KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

109. Please provide the following information:

a. Provide all studies and analyses that KAWC has performed or commissioned since the prior 2007 rate case that quantify the benefits that the Company's incentive compensation programs provide to its ratepayers.
b. Provide all studies and analyses that KAWC has performed or commissioned that address how the cost of KAWC's incentive compensation programs should be allocated between KAWC's shareholders and ratepayers.
c. Provide all studies and analyses that KAWC has performed or commissioned that address how other utilities allocate the cost of their incentive compensation programs between utility shareholders and ratepayers.

Response:

a. No such studies or analyses have been performed by the Company. However, an internet search performed by the Company located numerous studies performed by others that provide support for the utilization of an annual incentive plan as part of a total compensation plan which motivates better employees' performance. While the studies available to the Company indicate a positive effect on performance of incentive payments, there is disagreement on the precise effects and meaningfulness of the metrics. Please see attached study reports. The Company has not obtained reprint rights for several of the studies reviewed, and thus they are not attached to this response.

As noted in the response to this question in prior cases, the Annual Incentive Plan ("AIP") plan for employees of Kentucky American and American Water Works Service Company, Inc. is part of a total compensation package aimed at providing competitive market based compensation for employees. The portion of total compensation represented by the AIP is an at-risk portion intended to improve performance based on the parameters measured in the plan. The annual payout under the provisions of the plan are considered to be earned and a portion of total compensation.

In a prior rate case (Case No. 2004-00103) the majority of plan potential payout was based on the financial performance of the company. However, since that time the plan metrics have been changed significantly and the Company financial performance parameters make up only 30% (a few employees will have a 40% ratio based on financial performance) of the total potential plan payout for most of the employees included in the requested cost of service in this case. The balance of the employee incentive awards is based on metrics related to customer satisfaction, customer service quality, environmental, health and safety, efficiency metrics, or other measures of the quality of performance of the employee Please see the plan booklets provided in AG 1-105 and its attachments.

Therefore since the issuance of the Commission's order in Case No. 2004-00103, the Company's AIP has been changed to reflect a greater focus on customer service quality and efficiency. The company therefore believes that the balance thus achieved between plan customer service objectives, efficiency objectives and financial objectives in motivating improved performance from employees makes it appropriate to recover the costs of the AIP from ratepayers.

The Company also continues to maintain that the financial element of the incentive plan is beneficial to ratepayers in that a financially healthy company is in a better position to meet its public service obligations. A financially healthy company will be able to raise capital at lower cost, better respond to changes in business conditions, meet additional water quality regulations, and will be in a better position to meet the challenges of emergencies that occur from time to time. Employees' efforts directed at improving financial performance actually reduce waste and increase efficiency, both of which in the long term will provide a customer benefit. Therefore, it is in the customers' interest to have a compensation plan that motivates employees to keep the Company's financial performance in mind as they go about their duties. It is difficult to conceive of an action motivated by the financial component of the AIP plan that would improve financial performance and not also provide a benefit to customers.

b. No such studies or analyses have been performed by the Company. The Company performed a search for any such studies performed by other utilities, utility industry associations or regulatory associations, and was unable to locate any such studies by others.

As has been shown in prior cases employee incentive plans are a widely utilized component of most utility company compensation plans, and are widely utilized in industry in general. Given the Company's position that the AIP plan expense is a normal part of the cost of providing service, it would not expect to "allocate" any of the cost to shareholders. Indeed, should any portion of the cost of the Company's employee compensation plan be removed from the proposed cost of service or disallowed for recovery from ratepayers, it would result in a further dilution of the allowed return awarded by the Commission, since these are costs the Company has paid and continues to pay to motivate improvements in employee performance. It is the Company's sincere belief that all components of the AIP do motivate improved employee performance which has a benefit to ratepayers.

The company's compensation plan targets base salaries at the 50th percentile of market based compensation, based on salary surveys it performs and which have been provided previously in AG 1-242 and AG 1-248 in the prior case (Case No. 2007-00143). The AIP is intended to provide the possibility of compensation at the 65th percentile if all targets are met. It is widely recognized that such plans do have a positive impact on the performance of employees. The Company's AIP contributes to a reasonable compensation level and provides employees the opportunity to obtain compensation above the market 50th percentile, based on plan metrics. This approach gives the Company an additional means by which to retain high performing employees for whom market based 50th percentile salaries may be inadequate, but only on the basis of exceptional performance.

The wide and growing acceptance in other utilities and business in general of total compensation plans that place a portion of an employee's compensation at risk to improve business performance demonstrates that such a plan is not speculative or improvised, but is a necessary component of a program designed to retain and motivate employees who are qualified and capable of performing the functions necessary to operate a complex business.

d. No such studies or analyses have been performed by the Company. The Company performed a search for any such studies by other utilities, utility industry associations or regulatory associations, and was unable to locate any such study. However, please see the attached memo from Towers Perrin regarding the prevalence of such plans in the utility industry, as well as general business enterprises.

   For the electronic version, refer to KAW_R_AGDR1#109_122308.pdf.

TOWERS
PERRIN

HR SERVICES

Memorandum

DATE: July 10, 2007

TO: Debbie Krauss-Kelleher — American Water

FROM: Larry Parks — Towers Perrin
Jim Dickinson — Towers Perrin

RE: ANNUAL INCENTIVE PLAN PREVALENCE

As requested, this memorandum provides information on the prevalence of annual incentive plans in the utility and broader general industry.

Market References and Data Sources

Energy/Utility Industry

Data are based on the total sample of companies that provided data to our energy industry compensation databases and were collected from the following sources:

- Towers Perrin's 2006 Energy Services Industry Executive Compensation Database
- Towers Perrin's 2006 Energy Services Industry Middle Management and Professional (MMAPS) Database

General Industry

Data are based on the total sample of our general industry databases excluding a number of market segments viewed by American Water as less relevant from a competitive perspective (e.g. banking, financial services, insurance, media/ entertainment, pharmaceuticals). Data were collected from the following sources:

- Towers Perrin's 2006 General Industry Executive Compensation Database
- Towers Perrin's 2006 General Industry Middle Management and Professional (MMAPS) Database

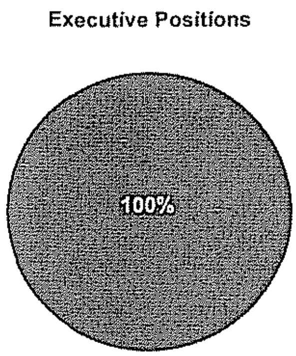
A list of the companies included in each sample is provided in the attached Exhibits.

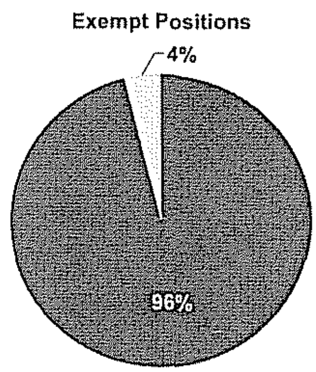
The data presented in our analysis are collected and reported by dedicated staff within Towers Perrin's Databases Unit. Data are collected each year through a survey of participating companies. Towers Perrin makes the data generated from our surveys available exclusively to participants in the surveys and does not sell, license or otherwise make the data available to any third-party sources or authorize any third parties to use the data in any way. Data are only available for the use of participants for purposes of their individual compensation planning, and by Towers Perrin for purposes of training, quality assurance, research and development, compensation consulting services for survey participants and general promotional activities. These databases are the primary source of competitive compensation information used in our work with clients.

Results

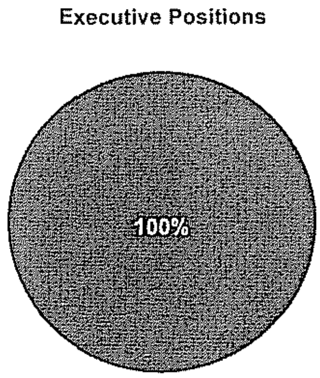
Annual incentive plans are very prevalent in both the energy/utility industry as well as the broader general industry. The following charts summarize the results of our analysis and provide data on the percent of companies that maintain a formal annual incentive plan.

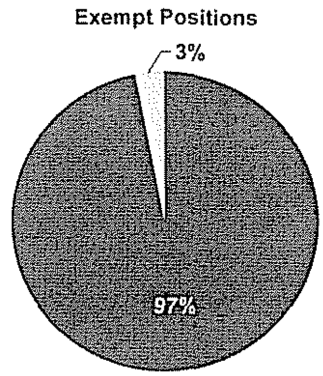
Energy/Utility Industry





General Industry





Maintain an annual incentive plan   Do not maintain an annual incentive plan

Exhibit 1

Energy Services Executive Compensation Database Participants

AGL Resources	Duke Energy	NW Natural	Progress Energy
Allegheny Energy	E.ON U.S.	National Fuel Gas	Public Service Enterprise
Allete	Edison International	New York Power Authority	Puget Energy
Ameren	Energen	Nicor	SCANA
American Electric Power	Energy East	NorthWestern Energy	Salt River Project
American Transmission	Entergy	OGE Energy	Sempra Energy
Aquila	Equitable Resources	ONEOK	Southern Company
Atmos Energy	Exelon	Oglethorpe Power	Southern Union Company
Avista	FPL Group	Omaha Public Power	TECO Energy
CH Energy Group	FirstEnergy	Otter Tail	TXU
CMS Energy	Great Plains Energy	PNM Resources	Tennessee Valley Authority
CenterPoint Energy	Hawaiian Electric	PPL	UIL Holdings
Cleco	IDACORP	PacifiCorp	UniSource Energy
Colorado Springs Utilities	JEA	Pacific Gas & Electric	Unitil
Consolidated Edison	Lower Colorado River Authority	Peoples Energy	Vectren
Constellation Energy	MDU Resources	Pepco Holdings	WPS Resources
DTE Energy	MGE Energy	Pinnacle West Capital	Westar Energy
Dominion Resources	NSTAR	Portland General Electric	Wisconsin Energy

Energy Services Middle Management and Professional (MMAPS) Compensation Database Participants

AGL Resources	Dominion Resources	New York Power Authority	Public Service Enterprise
Allegheny Energy	Duke Energy	NiSource	Questar
Allete	Duquesne Light	Nicor	SCANA
Ameren	E.ON U.S.	NorthWestern Energy	Salt River Project
American Electric Power	Edison International	Northeast Utilities	Sempra Energy
American Transmission	Energy East	OGE Energy	Sierra Pacific Resources
Aquila	Entergy	ONEOK	Southern Company
Atmos Energy	Equitable Resources	Oglethorpe Power	Southern Union Company
Avista	Exelon	Old Dominion Electric	TECO Energy
CH Energy Group	FPL Group	Omaha Public Power	TXU
CMS Energy	FirstEnergy	Otter Tail	Tennessee Valley Authority
CenterPoint Energy	Great Plains Energy	PNM Resources	UIL Holdings
Central Vermont Public Service	IDACORP	PPL	UniSource Energy
City Public Service	JEA	PacifiCorp	Unitil
Cleco	KeySpan	Pacific Gas & Electric	Vectren
Colorado Springs Utilities	Lower Colorado River Authority	Peoples Energy	WPS Resources
Consolidated Edison	MGE Energy	Pepco Holdings	Westar Energy
Constellation Energy	NSTAR	Pinnacle West Capital	Wisconsin Energy
DTE Energy	NW Natural	Portland General Electric	
Dayton Power & Light	Nebraska Public Power District	Progress Energy	

Exhibit 2

General Industry Executive Compensation Database Core Industry Participants

AAI
ACH Food
AT&T
Aerojet
Air Products and Chemicals
Alcatel USA
Alcoa
Alliant Techsystems
Altria Group
American Airlines
American Standard
Anadarko Petroleum
Anheuser-Busch
Apache
Arby's Restaurant Group
ArvinMeritor
Ashland
Avaya
Avery Dennison
BP
Barrick Gold of North America
Bayer CropScience
BellSouth
Black & Decker
Bob Evans Farms
Boeing
Boston Scientific
Bunge
Burlington Northern Santa Fe
C.H. Guenther & Son
CHS
CSM North America
CSX
Cadbury-Schweppes NA
Campbell Soup
Carpenter Technology
Charter Communications
Chemtura
Chevron
Cincinnati Bell
Clarke American Checks
Clorox
Coca-Cola
Colgate-Palmolive
Comair
ConAgra Foods
ConocoPhillips
Constellation Brands
Cooper Tire & Rubber
Corn Products
Crown Castle
Crown Holdings
Cytec
Dade Behring
DaimlerChrysler
Darden Restaurants
Dentsply
Devon Energy
Diageo North America
Dow Chemical
DuPont
EMCOR Group
Eastman Chemical
Eastman Kodak
Ecolab
EnCana Oil & Gas USA
Engelhard
ExxonMobil
Fleetwood Enterprises
Fluor
Ford
Freightliner
General Dynamics
General Mills
General Motors
Georgia Gulf
Goodrich
Gorton's
H.B. Fuller
H.J. Heinz
Harley-Davidson
Hasbro
Hercules
Hershey Foods
Hess
Hexcel
Honeywell
Hovnanian Enterprises
ICI Paints North America
ITT - Defense
International Flavors &
Interstate Brands
J.M. Smucker
Jack in the Box
Jacobs Engineering
Jarden
Johns-Manville
Johnson Controls
KB Home
Kellogg
Kennametal
Kerr-McGee
Kimberly-Clark
Kinross Gold
Kraft Foods
Land O'Lakes
Lear
Lockheed Martin
Lorillard
Lucent Technologies
Marathon Oil
Martin Marietta Materials
Masco
McDermott
McDonald's
Medtronic
Mission Foods
Modine Manufacturing
Molson Coors Brewing
Monaco Coach
Monsanto
Motorola
NIKE
Nalco
National Starch & Chemical
Navistar International
Nestle USA
Norfolk Southern
Nortel Networks
Northrop Grumman
Novartis Consumer Health
Occidental Petroleum
PPG Industries
PepsiCo
Pernod Ricard USA
Phelps Dodge
Procter & Gamble
QUALCOMM
Qwest Communications
Ralcorp Holdings
Raytheon
Revlon
Reynolds American
Rich Products
Rinker Materials
Rio Tinto
Roche Diagnostics
Rockwell Collins
Rohm and Haas
Russell
Sara Lee
Schwan's
Scotts Miracle-Gro
Shell Oil
Sherwin-Williams
Sigma-Aldrich
Sodexho
Solvay America
Sony Ericsson Mobile
Sprint Nextel
St. Jude Medical
St. Lawrence Cement
Starbucks
Sunoco
Syngenta
T-Mobile
TDS Telecom
Tesoro
Timken
Trex
Tupperware
Unilever United States
Union Pacific
United Parcel Service
United States Cellular
United States Steel
United Technologies
Valero Energy
Verizon
Verizon Wireless
Vistar
Visteon
Vulcan Materials
W.R. Grace
Washington Group International
Wells' Dairy
Wendy's International
Westinghouse Savannah River
Wm. Wrigley Jr.

