December 31, 2007 there was $0.8 million, $0.0 million and $ 9.0 million, respectively, outstanding under this revolving line of credit. If this line of credit were not extended beyond its current maturity date of December 31, 2009, AWCC would continue to have access to its $840.0 million unsecured revolving credit facility described below.

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AWCC, our finance subsidiary, has entered into an $840 million senior unsecured credit facility syndicated among the following group of 11 banks with JPMorgan Chase Bank, N.A. acting as administrative agent.

| Bank | Commitment Amount Through September 15, 2012 | | Commitment Amount Through September 15, 2013 |
|---|---|---|---|
| | | (in thousands) | |
| JPMorgan Chase Bank, N.A. | $ 115,000 | | $ 0 |
| Citibank, N.A. | 115,000 | | 115,000 |
| Citizens Bank of Pennsylvania | 80,000 | | 80,000 |
| Credit Suisse, Cayman Islands Branch | 80,000 | | 80,000 |
| William Street Commitment Corporation | 80,000 | | 80,000 |
| Merrill Lynch Bank USA | 80,000 | | 80,000 |
| Morgan Stanley Bank | 80,000 | | 80,000 |
| UBS Loan Finance LLC | 80,000 | | 80,000 |
| National City Bank | 50,000 | | 50,000 |
| PNC Bank, National Association | 40,000 | | 40,000 |
| The Bank of New York Mellon | 40,000 | | 0 |
| | $ 840,000 | | $ 685,000 |

This revolving credit facility, which was originally scheduled to terminate on September 15, 2011, is principally used to support the commercial paper program at AWCC and to provide up to $150.0 million in letters of credit. On September 14, 2007, this revolving credit facility was extended for an additional year by the facility bank group, making the new termination date September 15, 2012. On September 15, 2008, a majority of the banks agreed to further extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. On December 18, 2008 The Bank of New York Mellon joined the credit facility syndicate with a commitment amount of $40.0 million through September 15, 2012. If any lender defaults in its obligation to fund advances, the Company may request the other lenders to assume the defaulting lender's commitment or replace such defaulting lender by designating an assignee willing to assume the commitment, however, the remaining lenders have no obligation to assume a defaulting lender's commitment and we can provide no assurances that we will replace a defaulting lender. AWCC had $345.0 million of outstanding borrowings and $43.9 million of outstanding letters of credit under this credit facility as of February 23, 2009. As of February 23, 2009, AWCC had $178.5 million of commercial paper outstanding.

On December 31, 2008 and December 31, 2007, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper:

| | Credit Facility Commitment | Available Credit Facility Capacity | Letter of Credit Sublimit | Available Letter of Credit Capacity | Outstanding Commercial Paper (Net of Discount) | Credit Line Borrowings |
|---|---|---|---|---|---|---|
| | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) | (in thousands) |
| December 31, 2008 | $ 850,000 | $ 369,097 | $ 150,000 | $ 106,097 | $ 0 | $ 437,000 |
| December 31, 2007 | $ 810,000 | $ 711,611 | $ 150,000 | $ 60,659 | $ 169,267 | $ 0 |

Interest rates on advances under the revolving credit facility are based on either prime or LIBOR plus an applicable margin based upon our credit ratings, as well as total outstanding amounts under the agreement at the time of the borrowing. The maximum LIBOR margin is 55 basis points.

The revolving credit facility requires us to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. On December 31, 2008, our ratio was 0.56 and therefore we were in compliance with the ratio.

The weighted average interest rate on short-term borrowings for the year ended December 31, 2008 and December 31, 2007 was approximately 3.51% and 5.49%, respectively.

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On December 17, 2008, we filed a registration statement on Form S-1 with the Securities and Exchange Commission relating to a proposed follow-on public offering of our common stock. The proposed offering would include $300 million secondary offering by the selling stockholder, a subsidiary of RWE AG, with the proceeds going to RWE and concurrently, a $300 million primary offering by us will occur with proceeds used to redeem short-term debt. There are no assurances that this transaction will occur in 2009. If we are unable to complete this transaction in 2009 or secure additional long-term financing, we could reach our maximum limits on our short-term borrowing facilities.

***Capital Structure***

Our capital structure was as follows:

| | At December 31, 2008 | At December 31, 2007 | At December 31, 2006 |
|---|---|---|---|
| Common stockholder equity and preferred stock without mandatory redemption rights | 44% | 48% | 40% |
| Long-term debt and redeemable preferred stock at redemption value | 49% | 49% | 50% |
| Short-term debt and current portion of long-term debt | 7% | 3% | 10% |
| | 100% | 100% | 100% |

The changes to our capital resource mix during 2008, 2007 and 2006 were accomplished through the various financing activities noted above in "Cash from Financing Activities". The capital structure at December 31, 2008 more closely reflects our expected future capital structure.

As a condition to some PUC approvals of the RWE Divestiture, we agreed to maintain a capital structure with a minimum of 45% common equity at the time of the consummation of our initial public offering on April 28, 2008. As a result of the impairment charges recorded for the three months ended March 31, 2008, our capital structure did not meet this minimum requirement and we received a cash equity contribution from RWE of $245.0 million on May 1, 2008. This cash was used to repay $243.4 million of short-term debt. Contributions from RWE were $1,067.1 million for the year ended December 31, 2007. RWE is not obligated to make any additional capital contributions.

***Debt Covenants***

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in our ability to pay dividends, issue debt or access our revolving credit lines. We were in compliance with our covenants as of December 31, 2008. See "Risk Factors—Risks Related to Our Industry and Business—Our failure to comply with restrictive covenants under our credit facilities could trigger repayment obligations." Long-term debt indentures contain a number of covenants that, among other things, limit, subject to certain exceptions, the Company from issuing debt secured by the Company's assets. Certain long term notes required the company to maintain a ratio of consolidated total indebtedness to consolidated total capitalization of not more than 0.70 to 1.00. In addition, the Company has $1,104.9 million of notes which include the right to redeem the notes in whole or in part from time to time subject to certain restrictions.

***Security Ratings***

Our access to the capital markets, including the commercial paper market, and their respective financing costs in those markets depend on the securities ratings of the entity that is accessing the capital markets. We primarily access the capital markets, including the commercial paper market, through AWCC. However, we do issue debt at our regulated subsidiaries, primarily in the form of tax exempt securities, to lower our overall cost of debt. The following table shows the Company's securities ratings as of December 31, 2008:

| Securities | Moody's Investors Service | Standard & Poor's Ratings Service |
|---|---|---|
| Senior unsecured debt | Baa2 | BBB+ |
| Commercial paper | P2 | A2 |

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On June 19, 2008, Standard & Poor's Ratings Services, which we refer to as S&P, downgraded the senior unsecured issuer rating of AWCC to "BBB+" (stable outlook) from "A-" (negative outlook). In addition, S&P assigned a "BBB+" corporate credit rating to American Water and affirmed AWCC's "A-2" short-term rating. On November 14, 2008, S&P affirmed its "BBB+" corporate credit rating on AWCC and American Water. On January 16, 2009, S&P assigned its "BBB+" unsecured debt rating to AWCC $75.0 million senior unsecured monthly notes due December 1, 2038.

On August 28, 2007, Moody's Investors Service, which we refer to as Moody's, placed both the long-term and short-term ratings of AWCC on review for possible downgrade. On October 12, 2007, Moody's downgraded the senior unsecured issuer rating of AWCC to "Baa2" from "Baa1." In addition, Moody's assigned a "Baa2" senior unsecured issuer rating to American Water and affirmed AWCC's "P-2" short-term rating. The rating outlook for both American Water and AWCC is stable.

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows from financing and operating activities in an amount sufficient to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flow is sufficient to maintain our existing ratings.

None of our borrowings are subject to default or prepayment as a result of the downgrading of these security ratings, although such a downgrading could increase fees and interest charges under our credit facilities.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance. Depending on its net position with a counterparty, the demand could be for the posting of collateral. In the absence of expressly agreed provisions that specify the collateral that must be provided, the obligation to supply the collateral requested will be a function of the facts and circumstances of the Company's situation at the time of the demand. If we can reasonably claim that we are willing and financially able to perform our obligations, it may be possible to successfully argue that no collateral should be posted or that only an amount equal to two or three months of future payments should be sufficient. We do not expect to post any collateral which will have a material adverse impact on the Company's results of operation, financial position or cash flows.

*Recent Market Conditions*

The Company believes it has sufficient liquidity despite the current disruption of the capital and credit markets. The Company funds liquidity needs for capital investment, working capital and other financial commitments through cash flows from operations, public and private debt offerings, commercial paper markets and credit facilities with $850.0 million in aggregate total commitment from a diversified group of banks and we had $281.8 million available as of February 23, 2009. The Company closely monitors the financial condition of the financial institutions associated with its credit facilities.

The Company's retirement trust assets are exposed to the market prices of debt and equity securities. Changes to the retirement trust asset value can impact the Company's pension and other benefits expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover pension and other benefit costs through rates. In addition, pension and other benefits liabilities decrease as fixed income asset values decrease (fixed income yields rise) since the rate at which we discount pension and other retirement trust asset future obligations is highly correlated to fixed income yields. During 2008 the market value of our pension

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and postretirement benefit trust assets declined by $171.9 million. The Company performed an asset/liability study on its pension and postretirement benefit trust assets, and changed the asset allocation from 60% equities and 40% fixed income to 70% equities and 30% fixed income. This new investment allocation was implemented in December 2008. Additionally a reduction in fixed income yields (rate used to discount obligations) at the end of 2008 caused an increase to pension and postretirement benefit liabilities. The reduction of asset values combined with an increase in pension and postretirement benefit liabilities will constitute an increase to pension and postretirement benefit costs (net of capitalized amounts) of approximately $32.0 million during 2009 compared to 2008.

The Company also assessed the impact of the severe liquidity crises at major financial institutions on the Company's ability to access capital markets on reasonable terms. On September 15, 2008, the Company was unable to access short-term liquidity through its A-2/P-2 rated commercial paper program. The Company therefore utilized its credit facilities to repay maturing commercial paper and fund its short-term liquidity needs. Although the Company's credit facility syndicate banks are currently meeting all of their lending obligations, there can be no assurance that these banks will be able to meet their obligations in the future if the liquidity crises intensify or are protracted.

As of December 31, 2008, the Company had issued, through its subsidiaries, $120.3 million of variable rate demand bonds, which are periodically remarketed. We can provide no assurances that the bonds will be remarketed successfully or at reasonable interest rates. Bonds totaling $24.9 million are issued by Illinois American Water, bonds totaling $8.6 million are issued by Arizona American Water and the remaining $86.9 million of bonds are issued by AWCC. During the months of January and February 2009, AWCC purchased its variable rate demand bonds because no buyer was willing to purchase the bonds at market rates. Although buyers periodically purchased the bonds from AWCC at market rates during January and February 2009, AWCC holds all $120.3 million in treasury at February 23, 2009. Since the debt has been remarketed for periods no longer than one week and the Company cannot be certain remarketing will be successful, the debt is included in current portion of long-term debt at December 31, 2008.

At this time the Company does not believe recent market disruptions will impact its long-term ability to obtain financing. The Company expects to have access to liquidity in the capital markets on favorable terms before the maturity dates of its current credit facilities and the Company does not expect a significant number of its lenders to default on their commitments thereunder. In addition, the Company can delay major capital investments or pursue financing from other sources to preserve liquidity, if necessary. The Company believes it can rely upon cash flows from operations to meet its obligations and fund its minimum required capital investments for an extended period of time.

*Regulatory Restrictions*

The issuance by the Company or AWCC of long-term debt or equity securities does not require authorization of any state PUC if no guarantee or pledge of the regulated subsidiaries is utilized. However, state PUC authorization is required to issue long-term debt or equity securities at most regulated subsidiaries. Our regulated subsidiaries normally obtain the required approvals on a periodic basis to cover their anticipated financing needs for a period of time or in connection with a specific financing.

Under applicable law, our subsidiaries can pay dividends only from retained, undistributed or current earnings. A significant loss recorded at a subsidiary may limit the dividends that these companies can distribute to us.

*Insurance Coverage*

We carry various property, casualty and financial insurance policies with limits, deductibles and exclusions consistent with industry standards. However, insurance coverage may not be adequate or available to cover

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unanticipated losses or claims. We are self-insured to the extent that losses are within the policy deductible or exceed the amount of insurance maintained. Such losses could have a material adverse effect on our short-term and long-term financial condition and the results of operations and cash flows.

*Contractual Obligations and Commitments*

We enter into obligations with third parties in the ordinary course of business. These financial obligations, as of December 31, 2008, are set forth in the table below:

| Contractual obligation | Total | Less Than 1 Year | 1-3 Years ($ in thousands) | 3-5 Years | More Than 5 Years |
|---|---|---|---|---|---|
| Long-term debt obligations(a) | $ 4,733,980 | $ 175,433 | $ 78,940 | $ 140,846 | $ 4,338,761 |
| Interest on long-term debt(b) | 4,894,864 | 287,323 | 563,954 | 557,060 | 3,486,527 |
| Capital lease obligations(c) | 1,829 | 171 | 408 | 359 | 891 |
| Interest on capital lease obligations(d) | 1,761 | 191 | 328 | 254 | 988 |
| Operating lease obligations(e) | 235,013 | 32,342 | 50,787 | 28,980 | 122,904 |
| Purchase water obligations(f) | 761,823 | 44,938 | 92,583 | 90,667 | 533,635 |
| Other purchase obligations(g) | 92,305 | 92,305 | — | — | — |
| Postretirement benefit plans' obligations(h) | 195,036 | 41,636 | 80,700 | 72,700 | — |
| Pension ERISA minimum funding requirement(h) | 473,100 | 84,200 | 176,500 | 212,400 | — |
| Preferred stocks with mandatory redemption requirements | 24,425 | 218 | 636 | 3,456 | 20,115 |
| Interest on preferred stocks with mandatory redemption requirements | 28,008 | 2,036 | 4,039 | 3,841 | 18,092 |
| Other obligations(i) | 941,005 | 246,620 | 135,021 | 71,928 | 487,436 |
| Total | $ 12,383,149 | $ 1,007,413 | $ 1,183,896 | $ 1,182,491 | $ 9,009,349 |

Note: The above table reflects only financial obligations and commitments. Therefore, performance obligations associated with our Non-Regulated Businesses are not included in the above amounts.

(a) Represents sinking fund obligations and debt maturities.
(b) Represents expected interest payments on outstanding long-term debt. Amounts reported may differ from actual due to future refinancing of debt.
(c) Represents future minimum payments under noncancelable capital leases.
(d) Represents expected interest payments on noncancelable capital leases.
(e) Represents future minimum payments under noncancelable operating leases, primarily for the lease of motor vehicles, buildings, land and other equipment.
(f) Represents future payments under water purchase agreements for minimum quantities of water.
(g) Represents the open purchase orders as of December 31, 2008, for goods and services purchased in the ordinary course of business.
(h) Represents contributions expected to be made to pension and postretirement benefit plans for the years 2009 through 2013.
(i) Represents capital expenditures estimated to be required under legal and binding contractual obligations, liability associated with a conservation agreement and an estimate of advances for construction to be refunded.

*Public-Private Partnerships*

From 1997 through 2002, WVAWC, entered into a series of agreements with various public entities, which we refer to as the Partners, to establish certain joint ventures, commonly referred to as "public-private partnerships." Under the public-private partnerships, the WVAWC constructed utility plant, financed by the WVAWC, and the Partners constructed utility plant (connected to the WVAWC's property), financed by the

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Partners. WVAWC agreed to transfer and convey some of its real and personal property to the Partners in exchange for an equal principal amount of Industrial Development Bonds ("IDBs"), issued by the Partners under a state Industrial Development Bond and Commercial Development Act. WVAWC leased back the total facilities, including portions funded by both WVAWC and the Partners, under leases for a period of 40 years.

WVAWC leased back the transferred facilities under capital leases for a period of 40 years. The leases have payments that approximate the payments required by the terms of the IDBs. In accordance with Financial Accounting Standards Board Interpretation Number 39, *Offsetting of Amounts Related to Certain Contracts,* we have presented the transaction on a net basis in the consolidated financial statements. The carrying value of the transferred facilities was approximately $161.0 million at December 31, 2008.

*Non-Regulated Businesses Performance Obligations*

Our Non-Regulated Businesses Contract Operations Group enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. These military services agreements expire between 2053 and 2059 and have remaining performance of $1,185.0 million at December 31, 2008. The Operations and Maintenance agreements with municipalities and other customers expire between 2009 and 2038 and have remaining performance commitments as measured by estimated remaining contract revenue of $1,103.8 million and $1,178.8 million at December 31, 2008 and 2007, respectively. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain major maintenance for some of the facilities, in exchange for an annual fee.

Included in the military services performance commitment at December 31, 2008 are Contracts Operations Group was awarded during September 2008 for operation and maintenance of the water and wastewater systems at Army installations at Fort Hood, Texas and Fort Polk, Louisiana. According to the agreements, the awards of the contracts are estimated at approximately $329.0 million and $348.0 million, respectively, over a 50-year period as measured by gross contract revenue subject to price redeterminations and customary federal contracting termination provisions. Federal contract price redetermination is a mechanism to periodically adjust the service fee in subsequent periods to reflect changes in contract obligations and market conditions.

**Critical Accounting Policies and Estimates**

The application of critical accounting policies is particularly important to our financial condition and results of operations and provides a framework for management to make significant estimates, assumptions and other judgments. Although our management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on our financial condition and results of operations as reflected in our consolidated financial statements.

Our financial condition, results of operations and cash flow are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. Management believes that the areas described below require significant judgment in the application of accounting policy or in making estimates and assumptions in matters that are inherently uncertain and that may change in subsequent periods. Our management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with our audit committee. In addition, our management has also reviewed the following disclosures regarding the application of these critical accounting policies with the audit committee.

*Regulatory Accounting*

Our regulated utility subsidiaries are subject to regulation by state PUCs and the local governments of the states in which they operate. As such, we account for these regulated operations in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," which we refer to as SFAS No. 71, which requires us to reflect the effects of rate regulation in our financial statements. Use of SFAS No. 71 is applicable

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to utility operations that meet the following criteria: (1) third-party regulation of rates; (2) cost-based rates; and (3) a reasonable assumption that all costs will be recoverable from customers through rates. As of December 31, 2008, we had concluded that the operations of our regulated subsidiaries meet the criteria. If it is concluded in a future period that a separable portion of the businesses no longer meets the criteria, we are required to eliminate the financial statement effects of regulation for that part of the business, which would include the elimination of any or all regulatory assets and liabilities that had been recorded in the consolidated financial statements. Failure to meet the criteria of SFAS No. 71 could materially impact our consolidated financial statements as a one-time extraordinary item and through impacts on continuing operations.

Regulatory assets represent costs that have been deferred to future periods when it is probable that the regulator will allow for recovery through rates charged to customers. Regulatory liabilities represent revenues received from customers to fund expected costs that have not yet been incurred. As of December 31, 2008, we have recorded $919.7 million of net regulatory assets within our consolidated financial statements. Also, at December 31, 2008, we had recorded $307.3 million of regulatory liabilities within our consolidated financial statements. See Note 7 of the Notes to Consolidated Financial Statements for further information regarding the significant regulatory assets.

For each regulatory jurisdiction where we conduct business, we continually assess whether the regulatory assets and liabilities continue to meet the criteria for probable future recovery or settlement. This assessment includes consideration of factors such as changes in applicable regulatory environments, recent rate orders to other regulated entities in the same jurisdiction, the status of any pending or potential deregulation legislation and the ability to recover costs through regulated rates.

*Goodwill*

The Company's annual impairment reviews are performed as of November 30 of each year, in conjunction with the timing of the completion of the Company's annual strategic business plan. At December 31, 2008, the Company's goodwill was $1,699.5 million. The Company also undertakes interim reviews when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

The Company uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any) in accordance with SFAS No. 142. The step 1 calculation used to identify potential impairment compares the calculated fair value for each of the Company's reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit's carrying value, then step 2 is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of the fair value of each reporting unit above the fair value of such reporting unit's identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss is recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

The determination of the fair value of each reporting unit and the fair value of each reporting unit's assets and liabilities is performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date).

For the November 30, 2008 impairment test, the estimated fair value of the regulated reporting unit for step 1 was based on a combination of the following valuation techniques:

- observable trading prices of comparable equity securities of publicly-traded water utilities considered by us to be the Company's peers; and
- discounted cash flow models developed from the Company's internal forecasts.

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The estimated fair values of the non-regulated reporting units were determined entirely on the basis of discounted cash flow models.

The first valuation technique applies average peer multiples to the Regulated reporting unit's historic and forecasted cash flows. The peer multiples are calculated using the average trading prices of comparable equity securities of publicly-traded water utilities, their published cash flows and forecasts of market price and cash flows for those peers.

The second valuation technique forecasts each reporting unit's five-year cash flows using an estimated long-term growth rate and discounts these cash flows at their respective estimated weighted average cost of capital.

If step 2 of the impairment test is required, the Company determines the fair value of the applicable reporting unit's assets and liabilities. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. For the step 2 calculations of the fair value of debt, the Company uses observable prices of instruments and indices that have risks similar to those instruments being valued, adjusted to compensate for differences in credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit's debt.

The Company has completed its November 30, 2008 annual impairment review and does not believe that the Company's goodwill balance was impaired. However, there can be no assurances that the Company will not be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the Company's performance. These market events could include a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company's market price consistent with its peer companies, or decreases in control premiums and the overhang effect. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect the Company's reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to maintain its credit ratings, secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

In making the determination, we considered both qualitative and quantitative factors, including the effect of the recent volatility in the equity and debt markets on the Company's market capitalization. As such, the Company believes that the current valuation technique is more appropriate than solely relying on the current trading market value of the Company's common stock.

In reaching our conclusion, we also made certain assumptions, which we believe to be appropriate, that support the fair value of our reporting units. We considered, in addition to the listed trading price of the Company's shares, the effect on that price due to RWE's majority ownership, the effect of RWE's expected disposition of its owned Company shares on the market for those shares, the applicability of a control premium to our shares and certain other factors we deemed appropriate. As a result, we concluded that the Company's fair value exceeds what we might otherwise have concluded had we relied on market price alone.

In addition, given recent market conditions, management determined that it was appropriate for the Company to consider the average of the Company's closing market price over a thirty day period rather than using a particular date to calculate its market capitalization. The Company's calculated market capitalization within its 2008 impairment test period was approximately $940.0 million below the aggregate carrying value of its reporting units.

The difference between our calculated market capitalization and the aggregate fair value of our reporting units (which approximates book value) resulted from the estimated control premium and the estimated impact to the Company's market capitalization from the overhang created by RWE's announced plans to divest a substantial portion of its ownership through further public offerings of stock.

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The estimated control premium represents the incremental premium a buyer is willing to pay to acquire a controlling, majority interest in the Company. In estimating the control premium, management principally considered the current market conditions and historical premiums paid in utility acquisitions observed in the marketplace.

The estimated stock overhang represents the impact on the Company's share price that we believe results from investor concerns over market price dilution due to the anticipated increase in the number of the Company's publicly traded shares caused by the anticipated RWE sale of the Company's stock. As a condition of certain state regulator approvals for RWE's sale of the Company, RWE had agreed to sell 100% of its holdings of Company stock by April 2010 and previously announced its intentions to reduce its interest to below 50% prior to the end of 2008. Management estimated the impact of this overhang condition using reports from multiple analysts covering the Company's stock and other available market information.

The determination of our estimated fair value required the exercise of judgment and is highly sensitive to our assumptions. Our estimated fair values approximate the carrying value of reporting units leaving little estimated value in excess of the required threshold of the step 1 test. Had the fair value been less than the carrying value of the reporting units, differences between the carrying value and fair value of our long-term debt (which is not taken into account in step 1 but is required in step 2) would have increased any impairment charge indicated by step 1 by an estimated $300 million, due to accounting guidance that must be followed to measure the implied fair value of goodwill.

For the years ended December 31, 2008, 2007 and 2006, the Company recorded impairment charges for goodwill, including discontinued operations, in the amount of $750.0 million, $509.3 million and $227.8 million, respectively.

As of March 31, 2008, in light of the initial public offering price and trading levels in our common stock subsequent to the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, management concluded that the carrying value of the Company's goodwill was impaired. The Company believed that the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors recorded an impairment charge to the goodwill of its Regulated reporting unit in the amount of $750.0 million as of March 31, 2008. The impairment charge was primarily attributed to the market price of the Company's common stock (both the initial public offering price and the price during subsequent trading) being less than the estimate of the initial public offering price used during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH (a wholly-owned subsidiary of RWE) transferred $245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

During the third quarter of 2007, as a result of the Company's debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its Regulated reporting unit in the amount of $243.3 million as of September 30, 2007. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined that an impairment had occurred based upon information regarding the Company's market value in connection with the initial public offering. Management determined that the indicative fair value of the Company based on estimates of the initial public offering price range was the best evidence of the Company's market value and incorporated this indicated market value into the Company's valuation methodology, which also considered other items, such as peer multiples, discounted cash flows and a control premium. Based on the results of the impairment test, an impairment of $266.0 million to the Company's carrying value was recognized as of December 31, 2007.

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The 2006 impairment charge of $227.8 million was attributable to higher interest rates in the Regulated reporting unit and a change in the potential net realizable value of a non-regulated reporting unit.

*Impairment of Long-Lived Assets*

Long-lived assets, other than goodwill which is discussed above, include land, buildings, equipment and long-term investments. Long-lived assets, other than investments and land are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market price of a long-lived asset, a significant adverse change in the manner in which the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, we estimate the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets, and compare that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value. The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. A variation in the assumptions used could lead to a different conclusion regarding the realizability of an asset and, thus, could have a significant effect on the consolidated financial statements.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which we invest, as well as volatility inherent in the external markets. In assessing potential impairment for these investments, we consider these factors. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value. As a result of fair value analyses, we recorded pre-tax charge of $0 for the years ended December 31, 2008 and 2007, respectively, and $0.8 million for the year ended December 31, 2006.

*Revenue Recognition*

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are delivered to customers and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period. Unbilled revenues as of December 31, 2008 and 2007 were $134.2 million and $134.3 million, respectively. Increases in volumes delivered to the utilities' customers and favorable rate mix due to changes in usage patterns in customer classes in the period could be significant to the calculation of unbilled revenue. Changes in the timing of meter reading schedules and the number and type of customers scheduled for each meter reading date would also have an effect on the estimated unbilled revenue; however, since the majority of our customers are billed on a monthly basis, total operating revenues would remain materially unchanged.

Revenue from non-regulated operations is recognized as services are rendered. Revenues from certain construction projects are recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities on the

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balance sheet until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

*Accounting for Income Taxes*

The parent company and its subsidiaries participate in a consolidated federal income tax return for United States tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

*Accounting for Pension and Postretirement Benefits*

We maintain noncontributory defined benefit pension plans covering eligible employees of our regulated utility and shared service operations. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 will be provided with a 5.25% of base pay defined contribution plan. We also maintain postretirement benefit plans for eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002. We follow the guidance of SFAS 87, "Employers' Accounting for Pensions," and SFAS 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," when accounting for these benefits. In addition, we adopted the recognition and disclosure requirements of SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," effective December 31, 2006. See Note 15 of the Notes to Consolidated Financial Statements for further information regarding the accounting for the defined benefit pension plans and postretirement benefit plans.

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes. The primary assumptions are:

- Discount Rate—The discount rate is used in calculating the present value of benefits, which are based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due;
- Expected Return on Plan Assets—Management projects the future return on plan assets considering prior performance, but primarily based upon the plans' mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs we record currently;
- Rate of Compensation Increase—Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement; and
- Health Care Cost Trend Rate—Management projects the expected increases in the cost of health care.

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In selecting a discount rate for our pension and postretirement benefit plans, a yield curve was developed for a portfolio containing the majority of United States-issued Aa-graded non-callable (or callable with make-whole provisions) corporate bonds. For each plan, the discount rate was developed as the level equivalent rate that would yield the same present value as using spot rates aligned with the projected benefit payments. The discount rate for determining pension benefit obligations was 6.12% and 6.27% at December 31, 2008 and 2007 respectively. The discount rate for determining other post-retirement benefit obligations was 6.09% and 6.20% at December 31, 2008 and 2007 respectively. The discount rate for determining both the pension obligations and other postretirement benefit obligations was 5.90% at December 31, 2006.

The asset allocation for the Company's U.S. pension plan at December 31, 2008 and 2007 by asset category, are as follows:

| Asset category | Target Allocation 2008 | Percentage of Plan Assets At December 31, 2008 | 2007 |
|---|---|---|---|
| Equity securities | 70% | 70% | 60% |
| Fixed income | 30% | 30% | 40% |
| Total | 100% | 100% | 100% |

The investment policy guidelines of the pension plan require that the fixed income portfolio has an overall weighted average credit rating of AA or better by Standard & Poor's and the minimum credit quality for fixed income securities must be BBB- or better. Up to 20% of the portfolio may be invested in collateralized mortgage obligations backed by the United States Government.

The Company's other postretirement benefit plans are partially funded. The asset allocation for the Company's other postretirement benefit plans at December 31, 2008 and 2007, by asset category, are as follows:

| Asset category | Target Allocation 2008 | Percentage of Plan Assets At December 31, 2008 | 2007 |
|---|---|---|---|
| Equity securities | 70% | 70% | 61% |
| Fixed income | 30% | 30% | 39% |
| Total | 100% | 100% | 100% |

The Company's investment policy, and related target asset allocation, is evaluated periodically through asset liability studies. The studies consider projected cash flows of maturity liabilities, projected asset class return risk, and correlation and risk tolerance.

The pension and postretirement welfare plan trusts investments include debt and equity securities held directly and through commingled funds. The trustee for the Company's defined benefit pension and post retirement welfare plans uses independent valuation firms to calculate the fair value of plan assets. Additionally, the company independently verifies the assets values. Approximately 87.2% of the assets are valued using the quoted market price for the assets in an active market at the measurement date. The remaining 12.8% of the assets are valued using other observable inputs.

In selecting an expected return on plan assets, we considered tax implications, past performance and economic forecasts for the types of investments held by the plans. The long-term expected rate of return on plan assets, which we refer to as EROA, assumption used in calculating pension cost was 7.90% for 2008, 8.00% for 2007, and 8.25% for 2006. The weighted average EROA assumption used in calculating other postretirement benefit costs was 7.75% for 2008, 7.38% for 2007, and 7.95% for 2006.

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In selecting a rate of compensation increase, we consider past experience in light of movements in inflation rates. Our rate of compensation increase was 4.00% for 2008, and 4.25% for 2007 and 2006.

In selecting health care cost trend rates, we consider past performance and forecasts of increases in health care costs. Our health care cost trend rate used to calculate the periodic cost was 8.00% in 2008 gradually declining to 5% in 2014 and thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

| Change in Actuarial Assumption | Impact on Other Postretirement Benefit Obligation at December 31, 2008 | Impact on 2008 Total Service and Interest Cost Components |
|---|---|---|
| | ($ in thousands) | |
| Increase assumed health care cost trend by 1% | $ 59,525 | $ 6,226 |
| Decrease assumed health care cost trend by 1% | $ (49,853) | $ (5,100) |

We will use a discount rate and EROA of 6.12% and 7.90%, respectively, for estimating our 2009 pension costs. Additionally, we will use a discount rate and expected return on plan assets of 6.09% and 7.60%, respectively, for estimating our 2009 other postretirement benefit costs. A decrease in the discount rate or the EROA would increases our pension expense. Our 2008 and 2007 pension and postretirement costs were $51.4 million and $44.9 million, respectively. Based on current plan assets and expected future asset returns, the Company currently estimates the increase to pension and postretirement expense (net of capitalized amounts) in 2009 to be approximately $32 million, pretax. It is the Company's intent to work with PUCs in the states in which it operates to minimize the impact of such increases on its results of operations. The Company currently expects to make pension and postretirement benefit contributions to the plan trusts of $125.2 million, $132.5 million, $124.7 million, $161.9 million and $123.2 million in 2009, 2010, 2011, 2012 and 2013 respectively. Actual amounts contributed could change significantly from these estimates.

The assumptions are reviewed annually and at any interim remeasurement of the plan obligations. The impact of assumption changes is reflected in the recorded pension and postretirement benefit amounts as they occur, or over a period of time if allowed under applicable accounting standards. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. As these assumptions change from period to period, recorded pension and postretirement benefit amounts and funding requirements could also change.

**Recent Accounting Pronouncements**

In January 2009, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP"). Emerging Issues Task Force ("EITF") No. 99-20-1, "Amendments to the Impairment Guidance of EITF Issue No. 99-20" ("FSP EITF 99-20-1"). This pronouncement amends EITF 99-20. "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets." (EITF 99-20), to achieve more consistent determination of whether an other-than-temporary impairment has occurred. FSP EITF 99-21-1 also retains and emphasizes the objective of an other than-temporary impairment assessment and the related disclosure requirements in SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities," and other related guidance. FSP EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008, and is required to be applied prospectively. The adoption of FSP EITF 99-20-1 did not have an impact on the Company's results of operations, financial position or cash flows.

In December 2008, the FASB issued FAS No. 132(R)-1, "Employers" Disclosures about Postretirement Benefit Plan Assets" ("FSP FAS 132(R)-1"), which requires additional disclosures for employers' pension and other postretirement benefit plan assets. As pension and other postretirement benefit plan assets were not included within the scope of SFAS No. 157, FSP FAS 132(R)-1 requires employers to disclose information about fair value measurements of plan assets similar to the disclosures required under SFAS No. 157, the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan

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assets. FSP FAS 132(R)-1 will be effective for the Registrants as of December 31, 2009. As FSP FAS 132(R)-1 provides only disclosure requirements, the adoption of this standard will not have an impact on the Company's results of operations, financial position or cash flows.

On October 10, 2008, FASB issued FASB Staff Position No. 157-3, "Determining the Fair Value of a Financial Asset When a Market for That Asset Is Not Active" ("FSP 157-3"), which clarifies the application of Statement of Financial accounting Standards No. 157, "Fair Value Measurements" (SFAS 157") in an inactive market and provides an example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods of which financial statements had not been issued. The adoption of this standard as of September 30, 2008 did not have an impact on the Company's results of operations, financial position or cash flows.

In February 2008, the FASB issued FASB Staff Position SFAS 157-2 which allows a one-year deferral of the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment and goodwill) that are required to be measured at fair value on a periodic basis (such as at acquisition or impairment). The Company elected to use this deferral option and accordingly, only partially adopted SFAS 157 on January 1, 2008. SFAS 157 will be adopted for the Company's nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements," which we refer to as SFAS 157. SFAS 157 establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. On January 1, 2008, the Company adopted the provisions of SFAS 157 for financial assets and liabilities, and nonfinancial assets and liabilities with recurring measurements. The Company's assets and liabilities measured at fair value on a recurring basis during the period were cash and cash equivalents, restricted funds and short-term debt. These assets and liabilities were measured at fair value on the balance sheet date using quoted prices in active markets (level 1 inputs, as defined by SFAS 157). The adoption of SFAS 157 for the Company's financial assets and liabilities did not have a material effect on the Company's results of operations, financial position or cash flows. The Company measured the assets of its defined benefit pension and other postretirement welfare plans pursuant to SFAS 157 as of December 31, 2008. The Company does not believe the adoption of SFAS 157 for the Company's nonfinancial assets and liabilities will have an impact on its results of operations, financial position or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standard No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an Amendment of ARB No. 51," which we refer to as SFAS 160. SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will be effective for us on January 1, 2009. We do not believe this standard will have an impact on our results of operations, financial position and cash flows.

Also in December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), "Business Combinations," which we refer to as SFAS 141(R). SFAS 141(R), which will significantly change the accounting for business combinations, is effective for business combinations finalized on or after January 1, 2009. As the provisions of SFAS 141(R) are applied prospectively to business combinations for which the acquisition date occurs after the guidance becomes effective, the impact to the Company cannot be determined until the transactions occur. In December 2008, the Company expensed transaction costs of approximately $0.9 million for acquisitions that will not close until after January 1, 2009 and will not be capitalized as goodwill under the provisions of SFAS 141(R).

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—including an amendment of FASB Statement No. 115," (" SFAS 159"). This standard permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without

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having to apply complex hedge accounting provisions. SFAS 159 is effective for years beginning January 1, 2008. The Company has not elected to exercise the fair value irrevocable option. Therefore, the adoption of SFAS 159 did not have an impact on the Company's results of operations, financial position or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106 and 132(R)," which we refer to as SFAS 158. This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, actuarial gains and losses, prior service costs or credits, and transition obligations and assets that have not been recognized in net periodic benefit cost under previous accounting standards will be recognized as a regulatory asset for the portion of the underfunded liability that meets the recovery criteria prescribed in SFAS 71 and as accumulated other comprehensive income, net of tax effects, for that portion of the underfunded liability that does not meet SFAS 71 regulatory accounting criteria. We adopted the recognition and disclosure requirements of the statement on December 31, 2006.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements," which we refer to as SAB 108. SAB 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 was effective for the fiscal year ended December 31, 2006.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," which we refer to as FIN 48, an Interpretation of SFAS No. 109, "Accounting for Income Taxes." FIN 48 is intended to address inconsistencies among entities with the measurement and recognition in accounting for income tax deductions for financial statement purposes. Specifically, FIN 48 addresses the timing of the recognition of income tax benefits. FIN 48 requires the financial statement recognition of an income tax benefit when we determine that it is more-likely-than-not that the tax position will be sustained. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted it as required on January 1, 2007, and it did not have a significant effect on our results of operations or financial position.

During 2006, the Emerging Issues Task Force of the Financial Accounting Standards Board ratified EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, Gross versus Net Presentation)," which we refer to as EITF 06-3. The Task Force reached a consensus that the scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and that the presentation of such taxes is an accounting policy that should be disclosed. Our accounting policy is to present these taxes on a net basis (excluded from revenues).

See Note 2—Significant Accounting Policies in the notes to the audited consolidated financial statements for a discussion of new accounting standards recently adopted or pending adoption.

## ITEM 7A. QUANTITIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk associated with changes in commodity prices, equity prices and interest rates. We use a combination of fixed-rate and variable-rate debt to reduce interest rate exposure. As of December 31, 2008, a hypothetical 10% increase in interest rates associated with variable-rate debt would result in a $0.2 million decrease in our pre-tax earnings. Our risks associated with price increases for chemicals, electricity and other commodities are reduced through long-term contracts and the ability to recover price increases through rates. Non-performance by these commodity suppliers could have a material adverse impact on our results of operations, cash flows and financial position.

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Our common stock began trading on the New York Stock Exchange on April 23, 2008. The market price of our common stock may experience fluctuations, many of which are unrelated to our operating performance. In particular, our stock price may be affected by general market movements as well as developments specifically related to the water and wastewater industry. These could include, among other things, interest rate movements, quarterly variations or changes in financial estimates by securities analysts and governmental or regulatory actions. This volatility may make it difficult for us to access the capital markets in the future through additional offerings of our common stock, regardless of our financial performance, and such difficulty may preclude us from being able to take advantage of certain business opportunities or meet business obligations.

We are exposed to credit risk through our water, wastewater and other water-related activities for both our Regulated and Non-Regulated Businesses. Our Regulated Businesses serve residential, commercial, industrial and municipal customers while our Non-Regulated Businesses engage in business activities with developers, government entities and other customers. Our primary credit risk is exposure to customer default on contractual obligations and the associated loss that may be incurred due to the non-payment of customer account receivable balances. Our credit risk is managed through established credit and collection policies which are in compliance with applicable regulatory requirements and involve monitoring of customer exposure and the use of credit risk mitigation measures such as letters of credit or prepayment arrangements. Our credit portfolio is diversified with no significant customer or industry concentrations. In addition, our Regulated Businesses are generally able to recover all prudently incurred costs including uncollectible customer accounts receivable expenses and collection costs through rates.

We are also exposed to a potential national economic recession or further deterioration in local economic conditions in the markets in which we operate. The credit quality of our customer accounts receivable is dependent on the economy and the ability of our customers to manage through unfavorable economic cycles and other market changes. In addition, as a result of the downturn in the economy and heightened sensitivity of the impact of additional rate increases on certain customers, there can be no assurances that regulators will grant sufficient rate authorizations. Therefore our ability to fully recover operating expense, recover our investment and provide an appropriate return on invested capital made in our Regulated Businesses may be adversely impacted.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of
American Water Works Company, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in common stockholders' equity, of comprehensive income (loss) and of cash flows present fairly, in all material respects, the financial position of American Water Works Company, Inc. and Subsidiary Companies at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania

February 27, 2009

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## American Water Works Company, Inc. and Subsidiary Companies
## Consolidated Balance Sheets
(In thousands, except per share data)

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **ASSETS** | | |
| Property, plant and equipment | | |
| Utility plant—at original cost, net of accumulated depreciation of $2,969,869 in 2008 and $2,776,950 in 2007 | $ 9,991,783 | $ 9,199,909 |
| Nonutility property, net of accumulated depreciation of $101,287 in 2008 and $76,839 in 2007 | 132,145 | 118,052 |
| Total property, plant and equipment | 10,123,928 | 9,317,961 |
| Current assets | | |
| Cash and cash equivalents | 9,542 | 13,481 |
| Restricted funds | 454 | 3,258 |
| Utility customer accounts receivable | 149,198 | 147,640 |
| Allowance for uncollectible accounts | (18,644) | (20,923) |
| Unbilled utility revenues | 134,204 | 134,326 |
| Non-regulated trade and other receivables, net | 68,877 | 66,540 |
| Federal income taxes receivable | — | 23,111 |
| Materials and supplies | 28,948 | 27,458 |
| Other | 45,096 | 35,463 |
| Total current assets | 417,675 | 430,354 |
| Regulatory and other long-term assets | | |
| Regulatory assets | 919,654 | 660,992 |
| Restricted funds | 10,599 | 10,252 |
| Goodwill | 1,699,517 | 2,456,952 |
| Other | 60,445 | 74,816 |
| Total regulatory and other long-term assets | 2,690,215 | 3,203,012 |
| **TOTAL ASSETS** | $13,231,818 | $12,951,327 |

The accompanying notes are an integral part of these consolidated financial statements.