Exhibit 3

General Industry Middle Management and Professional (MMAPS) Database Core Industry Participants

AAI	Cytec	Kinross Gold	Sprint Nextel
ACH Food	Dade Behring	Kraft Foods	St. Lawrence Cement
AT&T	Darden Restaurants	Land O'Lakes	Starbucks
Aerojet	Dentsply	Lorillard	Sunoco
Air Products and Chemicals	Devon Energy	Lucent Technologies	Syngenta
Alcoa	Diageo North America	Marathon Oil	T-Mobile
Alliant Techsystems	Dow Chemical	Martin Marietta Materials	Tesoro
Altria Group	DuPont	Masco	Timken
American Airlines	EMCOR Group	McDermott	Trex
American Standard	Eastman Chemical	Medtronic	Tupperware
Anadarko Petroleum	Eastman Kodak	Mission Foods	Unilever United States
Anheuser-Busch	Ecolab	Molson Coors Brewing	Union Pacific
Apache	EnCana Oil & Gas USA	Monaco Coach	United Parcel Service
Arby's Restaurant Group	Engelhard	Monsanto	United States Cellular
ArvinMeritor	ExxonMobil	NIKE	United States Steel
Avaya	Fleetwood Enterprises	Nalco	United Technologies
Avery Dennison	Fluor	National Starch & Chemical	Valero Energy
BP	Ford	Navistar International	Verizon
Barrick Gold of North America	Freightliner	Nestle USA	Vistar
Bayer CropScience	General Dynamics	Norfolk Southern	Visteon
BellSouth	General Mills	Novartis Consumer Health	W.R. Grace
Black & Decker	General Motors	Occidental Petroleum	Washington Group International
Bob Evans Farms	Goodrich	PPG Industries	Wells' Dairy
Boeing	Gorton's	PepsiCo	Wendy's International
Boston Scientific	H.B. Fuller	Pernod Ricard USA	Westinghouse Savannah River
Bunge	H.J. Heinz	Qwest Communications	Wm. Wrigley Jr.
Burlington Northern Santa Fe	Harley-Davidson	Ralcorp Holdings	
CHS	Hercules	Revlon	
CSX	Hershey Foods	Reynolds American	
Cadbury-Schweppes NA	Hess	Rich Products	
Campbell Soup	Hexcel	Rinker Materials	
Carpenter Technology	Hovnanian Enterprises	Roche Diagnostics	
Charter Communications	ITT - Defense	Rohm and Haas	
Chemtura	Interstate Brands	Russell	
Chevron	J.M. Smucker	Sara Lee	
Clarke American Checks	Jack in the Box	Schwan's	
Coca-Cola	Jarden	Scotts Miracle-Gro	
Comair	Johns-Manville	Shell Oil	
ConAgra Foods	Johnson Controls	Sherwin-Williams	
ConocoPhillips	KB Home	Sigma-Aldrich	
Constellation Brands	Kellogg	Sodexho	
Corn Products	Kennametal	Solvay America	
Crown Castle	Kimberly-Clark	Sony Ericsson Mobile Communications	

Compensation and Incentive System Design Study

Independent Analysis of Incentive Compensation at the United States Postal Service

Submitted to:

President's Commission on the United States Postal Service

June 6, 2003

Watson Wyatt Worldwide

a) Table of Contents

b) Executive Summary of Recommendations

Watson Wyatt Worldwide is pleased to report the results of the Compensation and Incentive System Design Study we have conducted for the President's Commission on the United States Postal Service.

We believe it is possible to design an incentive compensation plan that will provide strategic direction and engage all employees in the goal of improving Postal Service productivity, reducing costs, enhancing customer service, and supporting the mission of the Postal Service. From our analysis, we believe that the current National Performance Assessment program (launched for fiscal year 2003 for USPS management), can be cascaded with some modification to the balance of the career employee workforce. The envisioned non-management program would be self-funded by operational financial improvement, calibrated by productivity and balanced against mission achievement.

The primary focus of a non-management program would be to reinforce and reward employees for:

- improvements in productivity
- teamwork, flexibility and responsiveness to meeting customer service levels, and
- implementing and supporting new management systems.

Our findings and recommendations are distilled from an analysis of broad USPS financial data, discussions with Postal Service associates at various levels along the spectrum, and Watson Wyatt's expertise in effective incentive plan design. At this stage of development, many of our positions are conceptual and provisional, requiring more specific Postal Service information, further modeling and testing. Significant work undoubtedly needs to be accomplished in the labor relations area. From our contact during this assignment with rank and file USPS employees, and with their bargaining unit representatives, we believe that employees appear to be more receptive to the idea of variable pay than are their union representatives.

The United States Postal Service is a complex business organization. Although change can be difficult to create within such an institution, the scale is so large that small individual improvements quickly aggregate to massive system benefits. We believe that a variable compensation program as we have described in this report can improve efficiencies in the system, and help accomplish the USPS mission on a more cost effective basis with a lower human capital content. Success will depend on proper implementation, communication, and the support of effective human resources processes such as training and performance management.

c) Assignment Objectives and Project Background

Assignment Objectives

Watson Wyatt was retained to assess the viability of an incentive compensation plan to engage all levels of the Postal Service workforce. The key issues addressed in our research and analysis included:

- Can an all-employee incentive compensation plan work at the USPS?
- If an incentive plan is viable at the USPS, what are the fundamental drivers for engaging the workforce?
- What are the organizational and operational considerations for a successful incentive compensation plan?

This report provides answers to the above questions as well as a recommended incentive design framework. It also includes criteria for cascading performance goals to motivate and engage USPS employees in operational improvement objectives (productivity, efficiency, quality, use of resources and customer satisfaction). The report discusses important design considerations and criteria for success. To support our recommendations and criteria, we have used published USPS performance data to illustrate various elements of our recommendations.

This report is intended as a high-level feasibility assessment and a theoretical examination of fundamental improvements that could be achieved by using an incentive compensation plan. Watson Wyatt was not contracted to provide financial modeling, assessment and analysis of current cash compensation, development of plan documents, and plan implementation and employee communication.

Background

Executive Order No. 13278 established the President's Commission on the United States Postal Service (the Commission) for the purpose of examining the state of the United States Postal Service (USPS), and to prepare and submit a report articulating a proposed vision for the future of the USPS and recommending the legislative and administrative reforms needed to ensure the viability of the USPS. The Commission sought specialized assistance from Unisys/Watson Wyatt in designing a compensation incentive system that will engage all levels of the Postal Service workforce in the goals of improving Postal Service productivity, reducing costs, enhancing customer service, and supporting the mission of the Postal Service.

Research Methodology

Because of a compressed timeline, our research was limited to interviews at USPS headquarters, postal worker union representatives and randomly selected employee groups from Northern Virginia processing and distribution centers. We initially met with finance, human resources and labor relations executives at the Postal Service headquarters in Washington, D.C. to gather information on past and current incentive plans, operational data and labor union contacts. Next, we met individually with six labor union and management association presidents (or their designees) to discuss their viewpoints on operational improvement opportunities, the motivational effect of an incentive plan, and the overall viability of an incentive plan.[1]

To gauge employee perceptions, we visited the Merrifield, Virginia processing plant to conduct focus group meetings. In total we conducted four focus groups involving approximately 40 employees. The purpose of these meetings was to gather employee perceptions and advice on opportunities for improvements within their areas of activity and their reactions to incentive opportunities.[2] We spoke with small (approximately 8-10 employees), yet diverse, volunteer groups of clerks, mail handlers, letter carriers and supervisors. Focus group participants were forthcoming on issues such as productivity, customer service, employee engagement and incentive compensation.

Finally, we returned to Postal Service headquarters to meet again with finance, human resources and labor relations executives to gather more refined viewpoints and data on improving productivity, reducing costs and enhancing customer service.

History of Incentives at the USPS

The Postal Service has been a pioneer in incentive pay programs within the federal government. These programs, which were designed to link incentive compensation to employee and organizational performance, have successfully improved customer service levels and productivity. Postal Service incentive plans include:

Striving for Excellence Together ("SET") – Fiscal years 1991 – 1994
Initially, this incentive plan was implemented within the mail handlers and rural carrier union represented employees and later extended to all non-bargaining employees. SET utilized two customer service measures and one organizational financial performance measure. Although the plan created organizational and employee alignment as evidenced by some employee and management collaboration, it was cancelled at its intended sunset. The payouts in the 1994 fiscal year proved to be less than meaningful to employees.

[1] See Exhibit 1 in Appendix for Union leader contacts
[2] See Exhibit 2 in Appendix for focus group questions

Economic Value Added (EVA) Variable Pay Program and Individual Merit Pay Program – Fiscal years 1996 – 2001
The EVA plan was developed and implemented to reinforce the organizational directive that the Postal Service should be managed similar to a business with the goals of improved customer satisfaction, reduced costs, and improved productivity. The plan was available to approximately 83,000 Executive and Administrative Schedule (EAS) and 800 Postal Career Executive Service (PCES) employees. According to USPS reports and studies, extraordinary accomplishments were realized while EVA was in place, including significant improvements in:

- Net income
- On-time delivery
- Labor intensity (total personnel costs as a percentage of operating expense), and
- Workday injuries per 200,000 work hours.

The EVA incentive compensation plan was a team-based, gain-sharing plan that was funded by audited financial performance, and had pre-established, objective goals and targets. Despite the EVA incentive compensation plan's success, according to USPS it was cancelled after the 2001 fiscal year due to outside criticism and political pressure.

National Performance Assessment (NPA) – Effective fiscal year 2003
Similar to the previous EVA plan, the newly implemented NPA plan is based on a balanced scorecard approach of organizational measures. Objective measures, including customer service, employee productivity, and business productivity, are pre-established and results are measured for each Performance Cluster, each Area, and nationwide. The plan will be funded through improved business performance. Plan rewards (including lump sum incentive payments and base salary increases) will be allocated based on individual performance assessment. An individual's performance will be assessed such that 70% of the evaluation will be based on contribution to corporate/individual success and 30% of the evaluation will be based on contribution to core requirements of the position.

Based on individual performance and the employee's salary level relative to the salary range maximum, salary increases can range from 0% to 14%. In addition, lump sum incentive payments (as a percentage of base salary) can range from 1% to 6% for those rated as contributors to as much as 15% for those rated as exceptional contributors. According to USPS representatives, incentive payments earned above the current statutory salary cap are deferred (determination of deferral payout timing to be determined by the USPS Board of Governors).

This plan is currently available to all PCES employees and may possibly be available to both EAS and PCES employees in fiscal year 2004. It should be noted that according to USPS executives, senior management has been willing to extend these programs to collectively bargained employee groups, but has met resistance by union leadership.

Considerations

Prevalence of Incentive Programs

Variable incentive designs have increased in popularity and prevalence nationally because they provide a means of controlling costs, supporting long-term cultural change efforts, and directing performance toward the accomplishment of business objectives. According to the 2002-2003 Industry Report on Technician and Skilled Trades Personnel Compensation report published by Watson Wyatt Data Services, 68% of survey respondents (or 996 organizations covering 405,302 employees) indicated they currently have a bonus or variable pay program in which technician and skilled trades personnel participate. Of the 405,302 incumbents for whom data were reported, 34.6% received variable pay awards in 2001 averaging 5% of base pay.

Although employers with collectively bargained workforces are not specifically segregated in the study, not-for-profit organizations (whose not-for-profit status may be likened to that of the USPS) are well represented. The report indicates that approximately 48% of not-for-profit organizations currently have a bonus or variable pay program. Additionally, in this same survey, another 14% of survey respondents (or 593 organizations) indicated that they will install new variable pay programs for technician and skilled trades personnel in the next two years. Not-for-profits reported an even higher rate of 18%.

The National Compensation Survey: Occupational Wages in the United States, January 2001 (released in January 2003) prepared by the U.S. Department of Labor Statistics indicates that among the blue collar occupational group, employees with wages that are at least partially based on productivity payments such as piece rates, commissions, and productions bonuses earn approximately 12% more per hour than those workers whose wages are based solely on an hourly rate or salary. Although no conclusions are drawn by the Department of Labor on this differential, it might be indicative of higher overall pay for higher personal performance. In other words, those employees that are focused on performance objectives tend to achieve those objectives and are rewarded.

Incentive Plans in Collectively Bargained Environments

The 2002 Employer Bargaining Objectives survey of establishments with collective bargaining agreements was conducted by the Bureau of National Affairs. Among other things, the survey examined the prevalence of incentive and variable pay plans in current contracts. According to their research (all employers, both manufacturing and non-manufacturing), 16% of employers utilize group incentive plans, 10% utilize gain-sharing plans, 9% utilize individual incentive plans, and 7% utilize profit-sharing plans. These percentages are approximately 50% higher for manufacturing (processing) concerns. Also, according to the research report 10% of the surveyed employers hope to establish at least one new incentive in their next agreement, and 7% will bargain to expand one or more current variable pay systems.

Role of Incentive Plans

Rewards are fundamentally communication vehicles, sending messages that are consistent with, and that reinforce, other messages employees are receiving about business goals, desired behaviors and culture. Organizations that use incentive plans effectively recognize that an incentive plan is but one component of the total reward philosophy of the organization. Other essential components to engage and reward the workforce include wages, benefits and recognition programs, as well as opportunities for skill training, communications, performance management, employee involvement and safe working environments.

As organizations are pressured to achieve higher levels of performance and productivity, they are searching for ways to leverage limited resources. Variable incentive pay is the number one design used to influence short- to mid-term business results. Coupled with astute strategy, solid leadership and good working conditions, variable pay incentive designs can:

- Communicate priorities to indicate the relative importance of certain objectives and goals of the organization
- Engage employees in business success by sharing the gains realized from changed behaviors
- Reward valued skills and behaviors
- Create business literacy by educating employees on how and why their contributions will benefit them and their organizations
- Create esprit and solidarity through a common cause and renewed energy, and
- Contribute to a compelling place to work.