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**American Water Works Company, Inc. and Subsidiary Companies**
**Consolidated Balance Sheets—(Continued)**
(In thousands, except per share data)

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **CAPITALIZATION AND LIABILITIES** | | |
| Capitalization | | |
| Common stock ($.01 par value, 500,000 shares authorized, 160,000 shares outstanding) | $ 1,600 | $ 1,600 |
| Paid-in capital | 5,888,253 | 5,637,947 |
| Accumulated deficit | (1,705,594) | (1,079,118) |
| Accumulated other comprehensive loss | (82,251) | (18,383) |
| Treasury stock | (7) | — |
| Common stockholders' equity | 4,102,001 | 4,542,046 |
| Preferred stock without mandatory redemption requirements | 4,557 | 4,568 |
| Long-term debt | | |
| Long-term debt | 4,624,063 | 4,674,837 |
| Redeemable preferred stock at redemption value | 24,150 | 24,296 |
| Total capitalization | 8,754,771 | 9,245,747 |
| Current liabilities | | |
| Short-term debt | 479,010 | 220,514 |
| Current portion of long-term debt | 175,822 | 96,455 |
| Accounts payable | 149,795 | 168,886 |
| Taxes accrued, including income taxes of $6,061 in 2008 and $8,086 in 2007 | 52,488 | 56,002 |
| Interest accrued | 53,629 | 50,867 |
| Other | 194,016 | 181,765 |
| Total current liabilities | 1,104,760 | 774,489 |
| Regulatory and other long-term liabilities | | |
| Advances for construction | 622,227 | 655,375 |
| Deferred income taxes | 705,587 | 638,918 |
| Deferred investment tax credits | 34,023 | 35,361 |
| Regulatory liabilities | 307,324 | 266,724 |
| Accrued pension expense | 502,062 | 290,722 |
| Accrued postretirement benefit expense | 241,193 | 158,552 |
| Other | 48,456 | 67,052 |
| Total regulatory and other long-term liabilities | 2,460,872 | 2,112,704 |
| Contributions in aid of construction | 911,415 | 818,387 |
| Commitments and contingencies | — | — |
| **TOTAL CAPITALIZATION AND LIABILITIES** | $13,231,818 | $12,951,327 |

The accompanying notes are an integral part of these consolidated financial statements.

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**American Water Works Company, Inc. and Subsidiary Companies**
**Consolidated Statements of Operations**
(In thousands, except per share data)

| | Years Ended December 31, 2008 | 2007 | 2006 |
|---|---|---|---|
| Operating revenues | $2,336,928 | $2,214,215 | $2,093,067 |
| Operating expenses | | | |
| Operation and maintenance | 1,303,798 | 1,246,479 | 1,174,544 |
| Depreciation and amortization | 271,261 | 267,335 | 259,181 |
| General taxes | 199,139 | 183,253 | 185,065 |
| (Gain) loss on sales of assets | (374) | (7,326) | 79 |
| Impairment charge | 750,000 | 509,345 | 221,685 |
| Total operating expenses, net | 2,523,824 | 2,199,086 | 1,840,554 |
| Operating income (loss) | (186,896) | 15,129 | 252,513 |
| Other income (deductions) | | | |
| Interest, net | (285,155) | (283,165) | (365,970) |
| Allowance for other funds used during construction | 14,497 | 7,759 | 5,980 |
| Allowance for borrowed funds used during construction | 8,171 | 3,449 | 2,652 |
| Amortization of debt expense | (5,895) | (4,867) | (5,062) |
| Preferred dividends of subsidiaries | (225) | (225) | (215) |
| Other, net | 4,909 | 6,401 | 1,164 |
| Total other income (deductions) | (263,698) | (270,648) | (361,451) |
| Loss from continuing operations before income taxes | (450,594) | (255,519) | (108,938) |
| Provision for income taxes | 111,827 | 86,756 | 46,912 |
| Loss from continuing operations | (562,421) | (342,275) | (155,850) |
| Loss from discontinued operations, net of tax | — | (551) | (6,393) |
| Net loss | $ (562,421) | $ (342,826) | $ (162,243) |
| Basic earnings per common share | | | |
| Loss from continuing operations | $ (3.52) | $ (2.14) | $ (0.97) |
| Loss from discontinued operations, net of tax | $ — | $ (0.00) | $ (0.04) |
| Net loss | $ (3.52) | $ (2.14) | $ (1.01) |
| Diluted earnings per common share | | | |
| Loss from continuing operations | $ (3.52) | $ (2.14) | $ (0.97) |
| Loss from discontinued operations, net of tax | $ — | $ (0.00) | $ (0.04) |
| Net loss | $ (3.52) | $ (2.14) | $ (1.01) |
| Average common shares outstanding during the period: | | | |
| Basic | 159,967 | 160,000 | 160,000 |
| Diluted | 159,967 | 160,000 | 160,000 |

The accompanying notes are an integral part of these consolidated financial statements.

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## American Water Works Company, Inc. and Subsidiary Companies
## Consolidated Statements of Cash Flows
(In thousands, except per share data)

| | Years Ended December 31, 2008 | 2007 | 2006 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Net loss | $ (562,421) | $ (342,826) | $ (162,243) |
| Adjustments | | | |
| Loss on sale of discontinued businesses | — | — | 1,001 |
| Depreciation and amortization | 271,261 | 267,335 | 259,181 |
| Impairment charge | 750,000 | 509,345 | 227,802 |
| Amortization of removal costs net of salvage | 41,515 | 38,442 | 34,627 |
| Provision for deferred income taxes | 95,643 | 41,918 | 34,464 |
| Amortization of deferred investment tax credits | (1,338) | (1,510) | (1,306) |
| Provision for losses on utility accounts receivable | 17,267 | 17,553 | 26,706 |
| Allowance for other funds used during construction | (14,497) | (7,759) | (5,980) |
| (Gain) loss on sale of assets | (374) | (7,326) | 79 |
| Gain on early extinguishment of debt | — | (13,113) | (3,739) |
| Other, net | 54,643 | 36,128 | 91,225 |
| Changes in assets and liabilities | | | |
| Receivables and unbilled utility revenues | (20,702) | (35,097) | 3,094 |
| Taxes receivable, including income taxes | 23,111 | (23,111) | — |
| Other current assets | (11,194) | (1,171) | 326 |
| Pension and non-pension post retirement benefit contributions | (105,053) | (81,245) | (81,491) |
| Accounts payable | 2,978 | 6,860 | 7,214 |
| Taxes accrued, including income taxes | 13,460 | 42,430 | (56,970) |
| Interest accrued | 2,790 | 16,092 | (18,131) |
| Other current liabilities | (4,920) | 10,767 | (32,111) |
| Net cash provided by operating activities | 552,169 | 473,712 | 323,748 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Construction expenditures | (1,008,806) | (750,810) | (682,863) |
| Acquisitions | (12,512) | (15,877) | (12,534) |
| Proceeds from sale of assets and securities | 12,604 | 16,346 | 3,665 |
| Proceeds from sale of discontinued operations | — | 9,660 | 30,151 |
| Removal costs from property, plant and equipment retirements, net | (24,793) | (9,852) | (20,446) |
| Net funds (restricted) released | 2,457 | 5,829 | (9,411) |
| Other | (2,617) | (1,874) | — |
| Net cash used in investing activities | (1,033,667) | (746,578) | (691,438) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from long-term debt | 279,941 | 3,869,109 | 582,498 |
| Repayment of long-term debt | (241,500) | (2,350,725) | (637,479) |
| Net borrowings (repayments) under short-term debt agreements | 258,684 | (541,623) | 345,682 |
| Proceeds from employee stock plan issuances | 836 | — | — |
| Advances and contributions for construction, net of refunds of $57,580 in 2008, $36,963 in 2007 and $52,624 in 2006 | 3,078 | 35,846 | 47,446 |
| Change in cash overdraft position | (188) | 42,198 | — |
| Capital contributions | 245,000 | 967,092 | — |
| Debt issuance costs | (4,008) | (14,916) | (5,239) |
| Redemption of preferred stocks | (229) | (1,750,388) | (541) |
| Dividends paid | (64,055) | — | — |
| Net cash provided by financing activities | 477,559 | 256,593 | 332,367 |
| Net decrease in cash and cash equivalents | (3,939) | (16,273) | (35,323) |
| Cash and cash equivalents at beginning of period | 13,481 | 29,754 | 65,077 |
| Cash and cash equivalents at end of period | $ 9,542 | $ 13,481 | $ 29,754 |
| **Cash paid during the year for:** | | | |
| Interest, net of capitalized amount | $ 294,508 | $ 295,707 | $ 402,370 |
| Income taxes, net of refunds of $40,400 in 2008, $16,111 in 2007 and $18,359 in 2006 | $ (22,161) | $ 17,823 | $ 11,633 |
| **Non-cash investing activity** | | | |
| Capital expenditures acquired on account but unpaid as of year-end | $ 72,657 | $ 94,930 | $ 73,595 |
| **Non-cash financing activity** | | | |
| Advances and contributions | $ 83,041 | $ 101,226 | $ 72,892 |
| Capital contribution (See Note 11) | $ — | $ 100,000 | $1,194,454 |

The accompanying notes are an integral part of these consolidated financial statements.

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## American Water Works Company, Inc. and Subsidiary Companies
## Consolidated Statements of Changes in Common Stockholders' Equity
(In thousands, except per share data)

| | Common Stock, $.01 Par Value: 500,000 Shares Authorized | | | | Accumulated Other | Treasury Stock | | Common |
|---|---|---|---|---|---|---|---|---|
| | Shares | Par Value | Paid-in Capital | (Accumulated Deficit) | Comprehensive Income (Loss) | Shares | At Cost | Stockholders' Equity |
| **Balance at December 31, 2005** | 160,000 | $ 1,600 | $3,376,401 | $ (574,049) | $ 764 | — | $ — | $ 2,804,716 |
| Net loss | — | — | — | (162,243) | — | — | — | (162,243) |
| Equity investment by RWE | — | — | 1,194,454 | — | — | — | — | 1,194,454 |
| Recognition of employee benefit plan underfunded status | — | — | — | — | (21,919) | — | — | (21,919) |
| Other comprehensive income (loss), net of tax of $1,416 | — | — | — | — | 2,389 | — | — | 2,389 |
| **Balance at December 31, 2006** | 160,000 | $ 1,600 | $4,570,855 | $ (736,292) | $ (18,766) | — | $ — | $ 3,817,397 |
| Net loss | — | — | — | (342,826) | — | — | — | (342,826) |
| Equity investment by RWE | — | — | 1,067,092 | — | — | — | — | 1,067,092 |
| Other comprehensive income (loss), net of tax of $660 | — | — | — | — | 383 | — | — | 383 |
| **Balance at December 31, 2007** | 160,000 | $ 1,600 | $5,637,947 | $ (1,079,118) | $ (18,383) | — | $ — | $ 4,542,046 |
| Net loss | — | — | — | (562,421) | — | — | — | (562,421) |
| Equity investment by RWE | — | — | 245,000 | — | — | — | — | 245,000 |
| Contribution of common stock by RWE | — | — | 1,933 | — | — | (90) | (1,933) | — |
| Stock-based compensation activity | — | — | 3,373 | — | — | 90 | 1,926 | 5,299 |
| Other comprehensive income (loss), net of tax of ($40,990) | — | — | — | — | (63,868) | — | — | (63,868) |
| Dividends paid per common share $0 40 | — | — | — | (64,055) | — | — | — | (64,055) |
| **Balance at December 31, 2008** | 160,000 | $ 1,600 | $5,888,253 | $ (1,705,594) | $ (82,251) | — | $ (7) | $ 4,102,001 |

The accompanying notes are an integral part of these consolidated financial statements.

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**American Water Works Company, Inc. and Subsidiary Companies**
**Consolidated Statements of Comprehensive Income (Loss)**
(In thousands, except per share data)

| | Year Ended December 31 | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Net loss | $(562,421) | $(342,826) | $(162,243) |
| Market value adjustments for investments, net of tax of $301 | — | — | 471 |
| Additional minimum pension liability, net of tax of $1,115 | — | — | 1,744 |
| Change in employee benefit plan funded status, net of tax of ($41,007) and $591, respectively | (64,139) | 924 | — |
| Pension plan amortized to periodic benefit cost: | | | |
| Prior service cost, net of tax of $17 and $23, respectively | 26 | 36 | — |
| Actuarial loss, net of tax of $0 and $46, respectively | 1 | 72 | — |
| Foreign currency translation adjustment | 244 | (649) | 174 |
| Total comprehensive loss | $(626,289) | $(342,443) | $(159,854) |

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**American Water Works Company, Inc. and Subsidiary Companies**
**Notes to Consolidated Financial Statements**
(In thousands, except per share data)

### Note 1: Organization and Operation

American Water Works Company, Inc. ("AWW") and its subsidiaries (collectively referred to herein as the "Company") is the holding company for regulated and non-regulated subsidiaries throughout the United States of America and Ontario, Canada. The regulated subsidiaries provide water and wastewater services and, as public utilities, function under rules and regulations prescribed by state regulators. These regulated subsidiaries have similar long-term economic characteristics and are operationally segregated into the 20 U.S. states in which the Company operates regulated utilities. The non-regulated subsidiaries include distinctive lines of business including Homeowner Services, which provides water and sewer line protection plans for homeowners, the Operations and Maintenance contracts group, which conducts operation and maintenance of water and wastewater facilities for municipalities and the U.S. Military, among others, and Carbon Regeneration, which sells granular activated carbon technologies to help remove contaminants and improve the quality of drinking water. The Company is a majority-owned subsidiary of RWE Aktiengesellschaft ("RWE") (See Note 9).

### Note 2: Significant Accounting Policies

#### Principles of Consolidation

The accompanying consolidated financial statements include the accounts of AWW and its subsidiaries. Intercompany balances and transactions between subsidiaries have been eliminated. The Company uses the equity method to report its investments in two joint venture investments in each of which the Company holds a 50% voting interest and cannot exercise control over the operations and policies of the investments. Under the equity method, the Company records its interests as an investment and its percentage share of earnings as earnings or losses of investee.

#### Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The Company considers benefit plan assumptions, the carrying values of goodwill and other long-lived assets, including regulatory assets, revenue recognition and accounting for income taxes to be its critical accounting estimates. The Company's significant estimates that are particularly sensitive to change in the near term are amounts reported for pension and other postemployment benefits, contingency-related obligations and goodwill.

#### Regulation

The Company's regulated utilities are subject to regulation by the public utility commissions and the local governments of the states in which they operate (the "Regulators"). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). This statement sets forth the application of generally accepted accounting principles for those companies whose rates are established by or are subject to approval by an independent third-party regulator. Under SFAS 71, regulated utilities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in operations by an non-regulated company. These deferred regulatory assets and liabilities are then reflected in the statement of operations in the period in which the costs and credits are reflected in the rates charged for service.

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### Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. The costs incurred to acquire and internally develop computer software for internal use are capitalized as a unit of property. The carrying value of these costs amounted to $35,971 and $29,103 at December 31, 2008 and 2007, respectively. The cost of repairs, maintenance, including planned major maintenance activities, and minor replacements of property is charged to maintenance expense as incurred.

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates, until the costs to retire those assets are incurred.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method.

Nonutility property consists primarily of buildings and equipment utilized by the Company for internal operations. This property is stated at cost, net of accumulated depreciation calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to fifty years.

### Cash and Cash Equivalents

Substantially all cash is invested in interest-bearing accounts. All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

The Company had book overdrafts for certain of its disbursement accounts of $42,010 and $42,198 at December 31, 2008 and 2007, respectively. A book overdraft represents transactions that have not cleared the bank accounts at the end of the period. The Company transfers cash on an as-needed basis to fund these items as they clear the bank. The balance of the book overdraft is reported as short-term debt and the change in the book overdraft balance is reported as cash flows from financing activities.

### Restricted Funds

Restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities and from customers for future services under operation and maintenance projects. The proceeds of these financings are held in escrow until the designated expenditures are incurred. Restricted funds expected to be released within 12 months subsequent to year-end are classified as current.

### Utility Customer Accounts Receivable

Regulated utility customer accounts receivable represent amounts billed to water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators and generally, collateral is not required.

### Allowance for Uncollectible Accounts

Allowances for uncollectible accounts are maintained for estimated probable losses resulting from the Company's inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes-off accounts when they become uncollectible. (See Note 5)

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### Non-regulated Trade and Other Receivables, Net

Non-regulated trade and other receivables, net consists of non-regulated trade accounts receivable and non-regulated unbilled revenues, net of a reserve for doubtful accounts and non-utility customer receivables of the regulated subsidiaries. In determining the reserve for uncollectible non-regulated accounts, the Company considers the length of time the trade accounts receivable are past due and the customer's current ability to pay their obligation. Unbilled receivables are accrued when service has been provided but has not been billed to customers. (See Note 6)

### Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

### Goodwill

The Company considers the carrying value of goodwill to be one of its critical accounting estimates. The Company believes the assumptions and other considerations used to value goodwill to be appropriate. However, if actual experience differs from the assumptions and considerations used in its analysis, the resulting change could have a material impact on the consolidated financial statements.

Goodwill is primarily associated with the acquisitions of American Water Works Company, Inc. in 2003 and E'town Corporation in 2001 (the "Acquisitions") and has been assigned to reporting units based on the fair values at the date of the Acquisitions. The regulated utility subsidiaries have been aggregated and deemed a single reporting unit as they have similar economic characteristics. In the non-regulated segment, the business is organized into seven reporting units for its non-regulated services. In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), goodwill is reviewed annually, or more frequently if changes in circumstances indicate the carrying value may not be recoverable. Annual impairment reviews are performed in the fourth quarter of the calendar year, in conjunction with the timing of the completion of the Company's annual strategic business plan.

For each of the years ended December 31, 2008, 2007 and 2006, the Company determined that its goodwill, including goodwill of discontinued operations, was impaired and recorded impairments of $750,000, $509,345 and $227,802, respectively. (See Note 8)

### Long-Lived Assets

The Company considers the carrying value of long-lived assets to be one of its critical accounting estimates. The Company believes the assumptions and other considerations used to evaluate the carrying value of long-lived assets to be appropriate. However, if actual experience differs from the assumptions and considerations used in its estimates, the resulting change could have a material adverse impact on the consolidated financial statements.

Long-lived assets, other than goodwill, include land, buildings, equipment and long-term investments. Long-lived assets, other than investments and land, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market value of a long-lived asset, a significant adverse change in the manner the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, the Company estimates the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets and compares that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recorded.

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The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the assets carrying value exceeds its fair value.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

The Company holds other investments including investments in privately held companies and investments in joint ventures accounted for using the equity method. The Company's investments in privately held companies and joint ventures are classified as other long-term assets.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which the Company invests, as well as volatility inherent in the external markets. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value. As a result of fair value analyses, the Company recorded pre-tax charges of $0 for the years ended December 31, 2008 and 2007, respectively, and $750 for the year ended December 31, 2006.

**Advances and Contributions in Aid of Construction**

Regulated utility subsidiaries may receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Advances which are no longer refundable are reclassified to contributions in aid of construction. Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such contributions generally serves as a rate base reduction since they represent non-investor supplied funds. Non-cash utility property has been received, primarily from developers, as advances or contributions of $83,041, $101,226, and $72,892 for the years ended December 31, 2008, 2007 and 2006, respectively.

Generally, the Company depreciates utility plant funded by contributions and amortizes its contributions balance as a reduction to depreciation expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for the contributions. Certain of the Company's subsidiaries do not depreciate contributed property, based on regulatory guidelines. Amortization of contributions in aid of construction was $20,219, $20,720 and $16,697 for the years ended December 31, 2008, 2007 and 2006, respectively.

**Recognition of Revenues**

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are provided and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period.

The Company has agreements with the United States Government to operate and maintain water and wastewater systems at various military bases pursuant to 50 year contracts ("military agreements"). These contracts also include construction components which are accounted for separately from the operations and management components. The military agreements are subject to periodic price redetermination adjustments and modifications for changes in circumstance. Additionally, the Company has agreements ranging in length from three to 40 years with various municipalities to operate and maintain water and wastewater systems ("O&M agreements"). Revenue from operations and management services are recognized as services are provided. (See Note 16)

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**Construction Contracts**

In accordance with the American Institute of Certified Public Accountants' Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production Type Contracts," revenues from construction projects are recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Under these agreements, revenues were $47,889, $32,141 and $56,069 and operation and maintenance expenses were $44,227, $34,543 and $53,845 as of December 31, 2008, 2007 and 2006, respectively. Included in the amounts are construction revenues of $25,766 and $12,902 and operation and maintenance expenses of $24,852 and $12,601 related to the Company's Fillmore contract at December 31, 2008 and 2007, respectively. The construction phase of the contract is expected to be completed by December of 2009.