In highlighting the qualities of an effective incentive plan, it is also important to consider what an incentive plan cannot do. An incentive plan cannot:

- Replace trusted, quality leadership
- Create results where barriers exist that inhibit performance (for example, technology deficiencies or process inefficiencies)
- Fix an outdated or ill-conceived business strategy, or
- Meet all of an organization's human resources objectives.

Because the purpose of variable incentive plans is to energize and focus employee efforts, the design must "fit" the culture and specifically address the needs of the organization. To this end, the design process is often iterative and complex. An effective plan design must be based on a philosophical underpinning, clearly defined objectives, line of sight metrics, appropriate performance periods, reasonable investment returns and, most importantly, communication, coaching and performance management. More information about these and other factors is presented below.

Factors Influencing the Effectiveness of Incentives

An effective incentive program motivates employees toward desired performance behaviors that translate into results for the organization and rewards for the employees participating in the program. An effective Postal Service incentive plan should cause employees to do something that they would not otherwise do if the plan did not exist.

Although a variety of issues can impact the effectiveness of an incentive plan, the items below constitute key elements that should be considered when assessing the Postal Service's ability to translate an incentive plan idea into a viable, robust reward tool. The greater the degree to which these elements exist in the USPS, the more likely it is that an incentive plan will produce the desired performance and a reward that is considered worthwhile by participants.

Plan Design

- The plan design effectively aligns strategic operating priorities with desired employee behavior
- Performance metrics appropriately balance competing priorities, including productivity and quality
- Stakeholders concur that targeted performance levels are realistic and potential incentive payments are fair, thereby creating a "win-win" work environment

Simplicity

- The plan design (including measures, relevance to employee behaviors, and payout potential) must be easy to understand by all employee levels
- The plan should be simple enough that it easily engages employees to work toward USPS objectives (simplicity must relate to complexity of jobs participating)

Implementation and Communication

- The design and related implementation communications are pre-tested for clarity and understanding
- Communication of performance results and progress toward goal attainment is comprehensive and clear
- The measurement, tracking and reporting process is regarded by all as credible and reliable

Line-of-Sight

- Employees must believe they are able to make an impact on the objective being measured through their performance
- An action causes a reaction (positive or negative) – individual performance or impact is recognized by the immediate supervisor

- Employees understand and embrace the performance measures
- Performance measures should cascade down through the USPS (i.e., narrower in scope with each descending responsibility level, but still aligned with the strategies supported by the NPA plan)

Integration of Plan with other Organizational Processes and Systems

- The incentive plan performance measures are integrated within a rigorous performance management process that sets expectations, measures performance, and provides feedback to employees about how well they are meeting expectations
- The performance management process translates, encourages and reinforces behaviors that lead to positive results
- A process exists for employees to provide feedback regarding barriers to performance improvement and to participate in problem solving aimed at eliminating barriers and improving business performance

Return on Investment

- To be successful, the plan must generate more return for the USPS than is paid to employees
- Positive financial returns must be carefully balanced against other non-financial measures

Culture and Organizational Context

- A level of open communication and trust exists among peer employees and between levels within the USPS
- Units, divisions and departments embrace teamwork, especially where work processes cross such boundaries
- Consistent messages are sent about what's important and required from employees in terms of results and behaviors

A well designed and implemented incentive plan can actually facilitate a change of culture over time. For example, an incentive plan that focuses on measures that span work groups, encourages employees to think about work beyond their own team and to focus on the "hand-offs" that occur from one group to another.

The Design Process

As indicated earlier, the design process is iterative. While there is a logical, sequential design process to follow, individual design decisions often overlap and should not be considered final until all design features have been finalized. Following is an outline of the primary design steps:

e) Incentive Compensation Plan Design Best Practices

Design Step	Key and Design Issues
Develop Philosophical Underpinning	• Where does variable incentive pay fit into USPS total reward philosophy? • When do we use it and what is the value proposition to employees? To the organization?
Establish Plan Objectives and Purpose	• Overall purpose and expected outcomes of the design
Select Plan Participants	• Eligibility, including collectively-bargained employees • Impact on cross-organizational processes
Develop Performance Measures/Metrics	• Desired results / work behaviors • Business success factors • Line-of-sight; simplicity
Perfect Targets, Leverage and Administrative Mechanisms	• Formulas (based on stretch performance) • Modifiers / triggers • Performance period and payout frequency • Performance tracking and reporting capability
Assess Plan Funding and Return on Investments	• Budget • Evaluation of effectiveness
Prepare for Plan Implementation and Ongoing Performance Management	• Communications • Coaching and feedback • Integration with other operating and performance management initiatives

It is critical to include in the design process ample time to adequately identify, evaluate and balance performance metrics. The performance metrics must be properly matched to employee level for engagement purposes. It would not be prudent to establish performance metrics for craft employees that bear no relation to their everyday responsibilities (i.e., no line-of-sight).

Can an all-employee incentive compensation plan work at the USPS?

From Watson Wyatt's point of view, an organization-wide incentive program with set targets and cascading performance goals designed to motivate individuals and engage all USPS employees in specific behaviors related to improving productivity, reducing costs and enhancing customer service makes very good sense. We believe, if designed correctly, it could result in improved financial performance and help illuminate improvement opportunities between operating units engaged in collection, processing and delivery. We are of the opinion that an organization-wide incentive design would also enhance solidarity among the ranks and serve to create line-of-sight for employees between their contributions and attainment of USPS's operating objectives.

Obviously, there are important considerations in evaluating the viability of an all employee incentive plan, such as union and employee support. Further, the plan must be designed to be self funded.

If an incentive plan is viable at the USPS, what are the fundamental drivers for engaging the workforce?

Inasmuch as the National Performance Assessment Program has recently been put in place for USPS management, we have focused our recommendations on the creation of a complimentary, cascaded design for the 754,000 USPS field career employees. Our preliminary incentive design criteria for these employees are that the plan would be:

1. Self-funded
2. Calibrated by productivity and mail volumes
3. Triggered by mission achievement.

Following are recommended design criteria:

1. **Self Funded:** The new plan should be self-funded, which means that USPS shares a portion of improved economic gains with employees.

2. **Calibration:** We believe that metrics that correlate with improved financial results should be used to set targets, track progress and determine award values for employees. From the USPS 2002 Annual Report we calculate that fully 79% of USPS's 2002 operating costs are related to the provision of compensation and benefits for employees. Therefore, we believe that good measures for tracking improved financial results are those associated with improved productivity and efficiency. For this reason, we believe that a target set around "Pieces per Employee" that move through the postal service system will appropriately track and report operating efficiencies for employees engaged in mail collection, processing and delivery. As a safeguard for service quality, it is anticipated that

a second measure, such as percentage of ontime delivery, would serve as a "trigger" or threshold under which productivity improvements would be penalized.

Total Factor Productivity (TFP) which the Postal Service has used to track productivity for several years, is an alternative metric to Pieces per Employee. However, as it incorporates labor and capital productivity, it is further removed from the labor component of the productivity equation. Further, even when process improvements are achieved via, for example, new technology or other capital investments, eventual cost reductions (a key goal) are primarily realized by lower labor content.

We believe that the Pieces per Employee measure has several very functional attributes:

- It is simple to understand by all employees
- Its line of sight is short, relating to the work of nearly every Postal Service field employee
- The numerator of the formula, i.e., pieces of mail processed through the system, and the denominator, employees, are currently tracked and publicly reported by the Postal Service
- Employees are likely to trust the reported numbers
- The measure is the essence of productivity; performance can be enhanced by processing more with static resources and/or reducing resources, and
- The measure could be the foundation of a communication program to educate employees on the interrelationships between employees and departments/units on getting the mail collected, processed and delivered.

One of the few shortcomings of this measure is that its relation to cost reduction or revenue generation is indirect. That is, individual and group productivity can improve in an environment of escalating costs for compensation, benefits, equipment, etc., and the improvements are obscured.

3. **Mission:** According to USPS officials, failure to achieve on-time delivery service levels over a period of time is predictive of decreased mail volume and heightened customer dissatisfaction. Inasmuch as achievement of the USPS's universal distribution mission is financially bolstered by first class mail and package services, customer loyalty is an important component of the USPS business model. As such, our recommendation is to use achievement of customer

service guarantees at current national levels as a "proxy" for customer loyalty and satisfaction and to set a performance threshold below which the plan does not pay, regardless of improvements in productivity.

Measurement of Pieces Per Employee

We recommend that the "Pieces per Employee" (PPE) performance be measured at the district or "cluster" level and be conducted on a quarterly basis. The performance bonus pool would be generated on a quarterly basis for PPE over a threshold and paid to employees within 30 days of quarter's end. It is also our recommendation that the measurement of pieces of mail be done as it is currently. To convey the message that performance is in the control of front-line employees, it is recommended that the numerator of "employees" be defined as field career employees assigned to a Performance Cluster or appropriate district. Removed from this group are all employees participating in the National Performance Assessment, other headquarters personnel and all non-career employees.

Illustration of Past Pieces Per Employee Results

The following table, from data disclosed in the USPS 2002 Annual Report, shows the PPE for the last five years:

Pieces Per Employee Results 1998-2002				
Year	Field Career Employees[3]	Pieces of Mail (millions)	PPE	% Change from Prior Year
2002	743,000	202,822	273,000	+ 0.55%
2001	764,000	207,463	271,500	+ 1.23%
2000	775,000	207,882	268,200	+ 4.56%
1999	786,000	201,644	256,500	+ 1.75%
1998	781,000	196,905	252,100	

From our calculations, over a five year period, a compounded annual rate of improvement of 1.6% was accomplished with only the existing recognition and reward programs. From remarks of Postmaster General Potter in the 2002 Annual Report, the 2002 results contributed to Postal Service cost avoidance of $2.8 billion. For illustrative purposes, the USPS might consider an annual PPE productivity improvement of 1.6% as a threshold level of improvement, at or below which no additional rewards should be made. The portion of financial gain above the threshold to share between employees and the USPS must be modeled.

[3] Exclusive of headquarters and non-career employees.

Plan Cost and Return on Investment Illustrations

To assess whether the underlying plan design concept is viable, it is necessary to illustratively model plan costs and return on investment. The modeling is based on information found in the USPS 2002 Annual Report.

Total direct compensation, i.e., salaries and wages, in 2002 were disclosed to be $36.9 billion for all USPS employees. Based on our assumption that, on average Headquarters compensation is 120% of field career compensation, and non-career employee compensation is 20% of field career, we arrive at an average annual total pay for field career at $47,800. This would include overtime pay. It is estimated that benefits would add an additional 30%, or $14,400 to the average total annual cost per field career employee, for a total of $62,200. A more detailed analysis can be conducted as the bonus plan design is refined.

Watson Wyatt surveys show that many organizations pay bonuses to employees below the management levels, as presented earlier. The average bonus as a percentage of salary or wages is shown to be very modest in some sectors, such as not-for-profit organizations. It is our belief that bonuses as little as 2.5% to 3% of wages can draw employees' attention and begin to encourage work-related behavior changes. At the other end of the reward spectrum, we do not believe it is necessary to award more than 7% to 8.5% of wages to achieve full employee involvement in the program. It is also essential that incentive payouts have noticeable volatility, including zero to avoid establishing an entitlement attitude among participants. With the population we have defined as eligible for the broad-based employee bonus plan, 3% of compensation is about $1.07 billion and 7% is nearly $2.5 billion.[4]

What level of productivity improvement or revenue generation is necessary to fund these payouts? Revenues achieved through postal rate increases must be removed from the bonus calculations. Further, revenues are a suboptimal measure since it is not clear how employees in the group we are addressing can drive demand, other than the practice of effective customer relations by those who have public contact.

The true leverage in the plan concept is to process the same or greater level of production with fewer resources. If mail volume declines, the human capital content must decrease more rapidly. All this must be accomplished either through improved individual productivity or advances in technology. Many employees we spoke with in the focus groups believe individual productivity can be improved.

[4] However, since the payroll includes overtime, these figures are likely overstated for a bonus plan that would be calculated based on straight-time salary or wages

Static examples of productivity improvements necessary to fund bonus pools are calculated in the following table. Although we recommend that the unit of measurement be at a Performance Cluster or district level, until those figures are analyzed, we present calculations on a system-wide basis.

A. Expected improvement in PPE at annualized 1.6% (2002: 273,000 PPE × 1.016 = 2003 Minimum PPE)	277,400
B. Human capital reduction to achieve 2003 Minimum PPE [2002 Employees minus (2002 Pieces ÷ Minimum PPE)]	12,000 employees

C. 2003 Pieces to achieve Minimum PPE (2002 Employees × 2003 Minimum PPE)	206.4 billion
D. Cost to fund 3% bonus pool (i.e., Threshold Bonus)	$1.07 billion
E. Total human capital reductions to fund 3% pool [($1.07 B ÷ $62,200 cost per field employee) + 12,000]	29,200 employees
F. Threshold *quarterly* bonus for $40,000 employee @ 3%	$300
G. Cost to fund 7% bonus pool (i.e., Superior Bonus)	$2.5 billion
H. Total human capital reductions to fund 7% pool [($2.5 B ÷ $62,200) + 12,000]	52,200 employees
I. Superior *quarterly* bonus for $40,000 employee @ 7%	$700

In the above example, presented for illustrative purposes only, a dynamic model would include a combination of mail volume volatility as well as human capital efficiencies. With static mail volume assumed in the illustration, the number of employees becomes dynamic. Clearly, headcount reductions cannot continue indefinitely at the USPS. Therefore, at some future point efficiency gains based on this incentive plan will stagnate and the incentive plan may need to be recalibrated. We would advise the Postal Service to carefully evaluate these issues annually.

In Line B above, the cost avoidance of $62,200 for each of 12,000 employees is about $750 million, approximately three-quarters of our estimate of the total increase in compensation and benefits for 2003. In Line C, an increase of 3.6 billion pieces, at an average rate of $0.33 per piece (based on 2002 volume and revenues) would generate about $1.2 billion of additional revenue. It is the cost avoidance or cost reductions above these levels that are expected to fund the employee incentive pool. In addition, depending on USPS's human resources strategies regarding increases in wages, it may be possible to divert these wage costs from fixed to variable expenses and assist in incentive pool funding.

It is expected that declines in service quality will severely affect the funding of the incentive pool. From an achievement of mission point of view, we believe it is prudent to set Performance Cluster/district on-time delivery levels as the threshold for plan payment. To the extent current levels cannot be maintained, the plan would not make incentive payments. This incentive plan design element will clearly communicate to employees the critical organizational objective of customer service and satisfaction.

What are the organizational and operational considerations for a successful incentive compensation plan?

Setting performance targets is a crucial exercise in the operation of any incentive plan. If the probability of achieving some payment from the plan is seen as too low, it will not motivate participants to change behaviors. Indeed, it could have a damaging effect on employee morale and their attitudes toward Postal Service management. On the other hand, goals that are set too low provide inadequate returns to the organization and an entitlement expectation among employees, which may not be reversible without damage to morale. The definition of precise performance targets, triggers, performance periods and other administrative design elements requires data analysis and modeling with actual performance information.

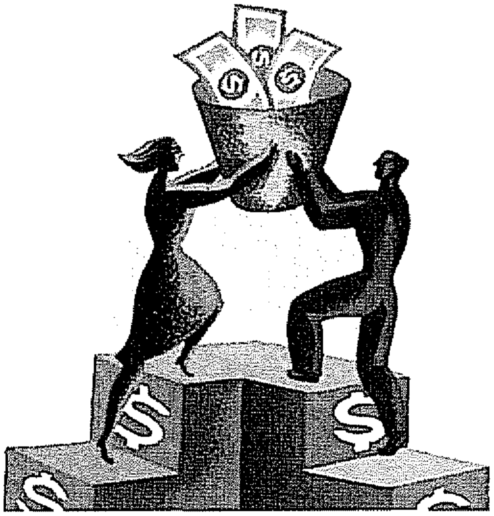
Performance measurement periods need to be tied closely to process periods and the nature of the jobs covered by the plan(s). As a broad generalization, craft employees' individual and group performance should be measured and communicated frequently (daily, weekly, and monthly), whereas executive and management performance should be measured and communicated on a somewhat longer time horizon (monthly, quarterly, and annually). While the performance cycle for the employee group we are addressing should have a short time horizon, it must be long enough to gauge productivity properly. Until we know more about the measurement process and other ingredients of productivity in the Postal Service, we believe quarterly cycles balance these issues.

Exhibit 1 – Union Leaders Participating in Study

Mr. William Burrus, President	American Postal Workers Union, AFL-CIO
Mr. Gus Baffa, President	National Rural Letter Carriers' Association
Mr. William Young, President	National Association of Letter Carriers, AFL-CIO
Mr. Steve LeNoir, President	National League of Postmasters of the United States
Mr. Vincent Palladino, President	National Association of Postal Supervisors
Mr. Bruce Lerner, General Counsel	National Postal Mail Handlers Union

Exhibit 2 – Employee Focus Group Questions

1. If you were to tell me that the USPS had a great year last year, what measures would you point to as proof?
2. Are employees as productive as they can be? If not, what are the obstacles?
3. Please provide your thoughts and ideas on measuring your work.
4. Why is customer service important? How do you know when you have met customer service expectations?
5. Would you like an incentive compensation plan? Why?



Annual Cash Incentives for Managerial and Professional Employees


Dow Scott, Ph D.
Loyola University Chicago


Thomas D McMullen
Hay Group


Marc Wallace
Hay Group


Dennis Morajda, MSIR
Performance Development International Inc.

Since the early 80's, there has been a substantial increase in the use of variable pay as a percentage of total pay that managers and professionals receive In recent years, management's mantra has been to increase the "leverage" of variable pay to better align managers and professionals with the business, to encourage outstanding performance, to share the risk of business success and to more fairly reward those employees who make the largest contributions. With the exception of executive compensation, few research studies have attempted to link annual cash incentive pay programs to organizational effectiveness. Lack of empirical evidence, however, has not prevented compensation managers, academicians and consultants from suggesting that organizations can gain a competitive advantage by using variable pay to increase performance Since annual cash incentives are widely used with managerial and professional employees, it would be in management's best interests to learn which designs of annual cash variable pay programs are most effective. Consequently, this study attempts to identify the most common design features of annual cash variable pay programs and determine if certain design features are more effective then others in driving organizational performance.

Research Methods

Identifying the Research Population

The first phase of the study focused on identifying the common features of annual variable pay programs in use today by reviewing the literature and discussing this issue informally with academics, consultants and practitioners. Differences in terminology and program definitions used in the compensation field created a significant challenge to the research. To meet this challenge, the team tried to find the most common or universally used terminology and definitions for policies or programs to minimize confusion for respondents.

The research team also recognized that there are variations in variable pay programs across different organizational levels and occupations within the same organization. For example, outside sales incentive programs are designed very differently than incentive programs for managers in a manufacturing operation. Consequently, research focused on managerial and professional employees for four reasons. First, most organizations tend to have a uniform set of policies and practices for this group. Incentive plans associated with the senior executive team or sales professionals were excluded from the study because incentive programs are often customized for these groups and even for individuals within these groups. Second, compensation managers will likely have substantial knowledge of the variable pay policies and programs for professional and managerial employees since they are typically accountable for program administration and are probably included in this group for pay purposes. Third, this employee group tends to have a significant impact on total organizational performance, making this a critical group to understand in terms of pay policies and programs and organizational effectiveness. Finally, the focus of the study provided continuity since managers and professionals were the focus of our previous study that examined the linkages between base-pay policies and practices and organizational effectiveness.

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Developing the Survey Instrument

In phase two, the team constructed a data collection instrument with statements and response categories that generated a set of standardized responses for use in quantitative analysis of the data. To enhance the richness of the findings, open-ended questions were also included to ensure that nonstandardized responses were captured. There were three cycles of pilot tests with compensation managers, consultants and academics before the survey instrument was finalized.

The final version of the survey instrument asked participants to describe and evaluate the annual variable pay program for which their managerial and professional employees were eligible as it related to:

During a two-week period, a total of 958 members responded. This represents variable pay programs covering approximately 2.8 million management and professional plan participants from a cross section of industries.

- Design features of the annual cash incentive pay program
- Identification of those involved in program design
- Administration and implementation
- Evaluation of program effectiveness

The study did not examine equity pay programs because a long-drawn-out survey might have discouraged compensation managers from responding.

Defining "Successful"

We used three measures to determine the effectiveness of the annual variable compensation program. First, the team compared the pay policies and programs between companies included in *Fortune* magazine's 2003 "America's Most Admired Companies" list for their industry sector and those that did not receive the designation. *Fortune's* "Most Admired Companies" is a highly regarded annual survey of corporate reputations, conducted by Hay Group, of more than 10,000 executives, directors and analysts. The survey invites them to rate companies overall and within industry groupings on eight criteria ranging from financial soundness and use of corporate assets to quality of management, products and services.

Second, the team collected 2003 total shareholder return (TSR) information for the publicly traded companies that responded to this survey. TSR is defined as the monthly percentage growth in stock price and dividends paid over a five-year period. The team divided the TSR data into quartiles and compared survey responses for the highest TSR quartile (i.e., the top 25 percent of companies) with data from companies in the lowest or bottom quartile of TSR (i.e., the lowest 25 percent of the companies).

Finally, survey respondents were asked to make a personal assessment of the effectiveness of their compensation policies and practices. Although this measure may be subjective, we believe that the education and experience of most compensation managers provides a relatively valid indicator of program success.

Response Rate

A representative sample of more than 9,000 WorldatWork members was sent a Web link to the electronic survey instrument in late November 2003. The membership sample targeted the highest-level compensation manager for each company. Virtually all responses were from compensation professionals or HR managers who had significant responsibility for compensation decisions. During a two-week period, a total of 958 members responded. This represents variable pay programs covering approximately 2.8 million management and professional plan participants from a cross section of industries including manufacturing (26 percent), financial and insurance (22 percent), information (seven percent), health care and social assistance (seven percent), utilities (seven percent) and professional, scientific and technical services (five percent).

Key descriptive findings are highlighted in the following section. Additional relevant descriptive statistics are provided in this report's appendix. All percentages are rounded up from .5 and therefore may not equal 100 percent.

More than 99 percent of respondents completed the entire survey and were included in the analysis. Figures 1, 2 and 3 show how the sample represented virtually all industries and organization sizes. The analyses reported here are descriptive statistics and t-tests comparing responses between "Most Admired" and other companies, and comparing companies with the highest TSR (i.e., top quartile) and the lowest TSR (i.e., bottom quartile).

Research Findings

Program Features

Over the past two decades, the prevalence of variable pay programs has increased substantially and today a significant majority of organizations offer these programs. Seventy percent of respondents believed that variable pay was "important to very important" to the success of their organizations' competitive strategies.

FIGURE 1 Program Types and Eligibility

Type of Variable Pay Program	% of Managers and Professionals Eligible	% Responded Strongly to Moderately Effective
Individual-based Performance Programs	79%	89%
Team-based Performance Programs	48%	83%
Gain-sharing Programs	19%	72%
Profit or Revenue Sharing Programs	46%	69%
Equity Programs	59%	68%
Spot/Other Cash-based Recognition Programs	75%	70%

FIGURE 2 Types of Measures Used to Determine Performance

Annual (or short-term) Variable Pay	% Used
Individual measures only	25%
Group measures	75%

Individual measures only	25%
Corporate measures only	31%
Business unit, team, department measures only	16%
Combination of corporate, business unit and individual measures	15%
Other combinations	13%

FIGURE 3 Program Objectives

Primary Objectives of Variable Pay Program (Respondents asked to select three most important)	Percentage
Improve organization or team financial performance	65%
Create a more competitive total compensation market position	58%
Improve individual performance or productivity	47%
Improve overall productivity	32%
Better recognize employee contributions	32%
Promote a sense of ownership	22%
Use variable pay to better manage compensation costs	17%
Improve employee involvement	12%
Support culture change	8%
Reduce employee turnover	7%

Furthermore, 36 percent believed that it is "moderately important" for "most" employee groups and 44 percent believed that variable pay is "important" for "all" employee groups

Data shown in Figure 1 excludes organizations that do not offer variable pay eligibility to both managers and professionals. However, 14 percent of this sample grants eligibility to "managers only" (not including the senior executive team), while less than one percent grants "only to professional" employees Specifically, Figure 1 details the types of variable pay programs for which managers and professionals are eligible and rates the effectiveness of those programs

Figure 2 indicates the types of measures used to determine performance A majority of organizations in the survey (75 percent) utilize some form of group measure in variable pay plan design and 25 percent of organizations rely on individual performance measures alone to determine payouts. Of the organizations using group measures, a significant subset uses corporate performance measures only (31 percent)

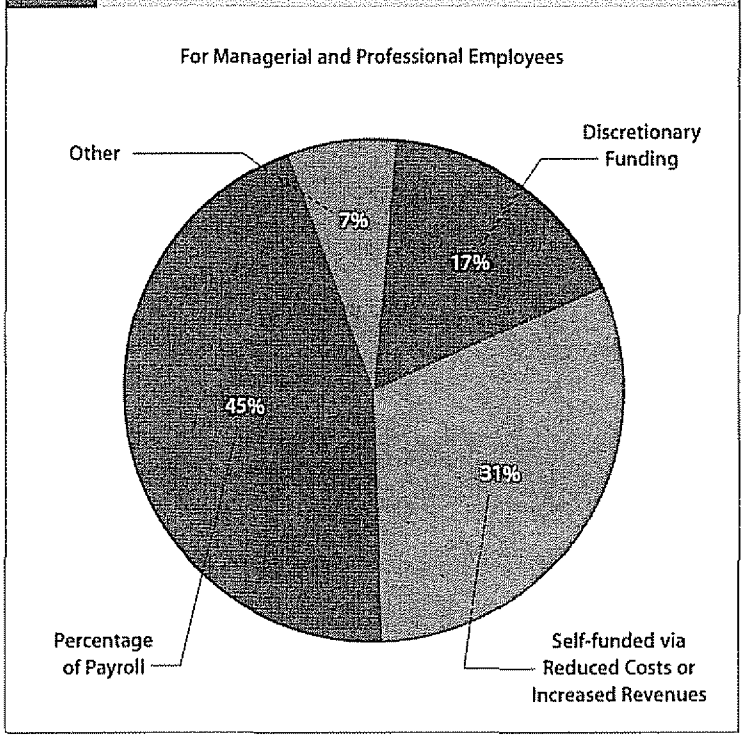
When asked their view regarding leverage (i.e., variable pay as percentage of base pay), 73 percent of compensation managers believed that their managerial and professional employees were "moderately to aggressively leveraged" as compared to other companies in the labor market As might be expected, higher-paid professionals and managerial employees are more highly leveraged than those who are paid less The range of reported variable pay (as a percentage of base) is provided below:

- Paid less than $50,000 are leveraged zero to nine percent
- $50,000 to $99,000 are leveraged 10 to 24 percent
- $100,000 to $149,000 are leveraged 10 to 39 percent
- $150,000 to $199,000 are leveraged 10 to 59 percent
- $200,000 to $299,000 are leveraged 40 to 79 percent

Survey participants reported diverse reasons for providing variable pay programs to managerial and professional employees Figure 3 indicates the number of respondents who said a particular objective was one of their top three objectives for the variable pay programs "Improve organization or team financial performance," "create a more competitive compensation market position" and "improve individual performance" are the most frequently mentioned variable pay objectives Improved overall productivity and employee recognition are in the second tier of objectives

Three primary funding sources for the managerial and professional annual or short-term variable plans were identified, as shown in Figure 4, (i e , discretionary, percentage of payroll and self-funded) Discretionary is defined as a means of funding in which, near the end

FIGURE 4 Funding Sources of Variable Pay Programs



of the performance period, the senior managers simply determine what the bonus pool will be and establish some method for dividing up the pool (i e the amount paid out is at the management's discretion) It was interesting that almost half (45 percent) of the managerial and professional annual incentives were simply budgeted as labor costs as opposed to self-funded plans (31percent)

Organizations tend to provide corporate safeguards in the design of variable pay programs The survey indicated that 82 percent of variable pay programs have a hurdle or trigger that can cancel a payout and 87 percent of programs have pre-established performance levels Likewise, most organizations have a maximum cap on earning opportunities in the variable pay program Approximately 80 percent of those surveyed utilize a performance cap on potential variable pay earnings Figure 5 shows that most caps are between 1 5 and 2 times the target

It should be noted that nearly one quarter of plans have a maximum that is between 100 and 124 percent of the target Our experience tells us that these are likely to be plans based on a hurdle In other words, there is a specific objective to achieve and once the objective is achieved, there is a payout Conversely, there is no payout if the objective is not achieved and there is no increased payout if results beyond the objective were achieved