**Taxes**

The parent company and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

Investment tax credits have been deferred by the regulated utility subsidiaries and are being amortized to income over the average estimated service lives of the related assets.

The Company recognizes accrued interest and penalties related to tax positions as a component of income tax expense.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

**Allowance for Funds Used During Construction ("AFUDC")**

AFUDC is a non-cash credit to income with a corresponding charge to utility plant which represents the cost of borrowed funds or a return on equity funds devoted to plant under construction. The regulated utility subsidiaries record AFUDC to the extent permitted by the Regulators.

**Environmental Costs**

The Company's water and wastewater operations are subject to federal, state, local and foreign requirements relating to environmental protection, and as such the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a

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future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued, on an undiscounted basis, when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to $10,538 and $11,000 at December 31, 2008 and 2007, respectively. Included in these balances were $10,100 of estimated liabilities pursuant to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the state of California. The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates. The Company expects to make an initial payment of $3,500 in April of 2009 and $1,100 annually from July 2010 to July 2016.

**New Accounting Standards**

In January 2009, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") Emerging Issues Task Force ("EITF") No. 99-20-1, "Amendments to the Impairment Guidance of EITF Issue No. 99-20" ("FSP EITF 99-20-1"). This pronouncement amends EITF 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets" ("EITF 99-20"), to achieve more consistent determination of whether an other-than-temporary impairment has occurred. FSP EITF 99-20-1 also retains and emphasizes the objective of an other than-temporary impairment assessment and the related disclosure requirements in Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and other related guidance. FSP EITF 99-20-1 is effective for interim and annual reporting periods ending after December 15, 2008, and is required to be applied prospectively. The adoption of FSP EITF 99-20-1 did not have an impact on the Company's results of operations, financial position or cash flows.

In December 2008, the FASB issued FSP FAS No. 132(R)-1, "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP FAS 132(R)-1"), which requires additional disclosures for employers' pension and other postretirement benefit plan assets. As pension and other postretirement benefit plan assets were not included within the scope of SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), FSP FAS 132 (R)-1 requires employers to disclose information about fair value measurements of plan assets similar to the disclosures required under SFAS No. 157, the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. FSP FAS 132(R)-1 will be effective for the Company as of December 31, 2009. As FSP FAS 132(R)-1 provides only disclosure requirements, the adoption of this standard will not have an impact on the Company's results of operations, financial position or cash flows.

In October 2008, the FASB issued FSP No. 157-3, "Determining the Fair Value of a Financial Asset When a Market for That Asset Is Not Active" ("FSP 157-3"), which clarifies the application of SFAS 157 in an inactive market and provides an example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon issuance, including prior periods for which financial statements had not been issued. The adoption of this standard as of September 30, 2008 did not have an impact on the Company's results of operations, financial position or cash flows.

In February 2008, the FASB issued FSP SFAS 157-2 which allows a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment and goodwill) that are required to be measured at fair value on a periodic basis (such as at acquisition or impairment). The Company elected to use this deferral option and accordingly, only partially adopted SFAS 157 on January 1, 2008. SFAS 157 will be adopted for the Company's nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009.

On January 1, 2008, the Company adopted the provisions of SFAS 157 for financial assets and liabilities, and nonfinancial assets and liabilities with recurring measurements. The Company's assets and liabilities measured at fair value on a recurring basis during the period were cash and cash equivalents, restricted funds and short-term debt. These assets and liabilities were measured at fair value on the balance sheet date using quoted

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prices in active markets (level 1 inputs, as defined by SFAS 157). The adoption of SFAS 157 for the Company's financial assets and liabilities did not have a material effect on the Company's results of operations, financial position or cash flows. The Company measured the assets of its defined benefit pension and other post retirement welfare plans pursuant to SFAS 157 at December 31, 2008. The Company does not believe the adoption of SFAS 157 for the Company's nonfinancial assets and liabilities will have an impact on its results of operations, financial position and cash flows.

In December 2007, the FASB issued SFAS No. 160 ("SFAS 160"), "Non-controlling Interests in Consolidated Financial Statements—An Amendment of ARB No. 51," which establishes new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for the Company on January 1, 2009. The Company does not believe the standard will have an impact on its results of operations, financial position and cash flows.

In December 2007, the FASB issued SFAS No. 141(R) ("SFAS 141(R)"), "Business Combinations," which will significantly change the accounting for business combinations. SFAS 141(R) is effective for the Company for business combinations finalized on or after January 1, 2009. In December 2008, the Company expensed transaction costs of approximately $860 for acquisitions that will not close until after January 1, 2009 and will not be capitalized as goodwill under the provisions of SFAS 141(R).

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115" ("SFAS 159"). This standard permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This standard is effective for years beginning January 1, 2008. The Company has not elected to exercise the fair value irrevocable option. Therefore, the adoption of SFAS 159 did not have an impact on the Company's results of operations, financial position or cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106 and 132(R)" ("SFAS 158"). This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, actuarial gains and losses, prior service costs or credits, and transition obligations and assets that have not been recognized in net periodic benefit cost under previous accounting standards will be recognized as a regulatory asset for the portion of the underfunded liability that meets the recovery criteria prescribed in SFAS 71 and as accumulated other comprehensive income, net of tax effects, for that portion of the underfunded liability that does not meet SFAS 71 regulatory accounting criteria. The Company adopted the recognition and disclosure requirements of the statement as of the end of fiscal year 2006.

**Reclassifications**

Certain reclassifications have been made to conform previously reported data to the current presentation.

**Note 3: Acquisitions**

During 2008, the Company closed on acquisitions of 10 regulated water and wastewater systems, for an aggregate purchase price of $12,512, including transaction costs of $2,622. The purchase price was allocated to the net tangible assets based upon their estimated fair values at the acquisition date.

During 2007, the Company acquired nine regulated water systems for a total aggregate purchase price of $15,877. Included in this total was the Company's acquisition on November 1, 2007 of all of the capital stock of S.J. Services, Inc. ("SJS") for $13,458. The acquisition was accounted for as a business combination in accordance with SFAS 141. Accordingly, operating results of SJS from November 1, 2007 were included in the Company's results of operations. The purchase price was allocated to the net tangible and intangible assets based

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upon their estimated fair values at the date of acquisition. Total SJS assets acquired were $23,420, including $4,727 of goodwill (See Note 8), and liabilities assumed totaled $9,962, including long-term debt of $2,791 and contributions in aid of construction of $5,566.

Also during 2007, the Company's New Jersey subsidiary entered into an agreement with the City of Trenton, New Jersey to purchase the assets of the City's water system located in the four surrounding townships. The agreement required approval from the New Jersey Regulator. The initial proposed purchase price of $100,000 was subsequently amended to $75,000; in addition the agreement has been amended to include the provision of technical services from the City over seven years to ensure a smooth transition of ownership at a total cost of $5,000. The administrative law judge hearing the matter has issued an initial decision (the "Initial Decision") approving a stipulation of settlement reflecting the changed agreement (the "Stipulation") and sent the Initial Decision to the New Jersey Regulator for consideration. On February 25, 2009, a petition seeking a referendum was filed with the City of Trenton. The petition seeks to force the City Council to reconsider its prior approval of sale, and a vote as to whether the Ordinance approving the sale of the system should go forward or be negated. The Company can provide no assurance as to the outcome of the referendum nor can the Company provide assurance that the Initial Decision will ultimately be approved by the New Jersey Regulator. Included in the Stipulation, and dependent upon final approval, the Company intends to purchase finished water from the City for the next 20 years under a water supply agreement. The acquisition is expected to add approximately forty thousand customers to the Company's customer base. Included in other current assets is a $10,000 refundable deposit the Company made in December 2007 which is being held in an interest bearing escrow account as required by the bidding process.

**Note 4: Utility Plant**

The components of utility plant by category at December 31 are as follows:

| | Range of Remaining Useful Lives | 2008 | 2007 |
|---|---|---|---|
| Water plant | | | |
| Land and other non-depreciable assets | | $ 144,624 | $ 144,909 |
| Sources of supply | 7 to 127 Years | 512,222 | 488,477 |
| Treatment and pumping facilities | 3 to 101 Years | 2,514,155 | 2,273,501 |
| Transmission and distribution facilities | 9 to 127 Years | 5,940,177 | 5,462,209 |
| Services, meters and fire hydrants | 4 to 96 Years | 2,224,568 | 2,027,746 |
| General structures and equipment | 1 to 112 Years | 656,043 | 774,051 |
| Wastewater plant | 4 to 100 Years | 630,983 | 506,049 |
| Construction work in progress | | 338,880 | 299,917 |
| | | 12,961,652 | 11,976,859 |
| Less accumulated depreciation | | 2,969,869 | 2,776,950 |
| | | $ 9,991,783 | $ 9,199,909 |

Utility plant depreciation expense amounted to $267,763 in 2008, $263,737 in 2007 and $249,355 in 2006.

The provision for depreciation expressed as a percentage of the aggregate average depreciable asset balances was 2.93% in 2008, 3.11% in 2007, and 3.14% in 2006.

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### Note 5: Allowance for Uncollectible Accounts

The following table summarizes the changes in the Company's allowances for uncollectible accounts:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Balance at January 1, | $(20,923) | $(23,061) | $(15,051) |
| Amounts charged to expense | (17,267) | (17,553) | (26,706) |
| Amounts written off | 22,583 | 22,192 | 21,538 |
| Recoveries of amounts written off | (3,037) | (2,501) | (2,842) |
| Balance at December 31, | $(18,644) | $(20,923) | $(23,061) |

### Note 6: Non-regulated Trade and Other Receivables, Net

Components of the Company's non-regulated trade and other receivables, net are as follows:

| | 2008 | 2007 |
|---|---|---|
| Non-regulated trade accounts receivable | $29,613 | $28,028 |
| Allowance for doubtful accounts—non-regulated trade accounts receivable | (5,221) | (5,567) |
| Non-regulated unbilled revenue | 16,602 | 17,232 |
| Other | 27,883 | 26,847 |
| | $68,877 | $66,540 |

### Note 7: Regulatory Assets and Liabilities

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Except for income taxes, regulatory assets are excluded from the Company's rate base and do not earn a return. The components of regulatory assets are as follows:

| | 2008 | 2007 |
|---|---|---|
| Income taxes recoverable through rates | $231,439 | $228,562 |
| Debt and preferred stock expense | 67,271 | 68,711 |
| Deferred pension expense | 237,665 | 102,130 |
| Deferred other postretirement benefit expense | 136,937 | 45,683 |
| Deferred security costs | 12,763 | 16,853 |
| Deferred business services project expense | 14,322 | 17,037 |
| Deferred tank painting costs | 22,347 | 18,502 |
| Deferred rate case expense | 14,000 | 11,854 |
| Purchase premium recoverable through rates | 61,003 | 60,869 |
| Environmental remediation recoverable through rates | 6,600 | 6,600 |
| Coastal water project costs | 18,262 | 15,739 |
| San Clemente Dam project costs | 15,341 | 11,980 |
| Removal costs recoverable through rates | 35,097 | 28,332 |
| Other | 46,607 | 28,140 |
| | $919,654 | $660,992 |

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the regulatory authorities of full normalization for rate making purposes. Full normalization requires no flow through of tax benefits to customers. The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

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Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from date of issue; expenses of issues with sinking fund provisions are charged to operations as shares are retired.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain subsidiaries. These costs will be recovered in future service rates as contributions are made to the pension plan. The Company also has regulatory assets of $198,506 and $45,933 at December 31, 2008 and 2007 which is the portion of the underfunded status that is probable of recovery through rates in future periods.

Postretirement benefit expense in excess of the amount recovered in rates through 1997 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service and will be fully recovered over a 20-year period ending in 2012 as authorized by the regulatory authorities. The Company has regulatory assets of $131,300 and $40,012 at December 31, 2008 and 2007 which is the portion of the underfunded status that is probable of recovery through rates in future periods.

The cost of additional security measures that were implemented to protect facilities after the terrorist attacks on September 11, 2001 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service by certain subsidiaries. These costs are being recovered over periods ranging from five to ten years.

Business services project expenses consist of reengineering and start-up activities for consolidated customer and shared administrative service centers that began operations in 2001. These costs are recognized in the rates charged for water service by certain subsidiaries.

Tank painting costs are generally deferred and amortized to current operations on a straight-line basis over periods ranging from 5 to 15 years, as authorized by the regulatory authorities in their determination of rates charged for service.

The Company amortizes rate case expenditures over regulatory approved amortization periods, typically three years. Rate case proceeding expenditures probable of future recovery are deferred.

Purchase premium recoverable through rates is the recovery of the acquisition premiums related to an asset acquisition by the Company's California subsidiary during 2002, and acquisitions in 2007 by the Company's New Jersey subsidiary. As authorized for recovery by the California and New Jersey Regulators, these costs are being amortized to operations through November 2048.

Environmental remediation recoverable through rates is the recovery of costs incurred by the Company's California subsidiary under a settlement agreement entered into with the National Oceanic and Atmospheric Administration to improve habitat conditions in the Carmel River Watershed.

Coastal water project costs include all preliminary costs associated with the studying, testing, and design of alternatives to help solve water supply shortages in Monterey, California. Coastal water project costs incurred through December 31, 2007 have been reviewed and approved for recovery through a surcharge that went into effect January 1, 2007. Costs deferred during 2008 totaled $4,731. The Company believes it is probable that the costs incurred since the last rate review will also be recoverable.

San Clemente Dam project costs include deferred costs for the Company's California subsidiary to investigate alternatives to strengthen or remove the San Clemente Dam due to potential earthquake or flood safety concerns. These cost are not yet in rates, however, the Company believes it is probable that the costs incurred will be recoverable.

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The components of regulatory liabilities are as follows:

| | 2008 | 2007 |
|---|---|---|
| Removal costs recovered through rates | $ 231,789 | $ 209,905 |
| Deferred income taxes | 34,180 | 29,518 |
| Other | 41,355 | 27,301 |
| | $ 307,324 | $ 266,724 |

Removal costs recovered through rates are retirement costs recovered through customer rates during the life of the associated assets. In December 2008, the Company's subsidiary in New Jersey, at the direction of the New Jersey Regulator, began to amortize $48,000 of the total balance into operations via straight line amortization through November 2048.

Deferred income taxes represent the income tax effect of the adjustment to record the full accumulated postretirement benefit obligation under SFAS 158.

Other regulatory liabilities include various regulatory balancing accounts.

**Note 8: Goodwill**

The Company's annual impairment reviews are performed as of November 30 of each year, in conjunction with the timing of the completion of the Company's annual strategic business plan. At November 30, 2008, the Company's goodwill was $1,704,310. During December 2008, the Company transferred $4,793 of goodwill to regulatory assets for purchase premiums recoverable through rates, resulting in the $1,699,517 balance outstanding at December 31, 2008, as shown in the table below. The Company also undertakes interim reviews when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

The Company uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any) in accordance with SFAS No. 142. The step 1 calculation used to identify potential impairment compares the calculated fair value for each of the Company's reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit's carrying value, then step 2 is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of the fair value of each reporting unit above the fair value of such reporting unit's identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss is recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

The determination of the fair value of each reporting unit and the fair value of each reporting unit's assets and liabilities is performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date).

For the November 30, 2008 impairment test, the estimated fair value of the regulated reporting unit for step 1 was based on a combination of the following valuation techniques:

- observable trading prices of comparable equity securities of publicly-traded water utilities considered by us to be the Company's peers; and
- discounted cash flow models developed from the Company's internal forecasts.

The estimated fair values of the non-regulated reporting units were determined entirely on the basis of discounted cash flow models.

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The first valuation technique applies average peer multiples to the Regulated reporting unit's historic and forecasted cash flows. The peer multiples are calculated using the average trading prices of comparable equity securities of publicly-traded water utilities, their published cash flows and forecasts of market price and cash flows for those peers.

The second valuation technique forecasts each reporting unit's five-year cash flows using an estimated long-term growth rate and discounts these cash flows at their respective estimated weighted average cost of capital.

If step 2 of the impairment test is required, the Company determines the fair value of the applicable reporting unit's assets and liabilities. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. For the step 2 calculations of the fair value of debt, the Company uses observable prices of instruments and indices that have risks similar to those instruments being valued, adjusted to compensate for differences in credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit's debt.

The Company has completed its November 30, 2008 annual impairment review and does not believe that the Company's goodwill balance was impaired. However, there can be no assurances that the Company will not be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the Company's performance. These market events could include a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities, the lack of an increase in the Company's market price consistent with its peer companies, or decreases in control premiums and the overhang effect. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect the Company's reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to maintain its credit ratings, secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

In making the determination, the Company considered both qualitative and quantitative factors, including the effect of the recent volatility in the equity and debt markets on the Company's market capitalization. As such, the Company believes that the current evaluation technique is more appropriate than relying solely on the current trading market value of the Company's common stock.

In reaching its conclusion, the Company also made certain assumptions, which it believes to be appropriate, that support the fair value of its reporting units. The Company considered, in addition to the listed trading price of the Company's shares, the effect on that price due to RWE's majority ownership, the effect of RWE's expected disposition of its owned Company shares on the market for those shares, the applicability of a control premium to the Company's shares and certain other factors the Company deemed appropriate. As a result, the Company concluded that the Company's fair value exceeds what the Company might otherwise have concluded had it relied on market price alone.

In addition, given recent market conditions, management determined that it was appropriate for the Company to consider the average of the Company's closing market price over a thirty day period rather than using a particular date to calculate its market capitalization. The Company's calculated market capitalization within its 2008 impairment test period was approximately $940,000 below the aggregate carrying value of its reporting units.

The difference between the calculated market capitalization and the aggregate fair value of the reporting units (which approximates book value) resulted from the estimated control premium and the estimated impact to the Company's market capitalization from the overhang created by RWE's announced plans to divest a substantial portion of its ownership through further public offerings of stock.

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The estimated control premium represents the incremental premium a buyer is willing to pay to acquire a controlling, majority interest in the Company. In estimating the control premium, management principally considered the current market conditions and historical premiums paid in utility acquisitions observed in the marketplace.

The estimated stock overhang represents the impact on the Company's share price that we believe results from investor concerns over market price dilution due to the anticipated increase in the number of the Company's publicly traded shares caused by the anticipated RWE sale of the Company's stock. As a condition of certain state regulator approvals for RWE's sale of the Company, RWE had agreed to sell 100% of its holdings of Company stock by April 2010 and previously announced its intentions to reduce its interest to below 50% prior to the end of 2008. Management estimated the impact of this overhang condition using reports from multiple analysts covering the Company's stock and other available market information.

The determination of estimated fair value required the exercise of judgment and is highly sensitive to the Company's assumptions. The estimated fair values approximate the carrying value of reporting units leaving little estimated value in excess of the required threshold of the step 1 test. Had the fair value been less than the carrying value of the reporting units, differences between the carrying value and fair value of our long-term debt (which is not taken into account in step 1 but is required in step 2) would have increased any impairment charge indicated by step 1 by an estimated $300,000, due to accounting guidance that must be followed to measure the implied fair value of goodwill.

For the years ended December 31, 2008, 2007 and 2006, the Company recorded impairment charges for goodwill, including discontinued operations, in the amount of $750,000, $509,345 and $227,802, respectively.

As of March 31, 2008, in light of the initial public offering price and trading levels in the Company's common stock subsequent to the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, management concluded that the carrying value of the Company's goodwill was impaired. The Company believed that the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors recorded an impairment charge to the goodwill of its Regulated reporting unit in the amount of $750,000 as of March 31, 2008. The impairment charge was primarily attributed to the market price of the Company's common stock (both the initial public offering price and the price during subsequent trading) being less than the estimate of the initial public offering price used during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased market interest rates). As a result of the impairment charge, RWE Aqua Holdings GmbH (a wholly-owned subsidiary of RWE) transferred $245,000 to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

During the third quarter of 2007, as a result of the Company's debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its Regulated reporting unit in the amount of $243,345 as of September 30, 2007. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined an impairment had occurred based upon information regarding the Company's market value in connection with the initial public offering. Management determined that the indicative fair value of the Company based on estimates of the initial public offering price range was the best evidence of the Company's market value and incorporated this indicated market value into the Company's valuation methodology, which also considered other items, such as peer multiples, discounted cash flows and a control premium. Based on the results of the impairment test, an impairment of $266,000 to the Company's carrying value was recognized as of December 31, 2007.

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The 2006 impairment charge of $227,802 was attributable to higher interest rates in the Regulated reporting unit and a change in the potential net realizable value of a non-regulated reporting unit.