Figure 6 shows that the vast majority of variable pay programs for managerial and professional employees are paid annually

Program Communications and Implementation

The survey indicates that 81 percent of the variable pay programs have been revised in the "last five years" with 47 percent revised during the "last two years " The primary designer of the variable pay plan for 66 percent of the respondents was "Human Resources," often with input from senior management It is interesting to note that 23 percent of responding organizations "seldom involved eligible employees" in the design of the program

Sixty-seven percent of compensation managers believe that "most to all eligible employees" understand the variable pay program

Ninety-three percent of respondents indicated that they provided some variable pay communication. The findings report in Figure 7 on page 12 indicates that variable pay plans are communicated in diverse ways "One-on-one discussions with supervisors" and "written materials outlining the plan" were listed as the primary means to communicate changes in the plan to employees This indicated to us that executives use traditional, reliable and perhaps the most effective forms of communication

FIGURE 5 Percentage of Target

If Plan Contains a Cap, the Maximum % of the Target	Percentage
100 – 124%	24%
125 – 149%	12%
150 – 199%	27%
200 – 249%	25%
250 – 300%	3%
Over 300%	1%
Not applicable	8%

FIGURE 6 When Programs are Paid Out

Primary Variable Pay Program Designed to Pay Out:	Percentage Responses
Annually	81%
Semi-annually	5%
Quarterly	7%
Monthly	1%
Achievement of objectives/milestones	2%

FIGURE 7 Communication Vehicles

Details and Updates are Communicated Through:	Percentage Responses
One-on-one discussions with supervisor	55%
Written materials outlining plan	52%
Information posted in a public place or on the intranet	31%
Employee meetings	34%
Variable pay information in NOT communicated	7%

Variable Pay Program Effectiveness

Compensation managers were asked to rate the effectiveness of their variable pay program for managers and professional employees on several dimensions. Figure 8 shows the percentage of managers that said that the variable pay plan was effective or very effective for the stated dimension. Figure 8 indicates that approximately two thirds of compensation managers are satisfied with the overall effectiveness of their variable pay programs. However, this still indicates that a significant minority (one in three) is not satisfied. The items that scored higher on perceived effectiveness tend to be design-related attributes such as frequency of payouts, funding mechanism and appropriateness of measures. The relationship between payouts and organization performance also scored high, but the relationship of payouts to individual performance and team/group performance scored lower. The motivational value of the program also scored relatively low. We could imply that since a high percentage of plans are based on corporate measures only, the motivational impact at the individual level is diluted.

The criteria used to judge the effectiveness of managerial and professional annual or short-term variable pay programs are shown in Figure 9.

FIGURE 8 Effectiveness of Programs

Variable Pay Program Dimension	Percent Responded Effective to Very Effective
Frequency of payouts	79%
Funding mechanism	77%
Relationship between variable pay program payouts to organizational performance	72%
Appropriateness of the variable payplan measures	68%
Overall effectiveness	64%
Administrative ease	64%
Appropriate return on investment	62%
Employee understanding the program	61%
Motivational value of the program	55%
Relationship between variable pay program payouts to individual performance	53%
Responsiveness to change	50%
Relationship between variable pay program payouts to group or team performance	43%

FIGURE 9 Criteria Used to Judge Effectiveness

Criteria Management Uses to Judge Effectiveness of Their Programs (Respondents asked to select all that apply)	Percent Response
Business operating results	73%
Informal opinion gathering from senior leadership	35%
Employee satisfaction survey measures	30%
Employee productivity metrics	28%
Employee turnover or retention	27%
Informal opinion gathering from employees	23%
Management does not evaluate variable pay plan success	16%
Labor costs are controlled or lowered	9%

Respondents indicated that "business operating results" are the primary criteria, with "informal opinion gathering from senior leadership" a distant second choice. This same question was asked in last year's survey regarding base pay practices. For base pay, respondents overwhelmingly chose employee retention as the primary effectiveness criterion. This shows that HR professionals are taking a balanced approach to compensation and using different compensation vehicles to meet different objectives. Base pay tends to be used to attract and retain talent and variable pay is typically used to reward performance.

Interviews with compensation managers supported these trends. Companies that were successful with variable pay attributed it to line of sight and communication. Mark Premock, general director of compensation at Burlington Northern Santa Fe, said during a personal interview on April 29, 2004, "We take extra time to get performance communication approved by the entire senior leadership team. That way, no matter how employees receive their information, it is always a consistent message."

Compensation managers indicate that improving the "line-of-sight"and the linkage between payout and performance are the most important ways to improve the variable pay programs. (See Figure 10). Despite these findings, a majority of organizations do not involve employees in the design of the variable pay program. This seems to be an obvious area for improvement. In focusing on line-of-sight issues, organizations are suggesting that they must do a better job of ensuring that their employees understand what they are being asked to do to earn their rewards, and that their individual goals are based on a realistic view of the future and connected to what the organization needs to succeed in the future.

Employees are typically motivated to provide additional discretionary effort in their jobs when they feel connected to the bigger picture and understand

In focusing on line-of-sight issues, organizations are suggesting that they must do a better job of ensuring that their employees understand what they are being asked to do to earn their rewards, and that their individual goals are based on a realistic view of the future and connected to what the organization needs to succeed in the future.

FIGURE 10 Areas for Improvement

How Variable Pay Programs Can Be Improved (Respondents asked to select three most important)	Percent Response
Improve plan "line of sight" to individual or team efforts	60%
Improve linkage between payout and performance	57%
Improve communication of plan objectives	48%
Increase understanding of the variable pay plan	33%
Improve ease of administration	23%
Increase payout opportunities	23%
Ensure goals are viewed as more attainable	22%
Reduce conflicting goals	9%

There were not many differentiating features in terms of plan design, but programs differ widely in terms of how they are executed — especially in the areas of communication, building line of sight and providing management with an important role in the design and implementation of these programs.

how their actions contribute This is both a variable pay issue as well as a communication issue. Goals and measures will have little value if employees are unaware of how they are progressing toward the goal until they have either met or missed it

Conclusions

In this research, we have seen that the prevalence and eligibility levels of variable pay programs are substantial and that compensation professionals view variable pay programs as instrumental in their reward strategy. The primary objectives of these programs tend to be squarely focused on improving organizational and individual performance and improving the overall market competitiveness of pay. The majority of plans consist of group measures, but there is renewed focus on individual measures

This study indicates that variable compensation for most managerial and professional employees is still administered under fairly traditional, time-tested methods such as individual bonuses, profit sharing, gain sharing and equity programs Compensation professionals believe that these methods are generally effective, as is evident by their widespread use and positive responses regarding the perceived effectiveness of these programs Designs for short-term or annual cash variable pay programs are generally given high ratings for effectiveness by the survey respondents, but program implementation is not viewed as favorably Relatively low marks are given for the effectiveness of the compensation programs' motivational value and communication to employees Although individual variable pay plans are rated highly, most plans have a group variable pay component We have found in this research that there were not many differentiating features in terms of plan design, but that programs differ widely in terms of how they are executed — especially in the areas of communication, building line of sight and providing management with an important role in the design and implementation of these programs

Compared to our previous study that examined base-pay issues, we found fewer connections between program design features and two measures of organizational effectiveness, i e , TSR and designation as a Most Admired Company (according to *Fortune* magazine) We did find that the most admired companies were more likely to involve program eligible employees in the design of the variable pay program. Involvement not only builds commitment to the program, it may also improve program design and help employees better understand how the program works

Compensation managers from most admired companies perceived their annual cash variable pay program as being more effective, especially as it related to the motivational value of the program and the relationship of variable compensation payouts to individual employee performance Respondents from most admired companies also had more confidence that employees understood the program, which is consistent with their willingness to involve employees in the design of the program The authors did not find any significant differences between variable pay program design features and TSR

Thus, we conclude that annual bonuses for managerial and professional employees will continue to be an important component of their pay. However, program effectiveness is less an issue of having the "right" program features and more dependent on program implementation and communication Therefore, companies that want to improve the effectives of their annual incentive programs should focus on helping employees understand the program and how their actions contribute to business results, and on building commitment for the program. WJ

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Authors

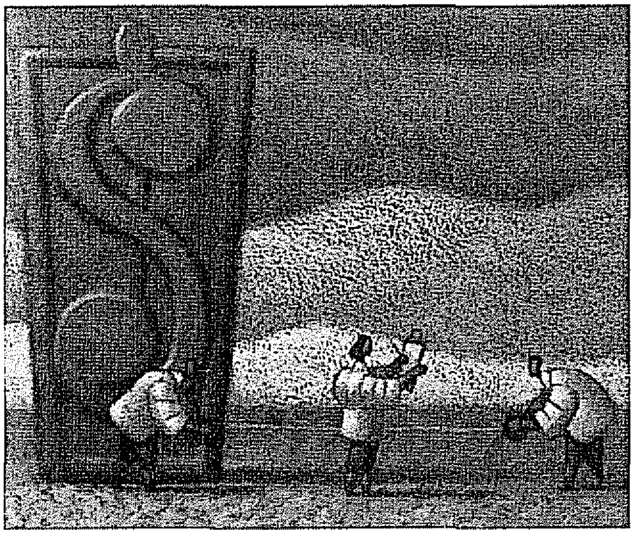
Dow Scott, Ph D (dscott@wpo it luc edu) is a professor of HR in the School of Business Administration at Loyola University Chicago His practical approaches to teaching, research and consulting focus on helping business leaders create more productive and satisfying work environments He has been published in more than 100 journals, books and conference proceedings, and received national recognition for team/productivity improvement and HR research Scott's research and consulting has focused on employee retention, creation of effective teams, performance improvement strategies, pay and incentive systems, evaluation of HR programs and the development of high-performance organizations

Dennis Morajda, MSIR (dmorajd@earthlink net) is vice president of Performance Development International, Inc., an HR consulting firm that specializes in working with organizations to build more satisfying and productive work environments He has worked with clients in a variety of industries toward reducing employee turnover and absenteeism, assessing employee attitudes on pay, and improving organizational and safety cultures He has extensive experience in designing employee attitude surveys, continuous improvement and performance evaluation systems

Marc Wallace (marc_wallace@haygroup com) is an experienced consultant in performance management and compensation He has presented for several regional organizations as well as at the WorldatWork annual conference on multiple occasions and at national conferences on variable pay As a consultant at Hay Group, Wallace works with organizations to develop strong rewards and performance management systems Wallace holds a master's degree in international management from Thunderbird and a bachelor's degree in economics from the University of Wisconsin at Madison

Thomas D McMullen (tom_mcmullen@haygroup com) is a senior consultant and Midwest Rewards practice leader in the Chicago office of Hay Management Consultants He has over 20 years of combined HR practitioner and consulting experience His work focuses primarily on total rewards and performance program design, including rewards strategy development, incentive plan design, employee pay and job evaluation

Prior to joining Hay, McMullen was in senior compensation roles with Kentucky Fried Chicken Corp. and Humana Inc He holds a master's degree in business administration and a bachelor's degree in mathematics from the University of Louisville



Evaluating Pay Program Effectiveness: A National Survey of Compensation Professionals


Dow Scott, Ph.D.
Loyola University Chicago


Thomas D. McMullen
Hay Group


Richard S. Sperling
Hay Group

This paper is the second in a two-part examination of pay program evaluation. The first paper, "Evaluating Pay Program Effectiveness" (published last quarter in the *WorldatWork Journal*), suggested that using return on investment (ROI) to determine the value of pay programs has significant limitations. The authors proposed that comprehensive pay program evaluation should not only assess ROI but should also:

- Provide necessary feedback for improving pay program effectiveness, given the constant changes in the work and business environment
- Identify problems early in the pay program's rollout
- Build employee and management commitment to the pay program by engaging them in the evaluation and improvement process
- Hold management responsible for implementing the program as designed, and
- Communicate pay values, policies and programs to employees and managers.

To accomplish these goals, a comprehensive two-dimensional framework for evaluating pay programs was proposed (adapted from the work of Donald Kirkpatrick 1998). The first dimension focuses on four evaluation perspectives that should be considered in the evaluation process:

- employee perception of the pay program
- their understanding of the pay program
- employee behaviors driven by the program and
- the impact the pay program has on results

Researchers widely use the second dimension in the process to collect and analyze data:

1 Setting goals or objectives
2 Identifying evaluation criteria
3 Selecting an evaluation methodology
4 Collecting and analyzing data
5 Interpreting findings and
6 Developing and implementing program improvement strategies

This process ensures the information collected is of sufficient rigor to provide accurate insights on pay program value This framework is explained in considerable detail in Part 1 of this series, published in the Second Quarter 2006 edition of the *WorldatWork Journal*

This paper, Part 2 of the series, presents the findings from a national survey of compensation, human resources and finance professionals who identify current practices of how pay programs are evaluated within their organizations To understand if a systematic and comprehensive evaluation process is used within organizations, the authors structured the survey to address the following questions:

- To what extent do organizations evaluate pay program effectiveness?
- How is pay program effectiveness evaluated?
- Does pay program evaluation tend to be quantitative or qualitative, formal or informal?
- To what degree does pay program evaluation focus on financial versus human resources measures (e g , turnover, absenteeism, attracting talent or motivation)?
- What impact, if any, does pay program evaluation have on organizational effectiveness?