The change in the Company's goodwill assets, as allocated between the reporting units is as follows:

| | Regulated Unit | Non-regulated Units | Consolidated |
|---|---|---|---|
| Balance at December 31, 2006 | $2,832,811 | $129,682 | $2,962,493 |
| Goodwill from acquisitions | 3,804 | — | 3,804 |
| Impairment losses | (509,345) | — | (509,345) |
| Balance at December 31, 2007 | 2,327,270 | 129,682 | 2,456,952 |
| Impairment losses | (750,000) | — | (750,000) |
| Felton water system asset sale | (2,373) | — | (2,373) |
| Reclassifications and other activity (a) | (5,062) | — | (5,062) |
| Balance at December 31, 2008 | $1,569,835 | $129,682 | $1,699,517 |

(a) Includes $4,793 of goodwill transferred to regulatory assets in December 2008 for purchase premiums recoverable through rates.

**Note 9: Stockholders' Equity**

**Common Stock**

On April 28, 2008, RWE completed the partial divestiture of its investment in the Company in an IPO through the sale of 58,000 shares of common stock at an IPO price of $21.50. The selling stockholder granted the underwriters a 30-day option to purchase up to an additional 8,700 shares of the Company's stock at a price of $21.50. On May 27, 2008, the Company announced the underwriters' partial exercise of their over-allotment option to purchase 5,173 shares to cover over allotments. The Company did not receive any proceeds from the sale of shares. Prior to the IPO, the Company was an indirect wholly-owned subsidiary of RWE. After the IPO, and exercise of the underwriters' over-allotment option, RWE owns approximately 60% of the Company's common shares.

Effective the first quarter of 2008, the Company's Board of Directors' authorized 50,000 shares of par value $0.01 per share preferred stock. As of December 31, 2008 there are no shares outstanding.

In September of 2008, the Company made a cash dividend payment of $0.20 per share to all common shareholders of record as of August 15, 2008, amounting to $31,992. In December 2008, the Company made a cash dividend payment of $0.20 per share to all common shareholders of record as of November 18, 2008, amounting to $31,997.

On February 6, 2009, the Company's Board of Directors declared a quarterly cash dividend payment of $0.20 per share payable on March 2, 2009 to all shareholders of record as of February 18, 2009.

**Accumulated Other Comprehensive Loss**

The following table presents accumulated other comprehensive loss:

| | 2008 | 2007 |
|---|---|---|
| Employee benefit plans funded status adjustments | $(84,271) | $(20,159) |
| Foreign currency translation | 2,020 | 1,776 |
| Balance at December 31 | $(82,251) | $(18,383) |

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**Stock Based Compensation**

On April 22, 2008, a subsidiary of RWE contributed 90 shares of the Company's common stock to the Company and the Company granted 90 restricted stock awards, 269 restricted stock units and 2,078 stock options. The awards were issued to the Company's employees and certain non-employee directors under its 2007 Omnibus Equity Compensation Plan (the "2007 Plan"). The total aggregate number of shares of common stock that may be issued under the 2007 Plan is 6,000. The restricted stock units and the stock options were awarded in two grants with "Grant 1" vesting on January 1, 2010 and "Grant 2" vesting January 1, 2011. Shares issued under the Plan may be authorized but unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market for purposes of the 2007 Plan. Additionally during August 2008, the Company granted 5 stock options and 1 restricted stock unit to newly appointed non-employee directors in two grants vesting on January 1, 2011.

The following table presents stock-based compensation expense for the years ended December 31, 2008 and 2007:

| | 2008 | 2007 |
|---|---|---|
| Stock Options | $ 1,607 | $ — |
| Restricted stock units | 957 | 680 |
| Restricted stock | 1,798 | — |
| Employee stock purchase plan | 172 | — |
| Stock-based compensation in operation and maintenance expense | 4,534 | 680 |
| Income tax benefit | (1,768) | (265) |
| After-tax stock-based compensation expense | $ 2,766 | $ 415 |

There were no significant stock-based compensation costs capitalized during the years ended December 31, 2008 and 2007.

In accordance with Statement of Financial Accounting Standards No. 123(R), "Share Based Payment" ("SFAS 123(R)"), the cost of services received from employees in exchange for the issuance of stock options and restricted stock awards is required to be measured based on the grant date fair value of the awards issued. The value of stock options and restricted stock awards at the date of the grant is amortized through expense over the requisite service period using the straight-line method, adjusted for retirement eligible participants. All awards granted in 2008 are classified as equity.

In addition to the requisite service period, 1,470 stock options and 190 restricted stock units are subject to performance-based vesting requirements. The performance conditions are based on the achievement of 120% of net income targets in 2008 and 2009. These stock option and restricted stock awards will vest proportionately depending upon the level of achievement with 1,470 stock options and 190 restricted stock units being the maximum.

The Company recognizes expense for the portion of the awards where achievement is considered probable. As of December 31, 2008, 757 stock option and 98 restricted stock awards are not considered probable to meet performance conditions.

The Grant 1 performance vesting period ended December 31, 2008 and according to the plan, the Company must certify the level of achievement no later than 90 days after January 1, 2009. Any portion of the stock options or restricted stock units that do not fully satisfy the performance goals will be forfeited as of the date the level of achievement is certified. In February 2009, 311 stock options and 39 restricted stock units were forfeited because the performance goals were not fully met.

The Company stratified its grant populations and used historic employee turnover rates and general market data to estimate employee forfeitures.

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On February 20, 2009, the Company granted 1,091 non-qualified stock options and 195 restricted stock units to certain employees under the 2007 Omnibus Equity Compensation Plan. The stock options and restricted stock units vest ratably over a three-year service period from January 1, 2009. The restricted stock units also have market condition vesting requirements. The stock options expire on December 31, 2015.

**Stock Options**

Non-qualified stock options to purchase shares of the Company's common stock were granted under the 2007 Plan. The exercise price of the stock options is equal to the fair market value of the underlying stock on the date of option grant. Stock options granted become exercisable upon a specified vesting date. The requisite service period for options granted is three years. All stock options expire seven years from the effective date of the grant. The remaining vesting period of the stock options outstanding as of December 31, 2008 ranged from one to two years. The fair value of each option is estimated on the date of grant using the Black-Scholes option-pricing model.

The following table presents the assumptions used in the pricing model for grants and resulting grant date fair value of stock options granted.

| | Grant 1 | Grant 2 |
|---|---|---|
| Dividend yield | 3.72% | 3.72% |
| Expected volatility | 29.00% | 29.00% |
| Risk-free interest rate | 2.69% | 2.90% |
| Expected life (years) | 3.69 | 4.69 |
| Grant date fair value | $ 3.84 | $ 4.19 |

The dividend yield is based on the Company's expected dividend payments and the IPO stock price. Expected volatility is based on historic volatilities of traded common stock of peer companies (regulated water companies) over the expected term of the stock options. The risk-free interest rate is the market yield on U.S. Treasury strips with maturities similar to the expected term of the stock options. The expected term represents the period of time the stock options are expected to be outstanding and is based on the "simplified method" as permitted by Staff Accounting Bulletin ("SAB") No. 107 and SAB No. 110.

The following table presents information with respect to stock option activity as of December 31, 2008.

| | Outstanding Shares | Weighted Average Exercise Price (per share) |
|---|---|---|
| Nonvested at December 31, 2007 | — | — |
| Granted | 2,083 | $ 21.50 |
| Vested | — | — |
| Forfeited | (23) | 21.50 |
| Nonvested at December 31, 2008 | 2,060 | $ 21.50 |

There are zero option awards vested and no option awards have been exercised as of December 31, 2008.

As of December 31, 2008, $3,503 of total unrecognized compensation costs related to the nonvested stock options is expected to be recognized over the remaining weighted-average period of 1.7 years.

**Restricted Stock Units**

The Company granted restricted stock units under the 2007 Plan. The requisite service period for restricted stock units is three years.

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The following table presents information with respect to restricted stock unit activity as of December 31, 2008.

| | Outstanding Shares | Weighted Average Grant Date Fair Value (per share) |
|---|---|---|
| Nonvested at December 31, 2007 | — | — |
| Granted | 270 | $ 21.50 |
| Vested | — | — |
| Forfeited | (3) | 21.50 |
| Nonvested at December 31, 2008 | 267 | $ 21.50 |

As these restricted stock units would have paid-out in cash if the IPO had not been completed, the Company reclassified the restricted stock units from liability-classified awards to equity-classified awards as of the completion of the IPO. As of December 31, 2008, $1,880 of total unrecognized compensation costs related to the nonvested restricted stock units is expected to be recognized over the remaining weighted-average period of 1.8 years.

If dividends are declared with respect to the shares of the Company's common stock during the vesting period of the restricted stock units, the Company credits a liability for the value of the dividends that would have been distributed if the restricted stock units were shares of Company common stock. When the restricted stock units vest, the Company will pay the employee a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company has recorded a long-term liability of $66 at December 31, 2008 related to the dividends accrued.

**Restricted Stock**

The Company granted restricted stock under the 2007 Plan. The requisite service period for the restricted stock is three months.

The following table presents information with respect to restricted stock activity at December 31, 2008.

| | Outstanding Shares | Grant Date Fair Value (per share) |
|---|---|---|
| Nonvested at December 31, 2007 | — | — |
| Granted | 90 | $ 21.50 |
| Vested | (84) | 21.50 |
| Forfeited | (6) | 21.50 |
| Nonvested at December 31, 2008 | — | $ — |

As of December 31, 2008, the restricted stock was fully vested and there were no unrecognized compensation costs related to the nonvested restricted stock units. The aggregate intrinsic value of restricted stock awards on the date of vesting was $1,647. The Company recognized an income tax shortfall of $60 at the vesting of these awards.

**Employee Stock Purchase Plan**

The Company's Nonqualified Employee Stock Purchase Plan ("ESPP") was effective as of July 1, 2008. Under the ESPP, employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value as of the beginning or end of each three-month purchase period. As of December 31, 2008 there were 1,961 shares of common stock reserved for issuance under the ESPP. The Company's ESPP is considered compensatory under SFAS 123(R). Compensation costs of $172 were recognized for year ended December 31, 2008. As of December 31, 2008, 39 shares were issued from treasury stock under the ESPP.

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## Note 10: Preferred Stock Without Mandatory Redemption Requirements

Certain preferred stock agreements do not require annual sinking fund payments or redemption except at the option of the subsidiaries and are as follows:

| Dividend Yield | Balance at December 31 2008 | 2007 |
|---|---|---|
| 4.50% | $1,720 | $1,720 |
| 5.00% | 1,962 | 1,968 |
| 5.50% | 486 | 488 |
| 5.75% | 389 | 392 |
| | $4,557 | $4,568 |

## Note 11: Long-Term Debt

The Company primarily incurs long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term at December 31 are:

| | Rate | Maturity Date | 2008 | 2007 |
|---|---|---|---|---|
| Long-term debt of American Water Capital Corp. ("AWCC") | | | | |
| Private activity bonds and government funded debt | | | | |
| Floating rate (a) | 1.55%-2.20% | 2018-2032 | $ 86,860 | $ 86,860 |
| Senior notes | | | | |
| Fixed rate | 5.39%-10.00% | 2011-2038 | 2,959,000 | 2,712,000 |
| Long-term debt of other subsidiaries | | | | |
| Private activity bonds and government funded debt | | | | |
| Fixed rate | 0%-6.88% | 2009-2038 | 937,835 | 942,941 |
| Floating rate (b) | 1.50%-10.00% | 2015-2032 | 33,420 | 178,145 |
| Mortgage bonds | | | | |
| Fixed rate | 6.59%-9.71% | 2009-2034 | 675,200 | 731,340 |
| Senior debt | | | | |
| Fixed rate | 5.60%-9.10% | 2009-2025 | 40,613 | 45,473 |
| Mandatory redeemable preferred stock | 4.60%-9.75% | 2013-2036 | 24,425 | 24,644 |
| Notes payable and other (c) | 5.76%-11.91% | 2012-2026 | 2,882 | 3,442 |
| Long-term debt | | | 4,760,235 | 4,724,845 |
| Unamortized debt discount, net (d) | | | 63,800 | 70,743 |
| Total long-term debt | | | $ 4,824,035 | $ 4,795,588 |

(a) Variable rate tax-exempt bonds remarketed for periods up to 270 days (1 to 119 days during 2008 and 1 to 127 days during 2007). These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. If the remarketing fails and no investors purchase the bonds, the Company is required to purchase the bonds. When the bonds fail to be remarketed to investors, the Company is obligated to purchase the bonds at par. However the Company intends to remarket the bonds until maturity. During January and February of 2009, AWCC purchased these bonds because no buyer was willing to purchase the bonds at market rates. Buyers periodically purchased the bonds at market rates during January and February of 2009. Since the debt has been remarketed for periods no longer than one week and the Company cannot be certain remarketing will be successful, the debt is included in current portion of long-term debt at December 31, 2008. As of February 23, 2009, AWCC held all the bonds in treasury.

(b) Bonds included in current portion of long-term debt at December 31, 2008. $24,860 of the total represents variable rate tax-exempt bonds which are remarketed every 7 days. These bonds may be converted to other

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short-term variable-rate structures, a fixed-rate structure or subject to redemption. The remaining $8,560 represents variable rate tax-exempt bonds remarketed as for periods up to 270 days. See (a) above.

(c) Includes capital lease obligations of $1,829 and $1,982 at December 31, 2008 and 2007, respectively. Lease payments of $171, $193, $215, $237, $122 and $891 will be made in 2009, 2010, 2011, 2012, 2013 and thereafter, respectively.

(d) Includes fair value adjustments previously recognized in acquisition purchase accounting.

All the subsidiaries' mortgage bonds and $791,390 of the subsidiaries' private activity bonds and government funded debt is collateralized by utility plant.

Long-term debt indentures contain a number of covenants that, among other things, limit, subject to certain exceptions, the Company from issuing debt secured by the Company's assets. Certain long term notes require the Company to maintain a ratio of consolidated total indebtedness to consolidated total capitalization of not more than 0.70 to 1.00. In addition, the Company has $1,104,902 of notes which include the right to redeem the notes in whole or in part from time to time subject to certain restrictions.

In 2007, the Company borrowed $1,750,000 from RWE and used the proceeds to redeem $1,750,000 of its 5.9% mandatory redeemable preferred stock.

Also during 2007, the Company issued senior notes in the principal amount of $2,117,000 and received equity contributions from RWE in the amount of $1,067,092. The Company used the proceeds from the senior notes and equity contributions to repay long-term and short-term RWE notes, repay outstanding commercial paper and for other corporate purposes amounting to $2,011,530, $624,446 and $548,116, respectively.

A portion of the RWE notes that were redeemed in 2007 were obtained for the use of certain of the Company's regulated subsidiaries. These notes were redeemed early resulting in a difference of $8,655 between the book value of the RWE notes and the cash consideration required to extinguish the notes. As agreed with the applicable Regulators, the difference on extinguishment was deferred as a regulatory liability by the Company's regulated subsidiaries and will be amortized to Interest, net over the remaining lives of the original RWE notes for periods ranging from 2014 to 2034. The amount amortized was $1,044 in 2008 and $531 in 2007.

The future sinking fund payments and maturities are as follows:

| Year | Amount |
|---|---|
| 2009 | $ 175,822 |
| 2010 | 44,897 |
| 2011 | 35,087 |
| 2012 | 32,562 |
| 2013 | 112,099 |
| Thereafter | 4,359,768 |

The following long-term debt was issued in 2008:

| Company | Type | Interest Rate | Maturity | Amount |
|---|---|---|---|---|
| American Water Capital Corp. | Senior notes | 6.25% | 2018 | $ 110,000 |
| American Water Capital Corp. | Senior notes | 6.55% | 2023 | 90,000 |
| American Water Capital Corp. | Senior notes | 10.00% | 2038 | 75,000 |
| Other subsidiaries | State financing authority loans and other | 1.00%-1.39% | 2024-2025 | 4,941 |
| Total issuances | | | | $ 279,941 |

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The following long-term debt and preferred stock with mandatory redemption requirements were repurchased or retired through optional redemption or payment at maturity during 2008:

| Company | Type | Interest Rate | Maturity | Amount |
|---|---|---|---|---|
| *Long-term debt* | | | | |
| American Water Capital Corp. | Senior notes—fixed rate | 6.87% | 2011 | $ 28,000 |
| Other subsidiaries. | Senior notes—floating rate | 6.48%-10.00% | 2021-2032 | 144,725 |
| Other subsidiaries | Fixed rate bonds and notes | 5.05%-9.35% | 2008-2029 | 61,065 |
| Other subsidiaries | State financing authority loans and other | 0.00%-9.87% | 2008-2034 | 10,389 |
| *Preferred stock with mandatory redemption requirements* | | | | |
| Other subsidiaries | | 4.60%-6.00% | 2013-2019 | 218 |
| Total retirements & redemptions | | | | $ 244,397 |

Other subsidiaries fixed rate bonds and notes redemptions includes $2,832 of debt assumed by the purchaser in the Felton water system asset sale.

The $144,725 of senior notes redeemed in 2008 are held in treasury and can be re-marketed.

Gains from early extinguishment of debt included in Interest, net amounted to $0, $13,113 and $3,739 in 2008, 2007 and 2006, respectively.

Interest, net includes interest income of approximately $5,690, $10,985, and $4,254 at December 31, 2008, 2007 and 2006, respectively.

On February 4, 2009, American Water Capital Corp., the Company's financing subsidiary, completed its public offering of $75,000 of 8.25% Senior Monthly Notes due 2038. The net proceeds of the offering were used to repay short term debt.

**Note 12: Short-Term Debt**

The components of short-term debt at December 31 are as follows:

| | 2008 | 2007 |
|---|---|---|
| Revolving credit line | $ 437,000 | $ — |
| Commercial paper, net of $0 and $680 discount at 12/31/08 and 12/31/07, respectively | — | 169,267 |
| Book overdraft | 42,010 | 42,198 |
| Other short-term debt | — | 9,049 |
| Total short-term debt | $ 479,010 | $ 220,514 |

AWCC had the following available capacity under its commercial paper program at December 31:

| | 2008 | 2007 |
|---|---|---|
| Commercial paper program | $ 700,000 | $ 700,000 |
| Commercial paper program available capacity | 700,000 | 530,053 |

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AWCC has entered into an $840,000 senior unsecured credit facility syndicated among the following group of 11 banks with JPMorgan Chase Bank, N.A. acting as administrative agent:

| Bank | Commitment Amount Through September 15, 2012 | Commitment Amount Through September 15, 2013 |
|---|---|---|
| JPMorgan Chase Bank, N.A. | $ 115,000 | $ — |
| Citibank, N.A. | 115,000 | 115,000 |
| Citizens Bank of Pennsylvania | 80,000 | 80,000 |
| Credit Suisse, Cayman Islands Branch | 80,000 | 80,000 |
| William Street Commitment Corporation | 80,000 | 80,000 |
| Merrill Lynch Bank USA | 80,000 | 80,000 |
| Morgan Stanley Bank | 80,000 | 80,000 |
| UBS Loan Finance LLC | 80,000 | 80,000 |
| National City Bank | 50,000 | 50,000 |
| PNC Bank, N.A. | 40,000 | 40,000 |
| The Bank of New York Mellon | 40,000 | — |
| | $ 840,000 | $ 685,000 |

This revolving credit facility is principally used to support the commercial paper program at AWCC and to provide up to $150,000 million in letters of credit. On September 15, 2008, a majority of the banks agreed to further extend $685,000 of commitments under this revolving credit facility to September 15, 2013. On December 18, 2008, The Bank of New York Mellon joined the credit facility syndicate with a commitment amount of $40,000 through September 15, 2012. If any lender defaults in its obligation to fund advances, the Company may request the other lenders to assume the default lender's commitment or replace such defaulting lender by designating an assignee willing to assume the commitment, however the remaining lenders have no obligation to assume a defaulting lender's commitment and we can provide no assurances that we will replace a defaulting lender.

At December 31, AWCC had the following sub-limits and available capacity under the credit facility.

| | 2008 | 2007 |
|---|---|---|
| Letter of credit sublimit | $ 150,000 | $ 150,000 |
| Letter of credit available capacity | 106,097 | 60,659 |

At December 31, 2008, the Company had $49,230 of outstanding letters of credit, $43,903 of which was issued under the revolving credit facility noted above.

The following table presents the short-term borrowing activity for AWCC for 2008 and 2007:

| | 2008 | 2007 |
|---|---|---|
| Average borrowings | $ 291,821 | $ 207,210 |
| Maximum borrowings outstanding | 570,429 | 720,964 |
| Weighted average interest rates, computed on a daily basis | 3.51% | 5.49% |
| Weighted average interest rates, at December 31 | 0.75% | 5.62% |

Interest rates on advances under the credit facility are based on either prime or the London Interbank Offering Rate ("LIBOR") plus an applicable margin based upon credit ratings of the Company, as well as total outstanding amounts under the agreement at the time of the borrowing. The maximum LIBOR margin is 55 basis points.

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The credit facility requires the Company to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. The ratio at December 31, 2008 was 0.56 to 1.00.

None of the Company's borrowings are subject to default or prepayment as a result of a downgrading of securities, although such a downgrading could increase fees and interest charges under the Company's credit facilities.