Data Collection Methods and Respondent Characteristics

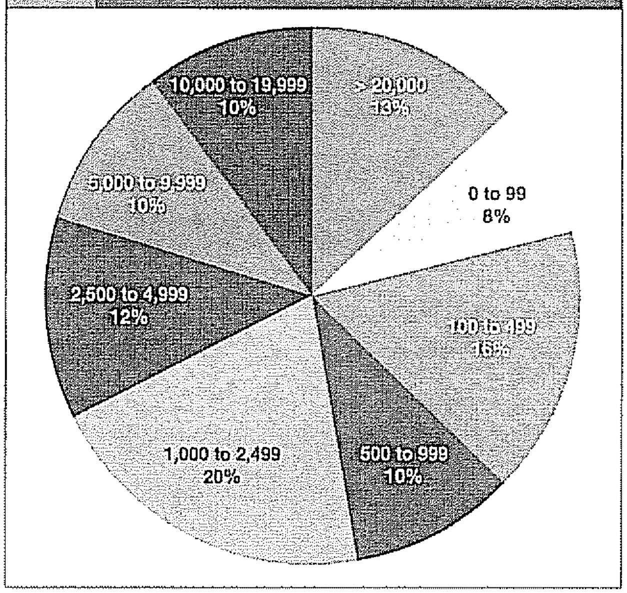
WorldatWork, Chicago Compensation Association members and registered Hay Group (a management consulting firm) Web site users were invited to participate in the research initiative in January 2006 The survey was open for a 30-day period, and the database was closed in February 2006 The survey required approximately 15 to 20 minutes to complete

Of the more than 600 respondents participating in the study, 55 percent were compensation professionals, 27 percent were human resources managers and 18 percent held other managerial positions (e g , primarily business-unit executives and finance professionals)

Participating organizations were fairly evenly distributed by size Approximately one-third of organizations had fewer than 1,000 employees, one-third had between 1,000 and 5,000 employees and one-third had greater than 5,000 employees (See Figure 1 on page 48) Only 8 percent of the sample reported representing organizations with fewer than 100 employees

Figure 2 on page 49 shows the sample included respondents from a diverse range of industries The

FIGURE 1 Survey Demographics: Company Size (# of employees)



Because of rounding, this figure totals 99 percent.

FIGURE 2 Survey Demographics: Industry Sector

INDUSTRY SECTOR	%
Manufacturing	16
Finance and Insurance	15
Health Care, Social Assistance	11
Professional, Scientific, Technical Services	8
Public Administration	6
Educational Services	6
Retail Trade	4
Utilities	3
Information (Publishing, Electronic, Print, IT)	3
Transport and Warehousing	3
Wholesale Trade	2
Other Services (Except Public Administration)	2
Real Estate and Construction	2
Other	20

Due to rounding, this figure totals more than 100 percent

largest representation were from manufacturing (16 percent); finance and insurance (15 percent); health care and social assistance (11 percent); and professional, scientific and technical services (8 percent).

While the Most Admired analysis uses a balanced set of rating attributes covering both financial and nonfinancial criteria, it is important to note that Most Admired Companies outperform the market as a whole.

Respondents were excluded from the analysis if more than one manager responded for a single organization (the highest-ranking manager was retained) or if the organization reported it had fewer than 10 employees.

To examine the impact pay program evaluation may have on organizational effectiveness, companies identified by *Fortune* magazine as a "Most Admired Company" were compared to respondents with the same range in employee size. The *Fortune* "Most Admired Companies" survey is a highly regarded annual analysis of corporate reputations. The Hay Group conducts the survey for *Fortune*. More than 10,000 executives, directors and industry analysts are involved in developing these overall rankings. The survey invites these respondents to rate companies, overall and within industry groupings, on nine criteria ranging from financial soundness and use of corporate assets to quality of management and quality of products and services. While the Most Admired analysis uses a balanced set of rating attributes covering both financial and nonfinancial criteria, it is important to note that Most Admired Companies outperform the market as a whole. In 2006, the top 10 Most Admired Companies delivered a five-year average total shareholder return of 11.1 percent, compared to -2.7 percent for the S&P 500.

Research Findings

In response to the question "Does your company evaluate the effectiveness of its pay program?" 66 percent responded "yes" for base pay programs and 53 percent responded "yes" for variable pay programs. From the total sample, 47 percent of the companies evaluate their base and variable pay programs. However, there was a significant difference in evaluation prevalence for the Most Admired Companies, with 81 percent of these organizations evaluating base and variable pay program effectiveness as compared to 51 percent of comparably sized companies (5,000 employees or more) that did not receive this designation.

The information reported in Figure 3 through Figure 8 (pages 50-52) is only for those organizations that reported they evaluated their pay programs Figure 3 shows the level at which pay programs are evaluated and the importance associated with that information, collected for evaluation purposes For base and variable pay programs, overall company or organization level was the most common point where pay program evaluation occurred; 87 percent and 76 percent for base pay and variable pay programs, respectively Evaluation at either the department, work unit or team level was less prevalent for both base and variable pay Although individual scores were not significantly different, companies with the "Most Admired" designation indicated that overall, they were more likely to evaluate base and variable pay programs at the organization and business-unit levels

For those organizations where pay programs are evaluated, this paper's findings showed considerable variations in the depth and rigor of the analysis (See Figure 4) Few organizations report that they seldom, if ever, evaluate their pay programs after the programs are implemented for base and variable pay (10 percent and 7 percent, respectively) Whereas at the other extreme, 27 percent of respondents indicated that their organizations evaluate base pay and 38 percent said they evaluate their variable pay programs by calculating both the cost and their bottom-line impacts The most common practice for organizations is to calculate the costs associated with the compensation program and to informally discuss the impacts on bottom-line performance

Companies were more likely to calculate the cost and at least discuss the bottom-line impact on variable pay programs than for base pay programs This finding is consistent with the authors' beliefs that variable pay programs, by their very nature, are easier to evaluate

Figure 5 on page 51 summarizes the criteria used to evaluate both base and variable pay programs The most often used criteria for base pay programs are "attracting new employees or time to fill open positions" and "impact on employee retention or turnover " Whereas, the most widely used criteria for variable pay are "impact on revenues, profits and net worth" and "impact on productivity or cost savings " Given the significantly different nature and objectives of the base and variable pay programs, it is not surprising that different criteria are used to evaluate these programs

Figure 6 reports the perspective used to evaluate base and variable pay programs For all participants, informal feedback from both employees and managers are heavily used information sources Formal employee feedback is relied upon for more than one-half of the

FIGURE 3 **Pay Program Evaluation Levels**

	Prevalence		Importance	
	Base Pay	Variable Pay	Base Pay	Variable Pay
Company or Organization Level	87%	76%	60%	56%
Business Unit or Division Level	45%	50%	23%	31%
Department Level	33%	27%	11%	9%
Work Unit or Team Level	16%	14%	6%	4%

FIGURE 4 **Depth of Pay Program Evaluation**

	Base Pay	Variable Pay
Seldom, if ever, evaluate after implementation	10%	7%
Calculate costs, but do not try to determine value/contribution	24%	12%
Calculate costs and discuss their impact on bottom line	39%	43%
Calculate costs and bottom-line impacts	27%	38%

respondents for both base and variable pay More than two-thirds of the respondents indicated that results or outcomes attributed to base pay, were used to evaluate base pay and 88 percent said the same was used for variable pay programs These data indicated that 80 percent calculated the ROI for variable pay programs, whereas a lower percentage of organizations (34 percent) calculate the ROI for base pay programs Companies designated as "Most Admired" were more likely to engage in a comprehensive evaluation approach that included employee understanding, behavior change and results to evaluate pay programs, especially for base pay programs

Figure 7 shows that the evaluation processes (i e , research methodology) used by most organizations are weak and largely informal The most-powerful evaluation methods are seldom used Less then one-third of the organizations even attempt to evaluate pay programs, and less than one-sixth compare pay program effectiveness with a nonparticipating employee group However, as one might expect, "Most Admired" companies are more likely to use rigorous methods for evaluating pay programs

Figure 8 on page 52 indicates that respondents strongly agree that more needs to be done to develop methods that accurately assess the contribution pay makes to the bottom line and to calculate ROI Ninety

FIGURE 5 Criteria Used to Evaluate Pay Programs

	Base Pay	Variable Pay
Impact on revenues, profits, net worth	80%	90%
Impact on productivity or cost savings	72%	83%
Impact on quality waste or rework time	53%	61%
Impact on employee retention or turnover	84%	79%
Impact on employee satisfaction/engagement	78%	82%
Attracting new employees or time to fill open positions	86%	66%
Impact on overtime or other labor expenses	54%	41%
Qualification of recruits or applicant pool	74%	40%
Other qualitative measures (e g , capability, competency)	67%	68%

FIGURE 6 Pay Program Evaluation Perspective

	All Participants		Most Admireds	
	Base Pay	Variable Pay	Base Pay	Variable Pay
Informal feedback from participating employees	39%	55%	60%	53%
Informal feedback from supervisors or managers	64%	71%	70%	50%
Formal feedback from participating employees	55%	79%	73%	79%
Level of employee understanding of program	47%	79%	69%	80%
Behavior change of participating employees	55%	N/A	84%	N/A
Results or outcomes attributed to pay program	67%	88%	93%	100%
ROI	34%	80%	70%	80%

FIGURE 7 Pay Program Evaluation Method

	All Participants		Most Admireds	
	Base Pay	Variable Pay	Base Pay	Variable Pay
Informally evaluate the pay program (no quantitative information is used)	52%	49%	70%	70%
Compare pay program criteria before and after program implementation	35%	47%	45%	75%
Compare pay program effectiveness with a nonparticipating employee group	16%	14%	15%	15%
Examine pay effectiveness measures over time	29%	30%	40%	50%

FIGURE 8 Pay Program Evaluation Improvement

	Base Pay	Variable Pay
Nothing needs to be done	20%	21%
Develop systems to provide capability to evaluate pay effectivesness	92%	93%
Develop better qualitative measures (e g , capability, competency)	80%	73%
More accurately assess the cost of pay	73%	77%
Develop methods to accurately assess contribution pay makes to bottom line	80%	93%
Develop methods to accurately assess cost and contribution of pay effectiveness	93%	91%
Calculate ROI of pay programs	88%	92%
Engage management to realize importance of base pay evaluation	91%	90%

percent of respondents said that they need to help management realize the importance of pay program evaluation

Conclusions and Recommendations

Most organizations evaluate their pay program using a variety of methodologies, however, informal processes are still the most common approach "Most Admired" companies are more likely to evaluate pay programs and to use more objective and formal methods for doing so Much remains to be done if the reader accepts the thesis that information from comprehensively designed pay program evaluation can substantially improve the quality and effectiveness of pay programs The majority of organizations do not evaluate their base and variable pay programs, and only about one-third of organizations calculate the cost and bottom line impact of their pay programs Less than one-half of the companies attempt to evaluate their pay programs pre- and post-implementation Even fewer attempt more rigorous comparative or time-series analysis

One important "qualitative" insight is the divide in thinking of human resources and compensation professionals about pay program evaluation On one side of the divide are those who tend to view pay programs as a cost of doing business Professionals holding this belief tend to have an orientation on focusing their evaluation efforts on cost control and benchmarking On the other side are compensation and human resources professionals who view pay programs as an *investment* and are concerned about optimizing the return on this investment As a result, they are more likely to be proactive in determining how employees, especially high performers, perceive their pay program Furthermore, those that see pay programs as an investment want to ensure their employees understand the pay program's purpose and design, and they are interested in how the pay program shapes employee behavior

To obtain senior management legitimacy and to enhance the impact of the pay program, the authors recommend that an organization follow a systematic and comprehensive process for evaluating pay programs, as suggested in "Evaluating Pay Program Effectiveness " Given the substantial investment made in pay programs and the program's impact on organizational effectiveness, comprehensive pay program evaluation only makes good business sense When management desires to know why the pay program did not meet expectations, compensation professionals must be prepared with answers and, more importantly, must be able to make suggestions as to how these pay programs can be improved More specifically, pay program evaluation must use multiple perspectives and rigorous analytical methods including the following:

- Use formal employee opinion surveys or focus groups to determine how eligible employees and the managers to whom they report feel about the pay program (e g , fair, equitable and competently administered)
- Test eligible employees' and manager understanding of the pay program

- Monitor the influence of the pay program on employee behavior since changes in behavior drive expected performance and pay.
- Assess the results that the pay program is expected to impact (e g , retention and performance).
- Calculate the ROI; program costs and value added.
- Use rigorous research methods to analyze data from each perspective.

Although evaluation methods and use of multiple perspectives may be new for many compensation professionals, human resources development and training professionals have considerable expertise in this area Furthermore, most HR development professionals routinely develop e-learning programs that can be used to effectively communicate the intent and substance of pay programs Thus, pay program evaluation provides an excellent opportunity to begin working with human resources development to educate employees about compensation and evaluate the impact of these programs The earlier paper in this series provides specific strategies as to how to comprehensively evaluate pay programs

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Authors

Dow Scott, Ph D , is a professor of human resources at Loyola University, Chicago, and president of Performance Development International Inc Scott is a nationally recognized compensation and human resources program evaluation expert, with more than 100 publications His teaching, research and consulting have focused on the creation of effective teams, employee opinion surveys, performance improvement strategies, pay and incentive systems and the development of high-performance organizations

Thomas D McMullen is the U S Reward Practice leader for Hay Group based in Chicago. He has more than 20 years of combined HR practitioner and compensation consulting experience His work focuses primarily on total rewards and performance program design, including rewards strategy development and incentive plan design

Prior to joining Hay Group, McMullen worked for Humana Inc and Kentucky Fried Chicken Corp in senior compensation analyst roles He earned bachelor of science and master of business administration degrees from the University of Louisville (He can be reached at tom_mcmullen@haygroup com)

Richard S Sperling, CCP, is a senior consultant in the Chicago office of Hay Group He works with clients to design and value jobs, build effective organization structures, and develop and implement reward systems He has designed leading-edge approaches to analyzing, understanding, designing and valuing work in clients' increasingly complex and varied organizational settings Sperling can be reached at richard_sperling@haygroup com

Prior to joining Hay Group in 1981, Sperling worked for Ford Motor Co in a variety of human resources positions He earned a bachelor of science degree from Yale University and a master of management degree from Northwestern University

The authors would like to thank Dennis Morajda, Performance Development International Inc , for his help in structuring the survey and analyzing the data

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Kirkpatrick, Donald L (1998) *Evaluating Training Programs: The Four Levels (2d Ed)* San Francisco: Berrett-Koehler Publishers Inc.

Scott, Dow, Thomas D McMullen and Dennis M Morajda (2006) "Evaluating Pay Program Effectiveness." *WorldatWork Journal*, Volume 15, Number 3, 50-59.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Keith Cartier/Sheila Miller

110. Exhibit 35 shows the actual dollar amounts charged to KAWC from American Carbon Services ("ACS")for each of the years 2004 through 2007 and as projected for the forecasted test period. In this regard, please provide the following information:

a. In which expense accounts, filing schedule and workpaper are the KAWC-allocated forecasted test period charges of $152,144 reflected?
b. What is the basis for the projected cost amount of $152,144.
c. Provide the actual KAWC-allocated ACS expenses for the 12-month period ended 11/30/08.
d. Provide the KAWC-allocated ACS expenses included in the Company's Operating Budgets for 2004 through 2008 and in the annual business plans for 2009 and 2010.

Response:

a. The Carbon Services are shown in account 641100 (JDE account 518001) chemical expense. It is detailed on workpaper KAW_R_PSCDR1#1a_WP3-3_111408.pdf page 8 of 10.
b. The amount for the forecasted test year is based on the 2009/2010 budget. The basis of the budget is historical operations. There are 16 filters and KAWC has a rotating plan of changing out the filter media in four of them each year. The volume of the GAC is known as it is based on the size of the filter. The price is determined by contract with American Carbon Services Group.
c. The expenses are determined by contract, not "allocated." The amount is $126,496.24
d. See c. above. Also, the expenses are:

2004	$96,040
2005	$100,065
2006	$94,752
2007	$102,169
2008	$106,020
2009	$141,693
2010	$169,644

For the electronic version, refer to KAW_R_AGDR1#110_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Sheila Miller

111. Please provide the Miscellaneous expenses shown on W/P 3-13, page 3 by the same account numbers as are shown on Exhibit 37D, pages 12 – 18 (NARUC Uniform System of Accounts).

Response:

See attached schedule.

For the electronic version, refer to KAW_R_AGDR1#111_122308.pdf.

Kentucky-American Water Company
Historical Comparison - Miscellaneous Exp
CASE NO: 2008-00427
AGDR1#111

JDE Account	JDE Sub	JDE Object Description	Line	NARUC Account	Actual 2005	Actual 2006	Actual 2007	Base Period Base Period	Forecast Period Forecast
504500	16	Other Welf Oper AG	P21	926200	2,045	23,792	11,655	32,152	26,540
504610	16	Employee Awards AG	P21	926200	3,107	9,384	14,838	22,420	16,354
504620	16	Employee Physical Exam AG	P21	926200	8,832	5,430	6,704	7,923	6,262
504640	16	Safety Incentive	P21	930210	0	0	0	4,016	5,997
504660	16	Tuition Aid AG	P21	926200	27,469	18,151	18,284	31,618	26,241
504670	16	Training AG	P21	926200	5,875	7,262	8,309	11,137	23,884
507100	16	401k Oper AG	P21	926250	77,950	44,786	86,196	98,663	117,585
508100	16	EIP Oper AG	P21	926220	28,870	-14,241	0	0	0
508101	16	DCP Oper AG	P21	926600	0	47,771	66,681	58,412	126,886
508102	16	Retiree Med Oper AG	P21	926600	0	3,690	8,283	3,646	10,264
520100	12	M & S Oper P	P21	626500	4,271	-4,311	2,025	3,479	3,060
520100	13	M & S Oper WT	P21	642300	26,377	20,055	20,846	29,899	20,370
520100	14	M & S Oper TD	P21	665300	67,833	107,353	105,628	116,591	124,088
531000	14	Contract Svc-Eng Oper TD	P21	923400	92	-142	0	0	0
532000	16	Contr Svc-Acctg Oper AG	P21	932200	46,154	66,367	101,038	72,288	75,402
533000	13	Contr Svc-Legal Oper WT	P21	923300	0	232	0	0	0
533000	16	Contr Svc-Legal Oper AG	P21	923300	-18,392	49,871	65,589	107,099	78,129
535000	11	Contr Svc-Other Oper SS	P21	923500	4,608	182	0	0	0
535000	13	Contr Svc-Other Oper WT	P21	923500	104,118	110,673	129,705	177,461	308,900
535000	14	Contr Svc-Other Oper TD	P21	923500	49,907	55,486	78,624	79,491	74,410
535000	15	Contr Svc-Other Oper CA	P21	923500	43,018	193,853	148,583	128,363	166,323
535000	16	Contr Svc-Other Oper AG	P21	923500	176,077	251,337	168,440	167,363	169,674
535001	14	Contr Svc-Temp Empl Oper TD	P21	923500	44,199	30,546	17,431	23,625	0
535001	15	Contr Svc-Temp Empl Oper CA	P21	923500	23,816	-1,015	0	0	0
535001	16	Contr Svc-Temp Empl Oper AG	P21	923500	12,977	-626	0	1,256	0
536000	13	Contr Svc-Lab Testing Oper W	P21	642300	3,011	3,417	14,127	16,658	304
536000	16	Contr Svc-Lab Testing Oper A	P21	642300	0	720	0	0	0
550000	1	Trans - Cap Credits	P21	642300	0	0	0	-63,807	0
550000	11	Trans Oper SS	P21	642300	0	20	0	0	0
550000	12	Trans Oper P	P21	642300	227	-188	57	0	0
550000	13	Trans Oper WT	P21	642300	0	85	0	0	0
550000	14	Trans Oper TD	P21	665300	3,159	6,113	14,737	4,313	0
550000	15	Trans Oper CA	P21	930600	325	486	0	0	0
550000	16	Trans Oper AG	P21	930600	-1,182	-37,034	-23,377	110,649	680,641
550001	16	Trans Oper AG Lease Cost	P21	930600	69,506	120,996	29,562	46,190	0
550002	16	Trans Oper AG Lease Fuel	P21	930600	202,500	260,992	292,466	316,866	0
550003	16	Trans Oper AG Lease Maint	P21	930600	244,741	145,669	235,876	185,353	
556000	16	Ins Vehicle Oper AG	P21	930600	0	0	0	22,129	41,849
568010	16	Water Res Conservation	P21	930210	152,277	150,838	153,348	111,536	159,668
575000	11	Misc Oper SS	P21	603100	350	2,960	731	418	3,060
575000	12	Misc Oper P	P21	643100	872	555	143	0	0
575000	13	Misc Oper WT	P21	643100	47,488	54,811	59,030	52,347	56,740
575000	14	Misc Oper TD	P21	665300	174,130	77,748	83,317	95,831	108,740
575000	1420	Misc Oper TD Meters	P21	665300	216	0	0	0	0
575000	16	Misc Oper AG	P21	930210	749,871	314,668	63,842	114,399	116,268
575001	16	Misc Oper Exp AG Consol	P21	930210	-22	-9	71	0	0

Kentucky-American Water Company
Historical Comparison - Miscellaneous Exp
CASE NO: 2008-00427
AGDR1#111

JDE Account	JDE Sub	JDE Object Description	Line	NARUC Account	Actual 2005	Actual 2006	Actual 2007	Base Period Base Period	Forecast Period Forecast
575030	16	Advertising	P21	930890	26,629	26,797	22,108	18,281	22,468
575120	16	Bill Inserts AG	P21	930210	0	2,980	166	0	0
575130	16	Brochures and Handouts	P21	930210	0	5,773	22,584	26,236	34,429
575220	16	Community Relations	P21	930210	0	62	26,075	47,540	47,586
575240	16	Co Dues/Membership Deduct	P21	930880	14,195	16,240	18,642	12,778	22,037
575242	16	Co Dues Deduct AWWA	P21	930880	143	0	7,693	13,092	9,507
575244	16	Co Dues Deduct NAWC	P21	930880	21,469	24,761	23,466	26,330	28,155
575250	16	Condemnation Costs	P21	923500	1,000,582	-63,153	-962	0	0
575270	16	Directors Fees	P21	930890	19,400	18,322	16,500	16,000	17,892
575271	16	Directors Expenses	P21	930890	0	216	0	0	0
575275	16	Discounts Available	P21	930210	-14,453	-12,647	-16,619	-7,623	-12,000
575276	16	Discounts Lost	P21	930210	2,054	747	0	167	2,004
575320	13	Electricity WT	P21	643100	6,958	5,664	7,306	8,238	10,298
575320	14	Electricity TD	P21	665300	11,439	32,269	15,759	16,820	12,860
575400	16	Bus Servies Proj Exp	P21	930200	1,111,275	-15,828	0	0	0
575480	13	Heat - Oil/Gas WT	P21	642300	105	-355	0	0	0
575480	14	Heat - Oil/Gas TD	P21	665300	21,678	28,906	20,236	33,578	53,155
575490	16	Injuries and Damages	P21	925300	1,672	1,314	-514	6,907	11,928
575500	13	Janitorial WT	P21	642300	15,216	12,925	19,730	21,343	34,515
575500	14	Janitorial TD	P21	665300	8,727	9,074	9,567	11,738	47,415
575545	13	Lab Supplies WT	P21	642300	76,793	88,526	81,651	74,827	93,033
575560	16	Lobbying Expenses	P21	930270	0	0	271	0	0
575620	13	Office & Admin Supplies WT	P21	643100	6,967	8,763	7,678	8,686	9,072
575620	14	Office & Admin Supplies TD	P21	665300	7,253	19,438	30,544	20,315	20,650
575625	13	Overnight Shipping WT	P21	643100	0	0	313	1,400	2,430
575625	16	Overnight Shipping AG	P21	930210	9,748	10,881	11,969	16,165	17,433
575640	16	Penalties Nondeduct	P21	930890	50	217,010	-175,775	0	0
575680	16	Research & Development Exp	P21	930300	-7,731	-970	0	0	0
575710	16	Security Service AG	P21	930210	0	2,669	0	0	0
575711	16	Add'l Security Costs AG	P21	930210	144,399	133,484	140,809	125,667	144,000
575715	16	Software Licenses & Support	P21	930230	27,924	25,915	40,744	32,205	33,000
575740	11	Telephone SS	P21	642300	165	-211	0	0	0
575740	13	Telephone WT	P21	642300	56	-172	150	0	0
575740	14	Telephone TD	P21	665300	147	258	1,432	40	0
575741	13	Cell Phone WT	P21	642300	5,916	5,517	4,954	5,227	5,171
575741	14	Cell Phone TD	P21	665300	5,915	18,144	9,153	12,568	0
575780	11	Trash Removal SS	P21	603100	5,297	8,596	7,397	10,140	10,288
575780	14	Trash Removal TD	P21	665300	3,034	4,764	4,974	6,459	7,009
575790	16	Trustee Fees AG	P21	930210	4,375	3,233	0	3,233	0
575820	13	Uniforms WT	P21	643100	4,584	9,257	7,071	6,227	8,355
575820	14	Uniforms TD	P21	662100	22,885	31,235	17,631	18,295	17,950
575830	11	Wtr & Waste Wtr Exp SS	P21	603100	46,700	21,259	26,437	27,460	28,175
575998	16	PCard Undistributed	P21	930210	17,518	0	330	3,100	2,400
631000	24	Contr Svc-Eng Maint TD	P21	923400	0	15,921	0	0	0

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

112. KAWC is proposing total Management Fees of $7,612,592 allocated to KAWC from AWWSC. In this regard, please provide the following information:

a. Basis for the projected expense level of $7,612,592.
b. Actual AWWSC management fees allocated to KAWC in each of the years 2003 through 2007 and for the 12-month period ended 11/30/08.
c. AWWSC management fees allocated to KAWC as included in the Company's Operating Budgets for 2003 through 2008 and as included in the annual business plans for 2009 and 2010.

Response:

a. The projected expense level is based on the 2009 and 2010 management fee budget. One time expenses related to SOX compliance were eliminated, as well as an allocated portion to the sewer operations.
b. See attached.
c. See attached.

For the electronic version, refer to KAW_R_AGDR1#112_122308.pdf.

Kentucky American Water Company
Management Fees
AGDR1#112 b

Object	Sub	Description	Actual 2003	Actual 2004	Actual 2005	Actual 2006	Actual 2007	Actual 12MO 11/08
534000		Contract Svc-Mgmt Fee	-	-	-	-		-
534000	13	Contr Svc-Mgmt Oper	146,318.00	147,762.00	-	-		-
534000	15	Contr Svc-Mgmt Oper	(128,990.00)	28,435.00	-	-		-
534000	16	Contr Svc-Mgmt Oper	135,899.00	282,245.00	880.00	-		-
534080	16	Mgmt Fees-Labor	2,178,423.00	3,141,531.00	-	-		-
534081	16	Mgmt Fees-Inc Plan	200,697.00	215,329.00	-	-		-
534140	16	Mgmt Fees-Group Ins	(4,343.00)	(4,482.00)	-	-		-
534150	16	Mgmt Fees-Pension	-	6,490.00	-	-		-
534190	16	Mgmt Fees-Rents	11,793.00	36,496.00	-	-		-
534200	16	Mgmt Fees-Gen Office	136,260.00	205,286.00	-	-		-
534210	16	Mgmt Fees-401K	236,699.00	277,158.00	-	-		-
534211	16	Mgmt Fees-ESOP	6.00	-	-	-		-
534212	16	Mgmt Fees-Misc	11.00	-	-	-		-
534213	16	Mgmt Fees-Research &	61,548.00	58,825.00	-	-		-
534214	16	Mgmt Fees-Bus Chg Co	-	841,869.00	-	-		-
534215	16	Mgmt Fees-IMO Costs	-	810,816.00	-	-		-
534250	16	Mgmt Fees-Maint Othe	44,510.00	72,359.00	-	-		-
534270	16	Mgmt Fees-Depreciati	4,214.00	-	-	-		-
534290	16	Mgmt Fees-Payroll Ta	-	15,637.00	-	-		-
534291	16	Mgmt Fees-Oth Gen Ta	328.00	(271.00)	-	-		-
534560	16	Mgmt Fees-LTD Intere	898.00	498.00	-	-		-
534590	16	Mgmt Fees-Other Int	2.00	-	-	-		-
534600	16	Mmgt Fees-Corporate	-	-	3,943,039.00	4,330,770.00	4,645,128.00	1,894,785.00
534615	16	SSC-Shrd Bus Srv Fee	-	-	-	-		598,399.00
534620	16	Mmgt Fees Bsn Change	-	-	279,136.00	89,322.00	(2,519.00)	28,074.00
534625	16	CSC-Shrd Bus Srv Fee	-	-	-	-		1,605,775.00
534635	16	ITS-Shrd Bus Srv Fee	-	-	-	-		1,148,448.00
534645	16	Procure-Shrd Bus Srv	-	-	-	-		77,445.00
534650	16	Mmgt Fees P13880-Cor	-	-	26,417.00	552,181.00	1,121,451.00	384,997.00
534655	16	Lab-Shrd Bus Srv Fee	-	-	-	-		181,031.00
534665	16	BSC-Shrd Bus Srv Fee	-	-	-	-		36,740.00
534700	16	Mmgt Fees-Region	-	-	1,663,223.00	1,589,013.00	1,744,600.00	1,920,995.00
534720	16	Mmgt Fees Bsn Change	-	-	(1,556.00)	-		9,111.00
534750	16	Mmgt Fees P13880-Reg	-	-	1,545.00	51,128.00	7,563.00	8,880.00
			3,024,273.00	6,135,983.00	5,912,684.00	6,612,414.00	7,516,223.00	7,894,680.00