As part of the normal course of business, the Company routinely enters contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit the Company and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if the Company is downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance. Depending on its net position with a counterparty, the demand could be for the posting of collateral. In the absence of expressly agreed provisions that specify the collateral that must be provided, the obligation to supply the collateral requested will be a function of the facts and circumstances of the Company's situation at the time of the demand. If the Company can reasonably claim that it is willing and financially able to perform its obligations, it may be possible to successfully argue that no collateral should be posted or that only an amount equal to two or three months of future payments should be sufficient. The Company does not expect to post any collateral which will have a material adverse impact on the Company's results of operations, financial position or cash flows.

AWCC has entered into a one year $10,000 committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2009 unless extended and is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on either the prime rate of the financial institution or the applicable LIBOR rate for the term selected plus 200 basis points.

**Note 13: General Taxes**

Components of general tax expense from continuing operations for the years presented are as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Gross receipts and franchise | $ 79,228 | $ 71,360 | $ 71,629 |
| Property and capital stock | 80,025 | 75,172 | 75,132 |
| Payroll | 31,060 | 28,406 | 27,853 |
| Other general | 8,826 | 8,315 | 10,451 |
| | $199,139 | $183,253 | $185,065 |

**Note 14: Income Taxes**

Components of income tax expense from continuing operations for the years presented are as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| State income taxes | | | |
| Current | $ 16,196 | $16,135 | $ 13,808 |
| Deferred | | | |
| Current | 409 | 2,079 | (977) |
| Non-current | 10,332 | (11) | 4,950 |
| | 26,937 | 18,203 | 17,781 |
| Federal income taxes | | | |
| Current | 1,522 | 30,213 | — |
| Deferred | | | |
| Current | 1,973 | 9,382 | (15,213) |
| Non-current | 82,929 | 30,468 | 45,704 |
| Amortization of deferred investment tax credits | (1,534) | (1,510) | (1,360) |
| | 84,890 | 68,553 | 29,131 |
| | $111,827 | $86,756 | $ 46,912 |

A reconciliation of income tax expense from continuing operations at the statutory federal income tax rate to actual income tax expense is as follows:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Income tax at statutory rate | $(157,708) | $ (89,432) | $(38,128) |
| Increases (decreases) resulting from— | | | |
| State taxes, net of federal taxes | 17,509 | 11,832 | 11,558 |
| Change in valuation allowance | (158) | (4,727) | (3,870) |
| Flow through differences | 2,731 | 2,780 | 2,363 |
| Amortization of deferred investment tax credits | (1,534) | (1,510) | (1,360) |
| Subsidiary preferred dividends | 716 | 799 | 707 |
| Impairment charges | 252,158 | 171,247 | 74,177 |
| Other, net | (1,887) | (4,233) | 1,465 |
| Actual income tax expense | $ 111,827 | $ 86,756 | $ 46,912 |

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The following table provides the components of the net deferred tax liability from continuing operations at December 31:

| | 2008 | 2007 |
|---|---|---|
| Deferred tax assets: | | |
| Advances and contributions | $ 539,165 | $ 521,323 |
| Deferred investment tax credits | 12,973 | 13,495 |
| Other postretirement benefits | 102,371 | 71,124 |
| Tax losses and credits | 124,311 | 90,725 |
| Pension benefits | 187,498 | 119,523 |
| Unamortized debt discount, net | 26,718 | 29,569 |
| Capital loss not utilized | 6,165 | 6,992 |
| Other | 54,965 | 82,000 |
| | 1,054,166 | 934,751 |
| Valuation allowance | (28,862) | (29,021) |
| | 1,025,304 | 905,730 |
| Deferred tax liabilities: | | |
| Utility plant, principally due to depreciation differences | 1,446,655 | 1,370,241 |
| Income taxes recoverable through rates | 76,159 | 76,998 |
| Deferred security costs | 5,358 | 6,980 |
| Deferred business services project expenses | 4,456 | 2,158 |
| Deferred other postretirement benefits | 51,145 | 17,637 |
| Deferred pension benefits | 88,768 | 40,308 |
| Other | 58,350 | 30,326 |
| | 1,730,891 | 1,544,648 |
| | $ (705,587) | $ (638,918) |

At December 31, 2008 and 2007, the Company recorded federal net operating loss ("NOL") carryforwards of $239,654 and $91,554, respectively. The Company believes the federal NOL carryforwards are more likely than not to be recovered and require no valuation allowance. The Company evaluated its ability to fully utilize the existing federal NOL carryforwards in light of the partial ownership change by RWE. Under Internal Revenue Code ("I.R.C.") Section 382, an ownership change occurs if there is a greater than fifty percent (50%) change in equity ownership of a company over a three year period determined by reference to the ownership of persons holding five percent (5%) or more of that company's equity securities. If a company undergoes an ownership change as defined by I.R.C. Section 382, the company's ability to utilize its pre-change NOL carryforwards to offset post-change income may be limited.

The Company believes that the limitation imposed by I.R.C. Section 382 generally should not preclude use of its federal NOL carryforwards, assuming the Company has sufficient taxable income in future carryforward periods to utilize those NOL carryforwards. The Company's federal NOL carryforwards do not begin expiring until 2025.

At December 31, 2008 and 2007, the Company recorded state NOL's of $431,694 and $381,623, respectively, the majority of which are offset by a valuation allowance because the Company does not believe these NOL's are more likely than not to be realized because the state NOL carryforwards began expiring in 2008.

At December 31, 2008 and 2007, the Company had Canadian NOL carryforwards of $17,528 and $20,155, respectively. The majority of these carryforwards are offset by a valuation allowance because the Company does not believe these NOL's are more likely than not to be realized because the Canadian NOL carryforwards began expiring in 2008.

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At December 31, 2008 and 2007, the Company had capital loss carryforwards for federal income tax purposes of $17,614 and $19,977, respectively. The Company has recognized a full valuation allowance for the capital loss carryforwards because the Company does not believe these losses are more likely than not to be recovered.

The Company files income tax returns in the United States federal jurisdiction, and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S income tax examinations by tax authorities for years before 2003.

During 2006, the Company filed federal refund claims with the Internal Revenue Service ("IRS"). The majority of the Company's refund claims were attributable to the carry back of NOL's generated in 2003. The refund claims procedurally required approval by the Joint Committee of Taxation ("JCT"). The Company received notification from the IRS outlining their final findings from the audit to which the Company and IRS agreed. In the fourth quarter of 2008, the Company received approximately $28,652 in refunds excluding interest of $6,317.

The Company has state income tax examinations in progress and does not expect material adjustments to result.

The Company adopted FIN 48 effective January 1, 2007. The adoption did not have any impact to the Company's opening balance of accumulated deficit in 2007 because the positions taken were adequately reserved. The Company's gross FIN 48 liability, excluding interest and penalties, for unrecognized tax benefits decreased during 2008 as follows:

| | |
|---|---|
| Balance at January 1, 2007 | $2,202 |
| Decreases relating to tax authority settlements | (36) |
| Decreases due to statute of limitations | (524) |
| Balance at December 31, 2007 | 1,642 |
| Decreases due to lapse of statute of limitations | (291) |
| Balance at December 31, 2008 | $1,351 |

The liability balance as of December 31, 2008 and 2007 does not include interest and penalties of $312 and $341, respectively, which is recorded as a component of income tax expense. The Company does not anticipate material changes to its unrecognized tax benefits within the next year. If the Company sustains all of its positions at December 31, 2008 and 2007, an unrecognized tax benefit of $1,104 and $1,396, respectively, excluding interest and penalties, would impact the Company's effective tax rate.

### Note 15: Employee Benefits

#### Pension and Other Postretirement Benefits

The Company maintains noncontributory defined benefit pension plans covering eligible non-union employees of its regulated utility and shared services operations. Benefits under the plans are based on the employee's years of service and compensation. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan.

The Company's funding policy is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974. Pension plan assets are invested in a number of investments including equity and bond mutual funds, fixed income securities and guaranteed interest contracts with insurance companies.

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Pension expense in excess of the amount contributed to the pension plans is deferred by certain regulated subsidiaries pending future recovery in rates charged for utility services as contributions are made to the plans. (See Note 7)

The Company also has several unfunded noncontributory supplemental non-qualified pension plans that provide additional retirement benefits to certain employees.

The Company maintains postretirement benefit plans providing varying levels of medical and life insurance to eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002.

The Company's policy is to fund postretirement benefit costs accrued. Plan assets are invested in equity and bond mutual funds.

The obligations of the plans are dominated by obligations for active employees. Because the timing of expected benefit payments is so far in the future and the size of the plan assets are small relative to the Company's assets, the investment strategy is to allocate a large portion of assets to equities, which the Company believes will provide the highest return over the long-term period. The fixed income assets are invested in long duration debt securities in order to better match the duration of the plan liability.

The liabilities of the pension and other postretirement benefit plans were adjusted to their fair value at the time of the Acquisitions.

The Company periodically conducts an asset liability modeling study to ensure the investment strategy is aligned with the profile of the obligations. The long-term goals are to maximize the plan funded status and minimize contributions and pension expense, while taking into account the potential volatility risks on each of these items.

None of the Company's securities are included in pension or other postretirement benefit plan assets. Combined plan assets of the benefit plan's include approximately $500 of RWE securities at December 31, 2008.

The asset allocation for the Company's U.S. pension plan at December 31, 2008 and 2007 by asset category, are as follows:

| Asset category | Target Allocation 2008 | Percentage of Plan Assets At December 31, 2008 | 2007 |
|---|---|---|---|
| Equity securities | 70% | 70% | 60% |
| Fixed income | 30% | 30% | 40% |
| Total | 100% | 100% | 100% |

The investment policy guidelines of the pension plan require that the fixed income portfolio has an overall weighted average credit rating of AA or better by Standard & Poor's and the minimum credit quality for fixed income securities must be BBB- or better. Up to 20% of the portfolio may be invested in collateralized mortgage obligations backed by the United States Government.

The Company's other postretirement benefit plans are partially funded. The asset allocation for the Company's other postretirement benefit plans at December 31, 2008 and 2007, by asset category, are as follows:

| Asset category | Target Allocation 2008 | Percentage of Plan Assets At December 31, 2008 | 2007 |
|---|---|---|---|
| Equity securities | 70% | 70% | 61% |
| Fixed income | 30% | 30% | 39% |
| Total | 100% | 100% | 100% |

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The postretirement benefit plan assets are invested in a manner consistent with the pension plan investment policy.

The following table provides a rollforward of the changes in the benefit obligation and plan assets for the most recent two years for all plans combined:

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| **Change in benefit obligation** | | | | |
| Benefit obligation at January 1 | $ 916,994 | $ 892,857 | $ 451,944 | $ 426,294 |
| Service cost | 26,207 | 25,611 | 12,425 | 12,683 |
| Interest cost | 58,195 | 53,288 | 28,197 | 25,383 |
| Plan participants' contributions | — | — | 1,803 | 1,682 |
| Amendments | 850 | — | — | — |
| Actuarial (gain) loss | 46,988 | (23,284) | 2,426 | 5,656 |
| Special termination benefits | — | 93 | — | — |
| Gross benefits paid | (32,345) | (31,571) | (22,669) | (21,300) |
| Federal subsidy | — | — | 1,616 | 1,546 |
| Benefit obligation at December 31 | $1,016,889 | $ 916,994 | $ 475,742 | $ 451,944 |
| **Change in Plan Assets** | | | | |
| Fair value of plan assets at January 1 | $ 626,272 | $ 578,280 | $ 293,392 | $ 281,390 |
| Actual return on plan assets | (158,322) | 25,535 | (65,400) | 4,403 |
| Employer contributions | 77,678 | 54,028 | 27,375 | 27,217 |
| Plan participants' contributions | — | — | 1,803 | 1,682 |
| Benefits paid | (32,345) | (31,571) | (22,669) | (21,300) |
| Fair value of plan assets at December 31 | $ 513,283 | $ 626,272 | $ 234,501 | $ 293,392 |
| Funded status at December 31 | $ (503,606) | $(290,722) | $(241,241) | $(158,552) |
| **Amounts recognized in the balance sheet consist of:** | | | | |
| Current liability | $ (1,544) | $ (1,609) | $ (48) | $ (44) |
| Noncurrent liability | (502,062) | (289,113) | $(241,193) | (158,508) |
| Net amount recognized | $ (503,606) | $(290,722) | $(241,241) | $(158,552) |

The following table provides the components of the Company's accumulated other comprehensive income and regulatory assets that have not been recognized as components of periodic benefit costs as of December 31.

| | Pension Benefits | | Other Benefits | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Net actuarial loss (gain) | $334,934 | $77,927 | $143,907 | $ 53,627 |
| Prior service cost (credit) | 1,722 | 1,053 | (13,301) | (14,482) |
| Transition obligation (asset) | — | — | 694 | 867 |
| Net amount recognized | $336,656 | $78,980 | $131,300 | $ 40,012 |
| Regulatory assets | $198,506 | $45,933 | $131,300 | $ 40,012 |
| Accumulated other comprehensive income | 138,150 | 33,047 | — | — |
| | $336,656 | $78,980 | $131,300 | $ 40,012 |

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At December 31, 2008 and 2007, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with a projected obligation in excess of plan assets were as follows:

| | Projected Benefit Obligation Exceeds the Fair Value of Plans' Assets | |
|---|---|---|
| | 2008 | 2007 |
| Projected benefit obligation | $ 1,017,000 | $ 917,000 |
| Fair value of plan assets | 513,000 | 626,000 |

| | Accumulated Benefit Obligation Exceeds the Fair Value of Plans' Assets | |
|---|---|---|
| | 2008 | 2007 |
| Accumulated benefit obligation | $ 887,000 | $ 793,000 |
| Fair value of plan assets | 513,000 | 626,000 |

The accumulated postretirement benefit obligation exceeds plan assets for all of the Company's other postretirement benefit plans.

In August 2006, the Pension Protection Act ("PPA") was signed into law in the U.S. The PPA replaces the funding requirements for defined benefit pension plans by requiring that defined benefit plans contribute to a 100% of the current liability funding target over 7 years. Defined benefit plans with a funding status of less than 80% of the current liability are defined as being "at risk" and additional funding requirements and benefit restrictions may apply. The PPA was effective for the 2008 plan year with short-term phase-in provisions for both the funding target and at-risk determination. The Company's qualified defined benefit plan is currently funded above the at-risk threshold, and therefore the Company expects that the plans will not be subject to the "at risk" funding requirements of the PPA. The Company is proactively monitoring the plan's funded status and projected contributions under the new law to appropriately manage the potential impact on cash requirements.

Minimum funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. The Company plans to contribute at least amounts equal to the minimum required contributions in 2009 to the qualified pension plans. The Company plans to contribute its 2009 other postretirement benefit cost to its Voluntary Employee's Benefit Association Trust.

Information about the expected cash flows for the pension and postretirement benefit plans is as follows:

| | Pension Benefits | Other Benefits |
|---|---|---|
| 2009 expected employer contributions | | |
| To plan trusts | $ 84,200 | $ 41,636 |
| To plan participants | 1,544 | 48 |

The Company made 2009 contributions to fund pension benefits and other benefits of $17,100 and $10,409, respectively through February 2009.

The following table reflects the net benefits expected to be paid from the plan assets or the Company's assets:

| | Pension Benefits | Other Benefits | |
|---|---|---|---|
| | Expected Benefit Payments | Expected Benefit Payments | Expected Federal Subsidy Payments |
| 2009 | $ 38,114 | $ 21,511 | $ 1,691 |
| 2010 | 41,626 | 24,220 | 1,845 |
| 2011 | 45,376 | 27,218 | 1,982 |
| 2012 | 49,519 | 29,849 | 2,169 |
| 2013 | 54,005 | 32,562 | 2,360 |
| 2014 - 2018 | 347,870 | 203,348 | 14,660 |

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Because the above amounts are net benefits, plan participants' contributions have been excluded from the expected benefits.

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes.

The significant assumptions related to the Company's pension and other postretirement benefit plans are as follows:

| | Pension Benefits | | | Other Benefits | | |
|---|---|---|---|---|---|---|
| | 2008 | 2007 | 2006 | 2008 | 2007 | 2006 |
| **Weighted-average assumptions used to determine December 31 benefit obligations** | | | | | | |
| Discount rate | 6.12% | 6.27% | 5.90% | 6.09% | 6.20% | 5.90% |
| Rate of compensation increase | 4.00% | 4.25% | 4.25% | N/A | N/A | N/A |
| Medical trend | N/A | N/A | N/A | graded from 8% in 2009 to 5% in 2015+ | graded from 8% in 2008 to 5% in 2014+ | graded from 9% in 2007 to 5% in 2011+ |
| **Weighted-average assumptions used to determine net periodic cost** | | | | | | |
| Discount rate | 6.27% | 5.90% | 5.65% | 6.20% | 5.90% | 5.65% |
| Expected return on plan assets | 7.90% | 8.00% | 8.25% | 7.75% | 7.38% | 7.95% |
| Rate of compensation increase | 4.25% | 4.25% | 4.25% | N/A | N/A | N/A |
| Medical trend | N/A | N/A | N/A | graded from 8% in 2008 to 5% in 2014+ | graded from 9% in 2007 to 5% in 2011+ | graded from 10% in 2006 to 5% in 2011+ |

N/A—Assumption is not applicable.

The discount rate assumption was determined for the pension and postretirement benefit plans independently. A yield curve was developed for a universe containing the majority of U.S.—issued Aa—graded corporate bonds, all of which were non callable (or callable with make-whole provisions). For each plan, the discount rate was developed as the level equivalent rate that would produce the same present value as that using spot rates aligned with the projected benefit payments.

The expected long-term rate of return on plan assets is based on historical and projected rates of return for current and planned asset classes in the plans' investment portfolios. Assumed projected rates of return for each of the plans' projected asset classes were selected after analyzing historical experience and future expectations of the returns and volatility of the various asset classes. Based on the target asset allocation for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to the benchmark returns and for the effect of expenses paid from plan assets. The Company's pension expense increases as the expected return on assets decreases.

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Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one -percentage -point change in assumed health care cost trend rates would have the following effects:

| | One - Percentage- Point Increase | One - Percentage- Point Decrease |
|---|---|---|
| Effect on total of service and interest cost components | $ 6,226 | $ (5,100) |
| Effect on other postretirement benefit obligation | $ 59,525 | $ (49,853) |

The following table provides the components of net periodic benefit costs for the years ended December 31:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Components of net periodic pension benefit cost** | | | |
| Service cost | $ 26,206 | $ 25,611 | $ 24,308 |
| Interest cost | 58,195 | 53,288 | 49,622 |
| Expected return on plan assets | (51,701) | (47,052) | (42,304) |
| Amortization of: | | | |
| Prior service cost (credit) | 181 | 127 | 494 |
| Actuarial (gain) loss | 5 | 262 | 1,482 |
| Periodic pension benefit cost | $ 32,886 | $ 32,236 | $ 33,602 |
| Special termination pension benefit charge | — | 93 | 373 |
| Curtailment charge | — | — | 971 |
| Settlement charge (credit) | — | — | 65 |
| Net periodic pension benefit cost | $ 32,886 | $ 32,329 | $ 35,011 |
| **Other changes in plan assets and benefit obligations recognized in other comprehensive income, net of tax** | | | |
| Amortization of prior service credit (cost) | $ (26) | $ (36) | |
| Current year actuarial (gain) loss | 64,139 | (924) | |
| Amortization of actuarial gain (loss) | (1) | (72) | |
| Total recognized in other comprehensive income | $ 64,112 | $ (1,032) | |
| Total recognized in net periodic benefit cost and comprehensive income | $ 96,998 | $ 31,297 | |
| **Components of net periodic other postretirement benefit cost** | | | |
| Service cost | $ 12,425 | $ 12,683 | $ 11,613 |
| Interest cost | 28,197 | 25,383 | 24,348 |
| Expected return on plan assets | (23,002) | (21,065) | (19,689) |
| Amortization of: | | | |
| Transition obligation (asset) | 173 | 173 | 173 |
| Prior service cost (credit) | (1,180) | (1,180) | (1,145) |
| Actuarial (gain) loss | 810 | — | 2,011 |
| Periodic other postretirement benefit cost | $ 17,423 | $ 15,994 | $ 17,311 |
| Curtailment charge | — | — | (18) |
| Net periodic other postretirement benefit cost | $ 17,423 | $ 15,994 | $ 17,293 |

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The Company's policy is to recognize curtailments when the total expected future service of plan participants is reduced by greater than 10% due to an event that results in terminations and/or retirements. The Company reflected curtailments in 2006 due to a significant number of aggregate terminations and retirements at one of its subsidiaries.

The estimated amounts that will be amortized from accumulated other comprehensive income and regulatory assets into net periodic benefit cost in 2009 are as follows:

| | Pension Benefits | Other Benefits |
|---|---|---|
| Actuarial (gain) loss | $23,968 | $ 9,155 |
| Prior service cost (credit) | 182 | (1,181) |
| Transition obligation (asset) | — | 173 |
| Total | $24,150 | $ 8,147 |

**Savings Plans for Employees**

The Company maintains 401(k) savings plans that allow employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution, subject to certain limitations. Due to the Company's discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plans totaling $7,789 for 2008, $7,305 for 2007 and $6,898 for 2006. All of the Company's contributions are invested in one or more funds at the direction of the employee.

**Long-Term Incentive Plan**

The Company participated in a RWE long-term incentive plan for executives ("RWE LTIP"). Under the RWE LTIP, Company employees were granted 120,004 performance shares of RWE common stock which vested over three years beginning January 1, 2005. Subject to the vesting provisions, the performance shares were payable in cash. In accordance with SFAS 123(R), the performance shares were accounted for as a liability. Participants received their awards in cash in 2008. No expense was recognized related to these shares during 2008 and no liability remains at December 31, 2008. The Company recorded a liability of $8,398 related to the performance shares at December 31, 2007, which was included in Other current liabilities. For the years ended December 31, 2007 and 2006, the Company recognized approximately $4,127 and $2,604, respectively, of share-based compensation expense related to the performance shares in operation and maintenance expense.

**Retention Bonuses**

The Company established a retention bonus program that was intended to retain employees in key leadership roles through the timely completion of the IPO. If a participant remained employed by the Company through March 31, 2008, the participant received a cash bonus based on a predetermined percentage of his or her base salary in effect on January 1, 2006, or his or her hire date, if he or she was hired after January 1, 2006. Participants received their awards in cash in 2008. For the years ended December 31, 2008, 2007, and 2006, the Company recognized approximately $455, $2,498, and $2,907, respectively, of expense related to the retention bonuses in operation and maintenance expense.

**Completion Bonuses**

The Company offered a completion bonus to reward selected senior executives for their contributions to the IPO process. Each eligible executive was entitled to receive a cash bonus based on a predetermined percentage of his or her base salary in effect on December 31, 2007, or his or her hire date, if he or she was hired after January 1, 2006. Participants received their awards in cash in 2008. For the years ended December 31, 2008, 2007, and 2006, the Company recognized approximately $749, $832, and $1,750, respectively, of expense related to the completion bonuses in operation and maintenance expense.

**Note 16: Commitments and Contingencies**

OMI/Thames Water Stockton, Inc. ("OMI/TW") is a 50/50 joint venture between a subsidiary of the Company and Operations Management International, Inc. ("OMI"). In February 2003, OMI/TW and the City of Stockton California (the "City") entered into a 20-year service contract for capital improvements and management services of water, wastewater and storm water utilities. By mutual agreement, OMI/TW and the City of Stockton terminated the contract effective February 29, 2008 (the "Termination Date"). Upon termination, responsibility for management and operation of the system was returned to the City. OMI/TW agreed to provide a limited twelve-month warranty relating to certain components of the facilities that OMI/TW constructed (the "WW39 Plant"), which expired on December 31, 2008. OMI/TW also agreed to correct any latent defects relating to significant deficiencies in the structural components of certain capital improvements discovered prior to November 15, 2009, if any. Additionally OMI/TW committed to pay for certain employee transition costs and assumed financial responsibility for regulatory fines levied through the Termination Date, if any, resulting from OMI/TW's failure to comply with applicable National Pollutant Discharge Elimination System permit requirements and/or incidents traced to design defects in the WW39 Plant. During 2007, the California State Water Resources Control Board issued a notice of violation and a corresponding Settlement Communication related to a discharge into an adjacent river. OMI/TW is responsible for any fines that may result from the Settlement Communication. Given the uncertainties related to resolving the remaining issues described above and financial settlement with OMI, the Company has a loss reserve of approximately $1,300 and $4,000 at December 31, 2008 and 2007, respectively.

The Company, through a subsidiary, holds a 50% interest in American Water-Acciona Agua LLC (formerly American Water-Pridesa LLC) ("AW-Acciona") a Delaware limited liability company. Acciona Agua Corporation (USA) holds the remaining 50% interest. In December 2007, AW-Acciona completed construction of a water filtration plant for total construction costs of approximately $32,000. Generally, as part of the contractual terms relating to construction contracts, the Company provides a one-year construction warranty period. As of December 31, 2008, no claims have been made related to this warranty which expired November 27, 2008.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At December 31, 2008, the Company has accrued approximately $4,600 as probable costs and it is reasonably possible that additional losses could range up to $21,500 for these matters. For certain matters, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military services agreements expire between 2053 and 2059 and have remaining performance commitments as measured by estimated remaining contract revenue of $1,184,999 and $496,872 at December 31, 2008 and 2007, respectively. The Company's Operations and Maintenance agreements with municipalities and other customers expire between 2009 and 2038 and have remaining performance commitments as measured by estimated remaining contract revenue of $1,103,839 and $1,178,778 at December 31, 2008 and 2007, respectively. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain major maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

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Included in the military services performance commitment at December 31, 2008 are contracts the Company was awarded during September 2008 for operation and maintenance of the water and wastewater systems at Army installations at Fort Hood, Texas and Fort Polk, Louisiana. According to the agreements, the awards of the contracts are estimated at approximately $329,000 and $348,000, respectively, over a 50-year period as measured by gross contract revenue subject to price redeterminations and customary federal contracting termination provisions. Federal contract price redetermination is a mechanism to periodically adjust the service fee in subsequent periods to reflect changes in contract obligations and market conditions.

Commitments have been made in connection with certain construction programs. The estimated capital expenditures required under legal and binding contractual obligations amounted to $268,989 at December 31, 2008.

The Company's regulated subsidiaries maintain agreements with other water purveyors for the purchase of water to supplement their water supply. The Company's subsidiaries purchased water expense under these types of agreements amounted to approximately $95,739, $92,403, and $85,345 during the years ended December 31, 2008, 2007, and 2006, respectively. The estimated annual commitment related to the minimum quantities of water purchased is expected to approximate $44,938 in 2009, $45,910 in 2010, $46,673 in 2011, $47,636 in 2012, $43,031 in 2013 and $533,635 thereafter.

**Note 17: Net Loss per Common Share**

Basic net loss per common share, loss from discontinued operations, net of tax, per common share and loss from continuing operations per common share are based on the weighted average number of common shares outstanding. Outstanding shares consist of issued shares less treasury stock. Diluted net loss per common share, loss from discontinued operations, net of tax, per common share and loss from continuing operations per common share are based on the weighted average number of common shares outstanding adjusted for the dilutive effect of common stock equivalents related to the restricted stock, restricted stock units, stock options and the employee stock purchase plan. The dilutive effect of restricted stock, restricted stock units, stock options, and the employee stock purchase plan is calculated using the treasury stock method and expected proceeds on vesting of the restricted stock and restricted stock units, exercise of the stock options and purchases under the employee stock purchase plan. The following table sets forth the components of basic and diluted earnings per share and shows the effect of the common stock equivalents on the weighted average number of shares outstanding used in calculating diluted earnings per share:

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Numerator | | | |
| Loss from continuing operations | $(562,421) | $(342,275) | $(155,850) |
| Loss from discontinued operations, net of tax | — | (551) | (6,393) |
| Net loss | $(562,421) | $(342,826) | $(162,243) |
| Denominator | | | |
| Average common shares outstanding—basic | 159,967 | 160,000 | 160,000 |
| Effect of dilutive securities: | | | |
| Stock options | — | — | — |
| Restricted stock units | — | — | — |
| Employee stock purchase plan | — | — | — |
| Average common shares outstanding—diluted | 159,967 | 160,000 | 160,000 |

Options to purchase 926 shares of the Company's common stock, 119 restricted stock units, and 33 shares under the employee stock purchase plan were excluded from the calculation of diluted common shares outstanding because they are anti-dilutive at December 31, 2008. There were also 1,134 stock options and 148 restricted stock units which were excluded from the calculation of diluted common shares outstanding because certain performance conditions were not satisfied as of December 31, 2008. The Company had no potentially dilutive shares for the years ending December 31, 2007 and 2006, respectively.

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On November 5, 2007, the Company's Board of Directors authorized 500,000 shares of common stock, par value $.01 per share and declared a one hundred and sixty thousand-for-one common stock split effective November 7, 2007 for all common shares outstanding. The Company's par value of $1.00 per share changed to $.01 per share and $1,599 was transferred from paid-in capital to common stock to record the split. All share and per share data for all periods presented have been restated to give effect to the stock split.

**Note 18: Fair Values of Financial Instruments**

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments.

Current assets and current liabilities: The carrying amount reported in the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt due to the short-term maturities and variable interest rates, approximates their fair values.

Preferred stock with mandatory redemption requirements and long-term debt: The fair values of preferred stock with mandatory redemption requirements and long-term debt are determined by a valuation model which is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company's debts do not trade in active markets, the Company calculated a base yield curve using a risk-free rate (a US Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for US Utility BBB+ debt securities. The Company used these yield curve assumptions to derive a base yield and then adjusted the base yield for specific features of the debt securities of call features, coupon tax treatment and collateral.

The carrying amounts (including fair value adjustments previously recognized in acquisition purchase accounting) and fair values of the financial instruments at December 31 are as follows:

| 2008 | Carrying Amount | Fair Value |
|---|---|---|
| Preferred stocks with mandatory redemption requirements | $ 24,368 | $ 23,887 |
| Long-term debt (excluding capital lease obligations) | 4,797,838 | 4,430,117 |

| 2007 | Carrying Amount | Fair Value |
|---|---|---|
| Preferred stocks with mandatory redemption requirements | $ 24,514 | $ 25,264 |
| Long-term debt (excluding capital lease obligations) | 4,769,092 | 4,653,765 |

**Adoption of SFAS 157**

Effective January 1, 2008, the Company partially adopted SFAS No. 157, which primarily requires expanded disclosure for assets and liabilities recorded on the balance sheet at fair value. As permitted by FSP FAS 157-2, the Company has elected to defer the adoption of the nonrecurring fair value measurement disclosures of nonfinancial assets and liabilities, such as goodwill and asset retirement obligations until January 1, 2009.

To increase consistency and comparability in fair value measurements, SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels as follows:

- Level 1—quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access as of the reporting date. Financial assets and liabilities utilizing Level 1 inputs include active exchange-traded equity securities, exchange-based derivatives, mutual funds and money market funds.

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- Level 2—inputs other than quoted prices included within level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data. Financial assets and liabilities utilizing Level 2 inputs include fixed income securities, non-exchanged-based derivatives, commingled investment funds not subject to purchase and sale restrictions and fair-value hedges.
- Level 3—unobservable inputs, such as internally-developed pricing models for the asset or liability due to little or no market activity for the asset or liability. Financial assets and liabilities utilizing Level 3 inputs include infrequently-traded non-exchange-based derivatives and commingled investment funds subject to purchase and sale restrictions.

## Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of December 31, 2008:

| Recurring Fair Value Measures | At Fair Value as of December 31, 2008 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| **Assets:** | | | | |
| Cash equivalents | $ — | $ — | $ — | $ — |
| Restricted funds | 11,053 | — | — | 11,053 |
| Rabbi trust investments | — | 3,562 | — | 3,562 |
| Deposits | 10,958 | — | — | 10,958 |
| Total assets | 22,011 | 3,562 | — | 25,573 |
| **Liabilities:** | | | | |
| Deferred compensation obligation | — | 7,741 | — | 7,741 |
| Total liabilities | — | 7,741 | — | 7,741 |
| Total net assets (liabilities) | $22,011 | $(4,179) | $ — | $17,832 |

Restricted funds – The Company's restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities and from customers for future services under operations and maintenance projects. The proceeds of these financings are held in escrow until the designated expenditures are incurred. Restricted funds expected to be released within twelve months subsequent to year-end are classified as current.

Rabbi trust investments – The Company's rabbi trust investments consist primarily of fixed income investments from which supplemental executive retirement plan benefits are paid. The Company includes these assets in other long-term assets.

Deposits – Deposits includes escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets.

Deferred compensation obligations – The Company's deferred compensation plans allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other long-term liabilities. The value of the Company's deferred compensation obligations is based on the market value of the participants' notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

## Note 19: Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $36,200 for 2008, $34,946 for 2007 and $36,136 for 2006. The operating leases for

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facilities will expire over the next 20 years and the operating leases for equipment will expire over the next five years. Certain operating leases have renewal options ranging from one to five years.

At December 31, 2008, the minimum annual future rental commitment under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are $32,342 in 2009, $28,474 in 2010, $22,313 in 2011, $16,836 in 2012, $12,144 in 2013 and $122,904 thereafter.

The Company has a series of agreements with various public entities (the "Partners") to establish certain joint ventures, commonly referred to as "public-private partnerships". Under the public-private partnerships, the Company constructed utility plant, financed by the Company, and the Partners constructed utility plant (connected to the Company's property), financed by the Partners. The Company agreed to transfer and convey some of its real and personal property to the Partners in exchange for an equal principal amount of Industrial Development Bonds ("IDBs"), issued by the Partners under a state Industrial Development Bond and Commercial Development Act. The Company leased back the total facilities, including portions funded by both the Company and the Partners, under leases for a period of 40 years.

The leases related to the portion of the facilities funded by the Company have required payments from the Company to the Partners that approximate the payments required by the terms of the IDBs from the Partners to the Company (as the holder of the IDBs). As the ownership of the portion of the facilities constructed by the Company will revert back to the Company at the end of the lease, the Company has recorded these as capital leases. In accordance with Financial Accounting Standards Board Interpretation Number 39, "Offsetting of Amounts Related to Certain Contracts", the lease obligation and the receivable of the principal amount of the IDBs is presented by the Company on a net basis. The carrying value of the facilities funded by the Company recognized as a capital lease asset was $160,997 and $161,803 at December 31, 2008 and 2007, respectively, which is presented within Utility Plant. The future payments under the lease obligation are equal to and offset by the payments receivable under the IDBs.

At December 31, 2008, the minimum annual future rental commitment under the operating leases for the portion of the facilities funded by the Partners that have initial or remaining non-cancelable lease terms in excess of one year included in the proceeding minimum annual rental commitments are $3,477 in 2009, $3,497 in 2010, $3,500 in 2011 through 2013, and $103,348 thereafter.

**Note 20: Related Party Transactions**

The Company's consolidated statement of operations for the year ended December 31, 2006 reflects expense allocations for some central corporate functions historically provided by Thames Water, including information systems, human resources, accounting and treasury activities and legal services. These allocations reflect expenses specifically identifiable as relating to the Company's business as well as the Company's share of expenses allocated based on capital employed, capital expenditures, headcount, revenues, production volumes, fixed costs, environmental accruals or other methods management considers to be reasonable. During the transition to a separate, stand-alone company, the Company has developed or obtained additional in-house capabilities related to these functions, and therefore there were no such expense allocations in 2008 or in 2007 from RWE or its affiliates.

Thames Water Plc, formerly an affiliate and wholly owned subsidiary of RWE, provided certain management services to the Company which amounted to $0 in 2008 and 2007 and $1,386 in 2006.

Thames Water International Services Limited, formerly an affiliate and wholly owned subsidiary of RWE, provided services of expatriate employees to the Company which amounted to $0 in 2008 and 2007 and $1,763 in 2006.

Interest on the Company's borrowings with RWE amounted to $0, $26,797, and $131,005 in 2008, 2007 and 2006, respectively.

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TWILUX, an affiliate and wholly owned subsidiary of RWE, was the holder of $1,750,000 of the Company's preferred stock. Preferred dividends included in interest expense amounted to $0, $74,569, and $103,270 in 2008, 2007 and 2006, respectively. The preferred stock was redeemed in 2007 utilizing the proceeds from $1,750,000 in variable rate borrowings from RWE. The variable rate borrowings from RWE were subsequently redeemed with proceeds from the senior notes issuance. (See Note 11)

The Company maintains agreements with both public and private water providers for the purchase of water to supplement water supply, particularly during periods of peak demand. The President and CEO of the Company is a Commissioner of one of these water providers. The Company purchased approximately $16,150, $16,793, and $16,374 of water from this provider in the years ended December 31, 2008, 2007 and 2006, respectively. The minimum purchase quantity amounts are known and the rates are set annually. Assuming an annual inflationary rate adjustment of 3.5%, the estimated commitments related to the minimum quantities of purchased water under these agreements are $15,448 in 2009, $15,988 in 2010, $16,548 in 2011, $17,127 in 2012, $17,726 in 2013 and $284,096 thereafter.

**Note 21: Discontinued Operations**

Based on management's ongoing evaluation of the non-regulated businesses, it was determined that the Company's U.S. Residuals and Underground businesses were not meeting growth expectations and were not considered core businesses of the Company's operations. Accordingly, the Company sold these businesses. As a result of these sales, the Company recorded a net gain/loss of $0 in 2008 and 2007 and a net loss of $1,001 in 2006.

In 2006, the Company sold a group of assets of the Residuals business for $2,500 and reported the related operations within discontinued operations. In June 2007, the Company sold another component of Residuals business for $9,660. The Company completed the sale of this component in 2007.

The Company's Underground business was sold for $27,651 in 2006. As a result of the sale, the Company recorded a loss of $1,001 in 2006.

A summary of discontinued operations presented in the Consolidated Statements of Operations include the following:

| | 2007 | 2006 |
|---|---|---|
| Operating revenues | $7,128 | $59,872 |
| Operating expenses | | |
| Operation, maintenance and depreciation | 7,071 | 60,297 |
| Impairment charges | — | 6,117 |
| Total operating expenses, net | 7,071 | 66,414 |
| Operating income (loss) | 57 | (6,542) |
| Other income (deductions) | | |
| Interest, net | 56 | 322 |
| Other, net | (749) | 1,875 |
| Total other income (deductions) | (693) | 2,197 |
| Loss before income taxes | (636) | (4,345) |
| Provision for income taxes | (85) | 1,047 |
| Loss from operations | (551) | (5,392) |
| Loss on sale, net of tax benefit | — | (1,001) |
| Loss from discontinued operations | $ (551) | $ (6,393) |

There were no assets or liabilities classified as discontinued operations in the accompanying Consolidated Balance Sheets at December 31, 2008 and 2007, respectively.

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**Note 22: Segment Information**

The Company has two operating segments which are also the Company's two reportable segments referred to as the Regulated Businesses and Non-regulated Businesses segments. The Company's chief operating decision maker regularly reviews the operating results of the Regulated and Non-regulated Businesses segments to assess segment performance and allocate resources. The evaluation of segment performance and the allocation of resources are based on several measures. The measure that is most consistent with that used by management is adjusted earnings before interest and income taxes from continuing operations ("Adjusted EBIT"). Management has grouped the Company's businesses into its Regulated and Non-regulated Businesses segments based upon the products and services they provide and whether they function under the rules and regulations of the public utility regulatory environment.

The Regulated Businesses segment includes the Company's 23 utility subsidiaries that provide water and wastewater services to customers in 20 U.S. states. With the exception of one company, each of these public utility subsidiaries is subject to regulation by public utility commissions and local governments. In addition to providing similar products and services and being subject to the public utility regulatory environment, each of the regulated subsidiaries has similar economic characteristics, production processes, types and classes of customers and water distribution or wastewater collection processes. Each of these companies is also subject to both federal and state regulation regarding the quality of water distributed and the discharge of wastewater residuals.

The Non-regulated Businesses segment is comprised of non-regulated businesses that provide a broad range of non-regulated water and wastewater services and products including homeowner water and sewer line maintenance services, water and wastewater facility operations and maintenance services, granular carbon technologies and products for cleansing water and wastewater, wastewater residuals management services and water and wastewater facility engineering services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 2). The Regulated and Non-regulated Businesses segment information includes intercompany costs that are allocated by American Water Works Service Company, Inc. and intercompany interest that is charged by AWCC, which are eliminated to reconcile to the consolidated results of operations. Inter-segment revenues, which are primarily recorded at cost plus mark-up that approximates current market prices, include carbon regeneration services and leased office space, furniture and equipment provided by the Company's non-regulated subsidiaries to its regulated subsidiaries. Other includes corporate costs which are not allocated to the Company's subsidiaries, eliminations of inter-segment transactions, and fair value adjustments and associated income and deductions related to the Acquisitions which have not been allocated to the segments for evaluation of segment performance and allocation of resource purposes. The adjustments related to the Acquisitions are reported in Other, as they are excluded from segment performance measures evaluated by management. The following table includes the Company's summarized segment information:

| | As of or for the Year Ended December 31, 2008 | | | |
|---|---|---|---|---|
| | Regulated | Non-regulated | Other | Consolidated |
| Net operating revenues | $ 2,082,740 | $ 272,186 | $ (17,998) | $ 2,336,928 |
| Depreciation and amortization | 254,803 | 5,858 | 10,600 | 271,261 |
| Impairment charges | — | — | 750,000 | 750,000 |
| Total operating expenses, net | 1,554,731 | 248,425 | 720,668 | 2,523,824 |
| Adjusted EBIT (1) | 531,774 | 26,307 | | |
| Total assets | 10,941,133 | 244,891 | 2,045,794 | 13,231,818 |
| Capital expenditures | 971,886 | 36,920 | — | 1,008,806 |

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| | As of or for the Year Ended December 31, 2007 | | | |
|---|---|---|---|---|
| | Regulated | Non-regulated | Other | Consolidated |
| Net operating revenues | $ 1,987,565 | $ 242,678 | $ (16,028) | $ 2,214,215 |
| Depreciation and amortization | 254,998 | 10,295 | 2,042 | 267,335 |
| Impairment charges | — | — | 509,345 | 509,345 |
| Total operating expenses, net | 1,490,794 | 225,600 | 482,692 | 2,199,086 |
| Adjusted EBIT (1) | 500,088 | 23,579 | | |
| Total assets | 10,180,482 | 280,692 | 2,490,153 | 12,951,327 |
| Capital expenditures | 738,824 | 11,986 | — | 750,810 |

| | As of or for the Year Ended December 31, 2006 | | | |
|---|---|---|---|---|
| | Regulated | Non-regulated | Other | Consolidated |
| Net operating revenues | $1,854,618 | $ 248,451 | $ (10,002) | $ 2,093,067 |
| Depreciation and amortization | 243,311 | 13,990 | 1,880 | 259,181 |
| Impairment charges | — | — | 221,685 | 221,685 |
| Total operating expenses, net | 1,387,418 | 253,850 | 199,286 | 1,840,554 |
| Adjusted EBIT (1) | 468,701 | (4,725) | | |
| Total assets | 9,439,975 | 339,761 | 3,003,323 | 12,783,059 |
| Capital expenditures | 656,155 | 26,708 | — | 682,863 |

(1) Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flow for periods presented and should not be considered as an alternative to net income as an indicator of the Company's operating performance or as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

The following table reconciles Adjusted EBIT, as defined by the Company, to loss from continuing operations before income taxes:

| | For the Year Ended December 31, 2008 | | |
|---|---|---|---|
| | Regulated | Non-regulated | Total Segments |
| Adjusted EBIT | $ 531,774 | $ 26,307 | $ 558,081 |
| Add: | | | |
| Allowance for other funds used during construction | 14,497 | — | 14,497 |
| Allowance for borrowed funds used during construction | 8,171 | — | 8,171 |
| Less: | | | |
| Interest, net | (227,384) | 2,958 | (224,426) |
| Preferred dividends of subsidiaries | (225) | — | (225) |
| Amortization of debt expense | (5,346) | — | (5,346) |
| Segments income from continuing operations before income taxes | $ 321,487 | $ 29,265 | 350,752 |
| Impairment charges | | | (750,000) |
| Interest, net | | | (60,729) |
| Other | | | 9,383 |
| Loss from continuing operations before income taxes | | | $ (450,594) |

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| | For the Year Ended December 31, 2007 | | |
|---|---|---|---|
| | Regulated | Non-regulated | Total Segments |
| Adjusted EBIT | $ 500,088 | $ 23,579 | $ 523,667 |
| Add: | | | |
| Allowance for other funds used during construction | 7,759 | — | 7,759 |
| Allowance for borrowed funds used during construction | 3,449 | — | 3,449 |
| Less: | | | |
| Interest, net | (219,371) | (8,629) | (228,000) |
| Preferred dividends of subsidiaries | (225) | — | (225) |
| Amortization of debt expense | (5,169) | — | (5,169) |
| Segments income from continuing operations before income taxes | $ 286,531 | $ 14,950 | 301,481 |
| Impairment charges | | | (509,345) |
| Interest, net | | | (55,165) |
| Other | | | 7,510 |
| Loss from continuing operations before income taxes | | | $ (255,519) |

| | For the Year Ended December 31, 2006 | | |
|---|---|---|---|
| | Regulated | Non-regulated | Total Segments |
| Adjusted EBIT | $ 468,701 | $ (4,725) | $ 463,976 |
| Add: | | | |
| Allowance for other funds used during construction | 5,980 | — | 5,980 |
| Allowance for borrowed funds used during construction | 2,652 | — | 2,652 |
| Less: | | | |
| Interest, net | (209,589) | (12,163) | (221,752) |
| Preferred dividends of subsidiaries | (273) | — | (273) |
| Amortization of debt expense | (5,196) | — | (5,196) |
| Segments income from continuing operations before income taxes | $ 262,275 | $ (16,888) | 245,387 |
| Impairment charges | | | (221,685) |
| Interest, net | | | (144,218) |
| Other | | | 11,578 |
| Loss from continuing operations before income taxes | | | $ (108,938) |

**Note 23: Felton Water System Asset Sale**

In September of 2008, the Company's California subsidiary completed its transfer of ownership of the Felton water system to the San Lorenzo Valley Water District ("SLVWD"). Under the terms of the agreement, SLVWD paid $13,400 for the operating assets of the water system that serves approximately 1,330 customers. The payment included a $10,568 cash payment and the assumption of $2,832 in debt. Including goodwill, the Company recognized a loss of $381 on the sale of these assets. (See Note 8)

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## Note 24: Unaudited Quarterly Data

The following table sets forth certain supplemental unaudited consolidated quarterly financial data for each of the twelve quarters in the period ended December 31, 2008. The operating results for any quarter are not indicative of results that may be expected for a full year or any future periods.

| 2008 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| | (in thousands, except per share data) | | | |
| Operating revenues | $ 506,815 | $589,369 | $672,193 | $568,551 |
| Operating income (loss) | (670,358) | 142,658 | 211,754 | 129,050 |
| Income (loss) from continuing operations | (732,484) | 45,498 | 88,158 | 36,407 |
| Net income (loss) | (732,484) | 45,498 | 88,158 | 36,407 |
| Basic and diluted earnings (loss) per common share | $ (4.58) | $ 0.28 | $ 0.55 | $ 0.23 |

| 2007 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| | (in thousands, except per share data) | | | |
| Operating revenues | $468,544 | $558,733 | $ 633,117 | $ 553,821 |
| Operating income (loss) | 73,318 | 151,490 | (54,615) | (155,064) |
| Income (loss) from continuing operations | 2,429 | 49,985 | (160,117) | (234,572) |
| Income (loss) from discontinued operations | 256 | (807) | — | — |
| Net income (loss) | 2,685 | 49,178 | (160,117) | (234,572) |
| Basic and diluted earnings (loss) per common share | $ 0.02 | $ 0.31 | $ (1.00) | $ (1.47) |

*Amounts may not sum due to rounding.*

Income (loss) from continuing operations includes impairment losses of $750,000, $266,000 and $243,345 in the first quarter of 2008, fourth quarter of 2007 and third quarter of 2007, respectively.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

## ITEM 9A. CONTROLS AND PROCEDURES

***Evaluation of Disclosure Controls and Procedures***

American Water Works Company, Inc. maintains disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 ("the Exchange Act")) that are designed to ensure that information required to be disclosed in its reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the chief executive officer and the chief financial officer, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

The Company was not required by Section 404 of the Sarbanes-Oxley Act of 2002 ("Section 404") and related SEC rules and regulations to perform an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2008. While we were not required to conduct a Section 404 evaluation, as of December 31, 2008, we identified a material weakness in our internal control over financial reporting relating to controls over maintenance of contracts and agreements. Specifically, effective controls did not exist to ensure the accuracy and completeness of accounting and disclosure for such contracts and agreements.

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Such deficiency could result in misstated consolidated financial statements affecting results of operations, financial position, cash flows and disclosures that would result in a material misstatement of the consolidated financial statements that would not be prevented or detected. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

As a result of this material weakness, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of December 31, 2008. Nevertheless, management has concluded that the consolidated financial statements in this Annual Report on Form 10-K fairly present, in all material respects, our financial position, results of operations and cash flows as of the dates, and for the periods, presented, in conformity with generally accepted accounting principles in the United States of America ("GAAP").

Due to a transition period established by the rules of the SEC for newly public companies, this Annual Report does not include a report of management's assessment regarding internal control over financial reporting or attestation report of the company's registered public accounting firm.

***Plan for Remediation of Material Weakness***

We believe that we have taken the appropriate actions to remediate the material weakness described above by (1) conducting training on controls over maintenance of contracts and agreements for personnel, (2) hiring additional resources, and (3) designing and implementing new policies, procedures and controls. We believe this material weakness will remain until we have had sufficient experience with the sustainability of the controls at the levels at which they have been operating as of December 31, 2008.

***Changes in Internal Control over Financial Reporting***

There have been no changes in our internal control over financial reporting that occurred during the last fiscal quarter ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**ITEM 9B. OTHER INFORMATION**

None.

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## PART III

### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE

Information required by this item is incorporated by reference from the Company's Proxy Statement for the 2009 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of the fiscal year covered by this report, under the captions entitled "Executive Officers and Executive Compensation", "Nominees for Election as Directors", "Information Relative to the Board of Directors and Certain of its Committees", "Section 16(a) Beneficial Ownership Reporting Compliance", and "Code of Ethics and Corporate Governance Guidelines".

We have adopted a Code of Ethics, which applies to directors and employees. The full text of the Code of Ethics is publicly available on our website at *http://www.amwater.com*. We intend to post on our website any amendments to certain provisions of our Code of Ethics and any waivers of such provisions granted to principal officers.

### ITEM 11. EXECUTIVE COMPENSATION

Information required by this item is incorporated by reference from the Company's Proxy Statement for the 2009 Annual Meeting of Stockholders, under the captions entitled "Executive Compensation", Compensation Discussion and Analysis", "Compensation Committee Report" and "Director Compensation".

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this item setting forth the security ownership of certain beneficial owners and management is incorporated by reference from the Company's Proxy Statement for the 2009 Annual Meeting of Stockholders, under the caption entitled "Security Ownership of Principal Stockholders and Management" and the "Equity Compensation Plan" table appearing under the caption "Long-Term Equity Incentive Compensation".

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information required by this item is incorporated by reference from the Company's Proxy Statement for the 2009 Annual Meeting of Stockholders, under the captions entitled "Certain Relationships and Related Transactions" and "Director Independence".

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this item is incorporated by reference from the Company's Proxy Statement for the 2009 Annual Meeting of Stockholders, under the caption entitled "Independent Registered Public Accounting Fees and Services".

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Financial statement schedules have been omitted since they are either not required, not applicable as the information is otherwise included in the financial statements on notes thereto.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 27th day of February, 2009.

AMERICAN WATER WORKS COMPANY, INC.

By: /s/ DONALD L. CORRELL
Donald L. Correll
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed on the 27th day of February, 2009 by the following persons in the capacities indicated.

/s/ DONALD L. CORRELL
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer and Director)

/s/ ELLEN C. WOLF
Ellen C. Wolf
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

/s/ GEORGE MACKENZIE
George MacKenzie
(Director)

/s/ MARTHA CLARK GOSS
Martha Clark Goss
(Director)

/s/ DR. MANFRED DÖSS
Dr. Manfred Döss
(Director)

/s/ RICHARD R. GRIGG
Richard R. Grigg
(Director)

/s/ JULIA L. JOHNSON
Julia L. Johnson
(Director)

/s/ WILLIAM J. MARRAZZO
William J. Marrazzo
(Director)

/s/ DR. ROLF POHLIG
Dr. Rolf Pohlig
(Director)

/s/ ANDREAS G. ZETZSCHE
Andreas G. Zetzsche
(Director)

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## EXHIBIT INDEX

| Exhibit Number | Exhibit Description |
|---|---|
| 2.1 | Agreement and Plan of Merger, dated as of September 16, 2001, among RWE Aktiengesellschaft, Thames Water Aqua Holdings GmbH, Apollo Acquisition Company and American Water Works Company, Inc. (incorporated by reference to Exhibit 2.1 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 2.2 | Separation Agreement by and among RWE Aktiengesellschaft and American Water Works Company, Inc. (incorporated by reference to Exhibit 2.2 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 3.1 | Restated Certificate of Incorporation of American Water Works Company, Inc. (incorporated by reference to Exhibit 3.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed November 6, 2008). |
| 3.2 | Amended and Restated Bylaws of American Water Works Company, Inc. (incorporated by reference to Exhibit 3.2 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed November 6, 2008). |
| 4.1 | Indenture, dated as of October 22, 2007 between American Water Capital Corp. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.4 to American Water Capital Corp.'s Registration Statement on Form S-4, File No. 333-148284, and American Water Works Company, Inc.'s Registration Statement on Form S-4, File No. 333-148284-01, filed December 21, 2007). |
| 4.2 | Indenture between American Water Capital Corp. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Form 8-K, File No. 001-34028, filed December 3, 2008). |
| 4.3 | Note Purchase Agreement, as amended, dated as of December 21, 2006, by and between American Water Capital Corp. and the Purchasers named therein for purchase of $101,000,000 5.39% Series A Senior Notes due 2013, $37,500,000 5.52% Series B Senior Notes due 2016, $329,500,000 5.62% Series C Senior Notes due 2018 and $432,000,000 5.77% Series D Senior Notes due 2021 (incorporated by reference to Exhibit 4.2 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 4.4 | Note Purchase Agreement, as amended, dated as of March 29, 2007, by and between American Water Capital Corp. and the Purchasers named therein for purchase of $100,000,000 5.62% Series E Senior Notes due 2019 and $100,000,000 5.77% Series F Senior Notes due 2022 (incorporated by reference to Exhibit 4.3 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 4.5 | Note Purchase Agreement, dated May 15, 2008, by and between AWCC and the Purchasers named therein for purchase of $110,000,000 6.25% Series G Senior Notes due 2018 and $90,000,000 6.55% Series H Senior Notes due 2023 (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed May 19, 2008). |
| 9.1 | Exchange and Registration Rights Agreement, dated as of October 22, 2007, between American Water Capital Corp., American Water Works Company, Inc. and Citigroup Global Markets Inc, Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated, as representatives of the several purchasers (incorporated by reference to Exhibit 4.5 to American Water Capital Corp.'s Registration Statement on Form S-4, File No. 333-148284, and American Water Works Company, Inc.'s Registration Statement on Form S-4, File No. 333-148284-01, filed December 21, 2007). |

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| Exhibit Number | Exhibit Description |
|---|---|
| 9.2 | Registration Rights Agreement by and among American Water Works Company, Inc., RWE Aktiengesellschaft and RWE Aqua Holdings GmbH (incorporated by reference to Exhibit 9.1 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 10.1 | Credit Agreement, dated as of September 15, 2006, among American Water Capital Corp., the Lenders identified therein and JPMorgan Chase Bank, N.A (incorporated by reference to Exhibit 10.1 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.2 | Support Agreement, as subsequently amended, dated June 22, 2000, by and between American Water Works Company, Inc. and American Water Capital Corp. (incorporated by reference to Exhibit 10.3 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.3 | Employment Agreement between Donald L. Correll and American Water Works Company, Inc., dated February 15, 2008 (incorporated by reference to Exhibit 10.4 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 10.4 | Employment Agreement between Ellen C. Wolf and American Water Works Company, Inc., dated February 15, 2008 (incorporated by reference to Exhibit 10.5 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 10.5 | Separation Agreement between Dietrich Firnhaber and RWE Aktiengesellschaft, dated June 18, 2007 (incorporated by reference to Exhibit 10.6 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 10.6 | RWE Long-Term Incentive Beat Plan 2005, dated as of April 20, 2005 (incorporated by reference to Exhibit 10.7 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.7 | Amended and Restated American Water Works Company, Inc. Executive Retirement Plan, dated as of March 1, 2007 (incorporated by reference to Exhibit 10.8 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.8 | Amended and Restated American Water Works Company, Inc. Deferred Compensation Plan, dated as of January 1, 2001 (incorporated by reference to Exhibit 10.9 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.9 | RWE Executive Deferred Compensation Plan (A) (incorporated by reference to Exhibit 10.10 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 10.10 | RWE Executive Deferred Compensation Plan (B) (incorporated by reference to Exhibit 10.11 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |
| 10.11 | Settlement Agreement by and between California American Water Company and the U.S. Department of Commerce, National Oceanic and Atmospheric Administration, dated as of June 29, 2006 (incorporated by reference to Exhibit 10.12 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 6, 2008). |

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| Exhibit Number | Exhibit Description |
|---|---|
| 10.12 | 2004 Thames Water/RWE Long-Term Incentive Plan, dated as of January 1, 2004 (incorporated by reference to Exhibit 10.13 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.13 | RWE Long Term Incentive Plan 2002 (LTIP), dated as of 2002 (incorporated by reference to Exhibit 10.14 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.14 | American Water Works Company, Inc. Nonqualified Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.15 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 31, 2008). |
| 10.15 | Form of Executive Completion Bonus in connection with the RWE Divestiture, dated as of March 20, 2006 (incorporated by reference to Exhibit 10.16 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.16 | Form of Retention Agreement in connection with the RWE Divestiture, dated as of March 20, 2006 (incorporated by reference to Exhibit 10.17 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.17 | American Water Works Company, Inc. Executive Severance Policy, dated as of June 14, 2006 (incorporated by reference to Exhibit 10.18 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.18 | Secondment Contract between RWE Solutions AG and Dietrich Firnhaber, dated as of January 1, 2003 (incorporated by reference to Exhibit 10.19 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.19 | 2007 American Water Senior Management Annual Incentive Plan (incorporated by reference to Exhibit 10.20 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.20 | 2006 American Water Senior Management Annual Incentive Plan (incorporated by reference to Exhibit 10.21 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007). |
| 10.21 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan (incorporated by reference to Exhibit 10.22 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 31, 2008). |
| 10.22 | Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries (incorporated by reference to Exhibit 10.23 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 26, 2008). |
| 10.23 | Nonqualified Deferred Compensation Plan for Non-Employee Directors of American Water Works Company, Inc. (incorporated by reference to Exhibit 10.24 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 26, 2008). |

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| Exhibit Number | Exhibit Description |
|---|---|
| 10.24 | 2008 American Water Senior Management Annual Incentive Plan (incorporated by reference to Exhibit 10.25 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed April 15, 2008). |
| 10.25 | 2009 American Water Senior Management Annual Incentive Plan (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed February 26, 2009). |
| 10.26 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan First Restricted Stock Unit Grant Form for ML1-ML3 Employees. Incorporated by reference to Exhibit 10.26 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.27 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan First Restricted Stock Unit Grant Form for ML4 Employees. Incorporated by reference to Exhibit 10.27 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.28 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Restricted Stock Unit Grant Form for Directors. Incorporated by reference to Exhibit 10.28 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.29 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Second Restricted Stock Unit Grant Form for ML1-ML3 Employees. Incorporated by reference to Exhibit 10.29 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.30 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Second Restricted Stock Unit Grant Form for ML4 Employees. Incorporated by reference to Exhibit 10.30 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.31 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan First Nonqualified Stock Option Grant Form for ML1-ML3 Employees. Incorporated by reference to Exhibit 10.31 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.32 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan First Nonqualified Stock Option Grant Form for ML4 Employees. Incorporated by reference to Exhibit 10.32 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.33 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Nonqualified Stock Option Grant Form for Directors. Incorporated by reference to Exhibit 10.33 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.34 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Second Nonqualified Stock Option Grant Form for ML1-ML3 Employees. Incorporated by reference to Exhibit 10.34 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| 10.35 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Second Nonqualified Stock Option Grant Form for ML4 Employees. Incorporated by reference to Exhibit 10.35 to American Water Works Company, Inc.'s Registration Statement on S-4, filed May 6, 2008. |
| *10.36 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Performance Stock Unit Grant Form for ML1-ML3B Employees. |
| *10.37 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Performance Stock Unit Grant Form for ML4-ML5 Employees. |

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| Exhibit Number | Exhibit Description |
|---|---|
| 10.38 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Nonqualified Stock Option Grant Form for ML1-ML3B Employees (incorporated by reference to Exhibit 10.4 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed February 26, 2009). |
| 10.39 | American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Nonqualified Stock Option Grant Form for ML4-ML5 Employees (incorporated by reference to Exhibit 10.5 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed February 26, 2009). |
| 10.40 | Amendment to the Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries, effective as of August 1, 2008 (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed November 6, 2008). |
| 10.41 | Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and Its Designated Subsidiaries, as amended and restated, effective as of January 1, 2009 (incorporated by reference to Exhibit 10.37 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-155245, filed November 18, 2008). |
| 10.42 | Nonqualified Deferred Compensation Plan for Non-Employee Directors of American Water Works Company, Inc., as amended and restated, effective as of January 1, 2009 (incorporated by reference to Exhibit 10.38 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-155245, filed November 18, 2008). |
| 10.43 | Amendment to the Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries, effective as of February 6, 2009 (incorporated by reference to Exhibit 10.6 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed February 26, 2009). |
| 10.44 | Amendment to the Nonqualified Deferred Compensation Plan for Non-Employee Directors of American Water Works Company, Inc., effective as of February 6, 2009 (incorporated by reference to Exhibit 10.7 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed February 26, 2009). |
| 21.1 | Subsidiaries of American Water Works Company, Inc. (incorporated by reference to Exhibit 21.1 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed January 29, 2008). |
| *23.1 | Consent of PricewaterhouseCoopers LLP. |
| *31.1 | Certification of Donald L. Correll, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act. |
| *31.2 | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act. |
| *32.1 | Certification of Donald L. Correll, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act. |
| *32.2 | Certification of Ellen C. Wolf, Senior Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act. |

* Filed herewith.