Kentucky American Water Company
Management Fees
AGDR1#112 c

Object	Sub	Description	Budget 2003	Budget 2004	Budget 2005	Budget 2006	Budget 2007	Budget 2008	Budget 2009	Budget 2010
534000		Contract Svc-Mgmt Fee	3,160,126.00	3,236,268.00	-	-	-	-	-	-
534600	16	Mmgt Fees-Corporate	-	-	3,323,940.00	4,498,000.00	4,819,564.00	1,376,845.00	1,785,452.00	1,783,942.00
534615	16	SSC-Shrd Bus Srv Fee	-	-	-	-	-	589,152.00	586,680.00	598,431.00
534620	16	Mmgt Fees Bsn Change	-	-	-	222,000.00	107,226.00	9,000.00	-	-
534625	16	CSC-Shrd Bus Srv Fee	-	-	-	-	-	1,832,985.00	1,827,101.00	1,836,200.00
534635	16	ITS-Shrd Bus Srv Fee	-	-	-	-	-	1,136,104.00	1,218,809.00	1,343,221.00
534645	16	Procure-Shrd Bus Srv	-	-	-	-	-	80,168.00	64,822.00	66,945.00
534650	16	Mmgt Fees P13880-Cor	-	-	352,308.00	-	410,574.00	297,000.00	-	-
534655	16	Lab-Shrd Bus Srv Fee	-	-	-	-	-	200,685.00	188,549.00	191,599.00
534665	16	BSC-Shrd Bus Srv Fee	-	-	-	-	-	41,959.00	45,811.00	45,207.00
534700	16	Mmgt Fees-Region	-	-	1,836,744.00	1,534,000.00	1,650,393.00	1,810,000.00	1,880,978.00	1,928,492.00
			3,160,126.00	3,236,268.00	5,512,992.00	6,254,000.00	6,987,757.00	7,373,898.00	7,598,202.00	7,794,037.00

KENTUCKY AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S INITIAL REQUEST FOR INFORMATION

Witness: Michael A. Miller

113. Please identify what dollar amounts are included in the allocated Management Fees expenses of $7,612,592 that are associated with the following type of expenses:

   a. Incentive compensation. In addition, explain what type of incentive compensation program(s) these expenses relate to.
   b. Charitable contributions.
   c. Lobbying.

Response:

a.	Incentive Plan-Off Annual	$437,247
	Incentive Plan-Off Long Term	$131,159
	Total Incentive	$568,409
b.	Charitable Contributions	$9,106
c.	Lobbying Expenses	$0

For the electronic version, refer to KAW_R_AGDR1#113_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

114. Please identify the expense portion of the Management Fees of $7,612,592 that is related to business development. If business development expenses are not included in the Management Fees, explain why since such expenses were identified as being included in the Company's prior two rate cases. Please provide the following additional information for the business development expenses included in the Management Fees:

a. Provide a detailed breakout of these business development expenses and a detailed description of the nature and purpose of such business development expenses.
b. Provide job descriptions of the service company's business development employees

Response:

a. The expense portion of management fees for business development totals $224,043. The purpose of these expenses is to develop an overall strategy for growth by analyzing and evaluating potential acquisition targets and other development opportunities for KAWC, which will ultimately benefit the customers by permitting fixed costs to be spread over a larger customer base and to generate revenue and earnings that will offset the need for future rate increases. It is the customers who ultimately benefit from growth in the utility, and they should bear the cost required to generate that growth and associated benefits.
b. KAWC does not have employees on staff dedicated to business development, but AWWSC provides that service because KAWC can share the cost of that function with other sister companies. The following functions are fulfilled by business development employees:
    1. Identify and direct development opportunities, initiate analyses, develop and validate evaluation factors and pursue deal prospects. Build and coordinate cross functional teams to support the analysis.
    2. Contribute to the development of the company's strategy formulation process and develop major transactions based on the approved strategy.
    3. Negotiate and manage relationships with outside service providers and other specialists engaged to support business development activity.
    4. Coordinate the operational and financial requirements of an asset divestiture. Support the integration of acquisitions.

5. Develop relationships with current and prospective customer base, industry peers and technology firms that lead to new business opportunities. Knows current industry trends and identifies potential or emerging threats and opportunities for the company's growth plans.
6. Monitor and coordinate monthly sales/business development metrics analysis.

For the electronic version, refer to KAW_R_AGDR1#114_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

115. Please identify the expense portion of the Management Fees of $7,612,592 that is related to (a) external affairs and/or (b) government affairs. Also, please provide the following additional information for the allocated external affairs and/or government affairs expenses included in the Management Fees:

a. Provide a detailed breakout of these external affairs expenses and/or government affairs expenses and detailed description of the nature and purpose of such expenses.
b. Provide job descriptions of the service company's external affairs and/or government affairs employees.
c. Explain whether any of the external affairs and/or government affairs employees spend part of their time on legislative and regulatory advocacy and any other lobbying related activities. If so, quantify the percentage of time devoted to these activities.

Response:

a. Please see the following expense detail:

External affairs	$219,832
Government affairs	22,693
Total	$242,525

The purpose of these expenses is to implement programs and practices to support the corporate social responsibility, communication, media relations, community affairs and government relationship activities.

b. The following functions are fulfilled by external affairs employees:
   1. Contribute to the development of company strategies and policies associated with community affairs and government relations.
   2. Promote the interests of the business.
   3. Promote the understanding of activities for corporate citizenship, community investment, corporate accountability, environmental stewardship and sustainability within the business.
   4. Embed corporate social responsibility into all business operations, supply chain and decision making processes.
   5. Effectively manage internal and external resources such as public relations agencies and other communications consultants, and adhere to all budget management requirements.
   6. Develop comprehensive strategic communications plans and supporting materials for public communications including media relations, conference participation, community relations/events, local

governmental relations, and sponsorship/memberships and execute in a proactive manner. Develop effective crisis plans, crisis communications and serves as spokesperson in a crisis situation.

7. Predicts and anticipates the needs of the news media/reporters and is cognizant of meeting those needs. Plans and manages large press and community events.

c. Please see the response to 116b.

For the electronic version, refer to KAW_R_AGDR1#115_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Nick Rowe/Michael A. Miller

116. Exhibit MAM-6, page 1, footnote 6 indicates that KAWC has a Director of Government Affairs. In this regard, please provide the following information:

a. Describe the employees working in KAWC's Government Affairs department and provide job descriptions for these Government Affairs employees and a description of the nature and purpose of their activities.
b. Explain whether any of the KAWC government affairs employees spend part of their time on legislative and regulatory advocacy and any other lobbying related activities. If so, quantify the percentage of time devoted to these activities.
c. Provide the portion of KAWC's requested O&M payroll amount of $7,062,548 associated with KAWC's government affairs employees, including base and incentive pay.

Response:

a. KAWC's Director of Government Affairs serves to fulfill the following functions:
   - Provide strategic leadership and representation in the area of local, state and federal governmental official and agency relations.
   - Serve as a liaison with elected officials and their constituents to facilitate the timeliest resolution possible of customer service issues that are brought to the attention of elected officials.
   - Represent the company and its customers in public agency meetings, including meetings of groups such as local governmental committees, task forces, councils and fiscal courts; state legislative meetings; and, state executive branch meetings of organizations such as the Public Service Commission, Division of Water, the Kentucky River Authority and the Kentucky Infrastructure Authority.
   - Represent the company and our customers in public association meetings, including organizations such as the Kentucky League of Cities, the Kentucky Association of Counties, the Kentucky County Judge Executives and Kentucky Magistrates Associations, and the Kentucky Association for Economic Development.
   - Provide lobbying representation to advocate for specific legislation and/or regulation as needed.

In addition to the Director of Governmental Affairs, the department includes an administrative support position. This position is shared with the Vice-President of Operations. Approximately 75% of the position is dedicated to operations, and approximately 25% of time to Governmental Affairs. This position provides general administrative support services, including:

- Managing internal administrative procedures, including payroll processing and expense report processing
- Scheduling and maintaining contact database
- Special meeting support
- Office management, including general office supplies

Assisting in office external communications efforts

b. KAWC's Director of Governmental Affairs (GA) focuses most efforts on providing liaison services between the company and officials in state and local governmental agencies to ensure that constituent and customer concerns are addressed in a comprehensive and timely manner. Since his appointment in June 2008 to date, the current GA Director has not devoted any time or resources to lobbying activities as defined by KRS 6.611. Occasionally in the future, the GA Director may represent the company's interests by engaging in lobbying activity as defined by KRS 6.611. It is estimated that approximately 13% of the GA Director's time may be spent on lobbying activity in 2009.

c. A total of $127,322 is included in the O&M payroll amount for the Director of Governmental Affairs which is made up of base pay in the amount of $107,107 and incentive pay in the amount of $21,421 less $1,206 (allocated to the sewer operations). The O&M payroll amount includes a total of $48,592 for the administrative assistant which consists of base pay in the amount of $46,385 and incentive pay of $2,207 less $358 allocated to the sewer operations. Note: Only approximately 25% is used to assist the Director of Governmental Affairs.

For electronic version, refer to KAW_R_AGDR1#116_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Keith Cartier/Sheila Miller

117. Please provide KAWC's average number of Full-Time-Equivalent (FTE) employees for each of the years 2001 through 2008 and as budgeted for 2009 and 2010.

Response:

2001	145
2002	142
2003	135
2004	119*
2005	118
2006	125
2007	134
2008	136 (as of 11/30/08)
2009	145
2010	150

*Note: Reflects SE Reogranization including movement of employees to AWWSC and movement to Customer Call Center (CCC) and Shared Services Center (SSC).

For electronic version, refer to KAW_R_AGDR1#117_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Sheila Miller

118. The AG has calculated that the average number of KAWC employees shown in the response to PSC-1-18 are 135 for 2003, 119 for 2004, 118 for 2005, 125 for 2006, 134 for 2007 and 135 for the 12-month period ended 10/31/08. If the average number of FTEs for 2003 through 2008 to be provided in response to the prior AG data request do not reconcile with the above-referenced average number of employees for these same years in the response to PSC-1-18, provide a reconciliation of these numbers.

Response:

The average number of KAWC employees provided in response to AG DR 1, Question 117 agree to the number provided in response to PSC-1-18.

For the electronic version, refer to KAW_R_AGDR1#118_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

119. With regard to Exhibit MAM-6, please provide the following information:

a. Provide the total number of average employees (FTES) underlying the KAWC labor cost amounts in columns (1) through (14). In addition, explain whether the employees that were added in columns (2), (4), (7), (9) and (11) are supposed to represent all of the FTE employees added from the 11/30/01 base case through 2008 or only certain selected employees. If the latter, provide the reasons why the added employees were selected.
b. Explain why Mr. Miller's addition of one sewer employee in 2004 to his cost analysis on this exhibit should be considered appropriate in this water rate case.
c. Please confirm that the $294,192 savings from the 2003 National Procurement function establishment is already incorporated in the forecasted test period AWWSC cost of $7,612,592, i.e., without this $294,192 savings the forecasted test period AWWSC cost would be $7,906,784. If you do not agree, explain your disagreement in detail.
d. Please confirm that the 2001 base case-escalated AWWSC cost of $1,888,419 for the forecasted test period in column (13) does not include the $294,192 savings from the 2003 National Procurement function establishment and if this savings were to be reflected, this would make the $1,888,419 cost number $294,192 lower, or $1,594,227. If you do not agree, explain your disagreement in detail.
e. Is the $670,541 referenced in adjustment no. 3 included in the forecasted test period AWWSC expense of $7,612,592, but should be added to the 2001 base case-escalated AWWSC cost of $1,888,419 for the forecasted test period in column (13) ? If so, explain why this latter addition would be appropriate.

Response:

a. The average actual employees at KAWC are shown on page 2 of Exhibit MAM-6. The actual average employees were only used on Exhibit MAM-6 to determine the employee benefit costs per customer and to develop the inflation factor to move the employee labor costs forward based on the employee level approved in the 2000-0120 rate case, (as adjusted for acquisition, growth and new functions) to the level that would have been present in the current forecasted test-year if no reorganizations and realignments had occurred. The 2000-0120 rate case filing was based on employee levels of 157. The Order indicates that two employees were not recognized for rate recovery, leaving 155 employees approved for rate recovery. Based on that beginning point, the Company labor expense shown on page 1 of 2 on Exhibit MAM-6 for the period 2001- 2009/2010 attrition year would be:

2000-120 rate case	155
2001 with acquisition	161
2002 with 1 add'l meter reader (Footnote 2)	162
2003	162
2004	162
2005 with acquisition (Footnote 3)	170
2006 with add'l employees (Footnote 4)	174
2007 with add'l employees (Footnote 5)	176
2008 with add'l employees (Footnote 6)	183
2009	183
Attrition Year in current rate case	183

b. The additional employee does not handle the Company's sewer operations. The additional employee handles third party sewer billings for the LFUCG and other municipal or public sector sewer authorities. The Company is paid by the LFUCG and other sewer entities for providing third party sewer billing and collection, and that revenue is shown as other revenue in this case. Given the water customers receive the benefit of the revenue generated from providing third party sewer billing and collection services it is appropriate to include the cost of the additional employee hired to meet that contract obligation.

c. The Company disagrees with the assumption placed in this question. The procurement savings are embedded in the operation and maintenance costs (non-labor/benefits cost) specific to KAWC for the forecasted test-year, not the AWWSC costs. Therefore, they are not reflected in the attrition year total of $18.013 million for KAWC labor/benefits cost and the AWWSC shown on Exhibit MAM-6 page 1 of 2 at all. Since the additional employees at AWWSC procurement are included in the attrition year AWWSC costs, the procurement savings generated by the procurement activity must be shown as a reconciling item on the Exhibit MAM-6 to show the true impact to KAWC from the reorganization/realignments, and the additional procurement employees who generated those procurement savings.

d. The Company disagrees with the assumption placed in this question. Please see the response to part c. above. The calculation of the $1,888,419 assumes that there were no reorganization/realignments since 2000, therefore it would be inappropriate to reduce the $1,888,419 as suggested by the Attorney General.

e. The $670,541 adjustment is included in the forecasted test-year AWWSC costs of $7,612,592. It should not be added to the $1,888,419 since there was no capitalized plant at AWWSC in the 2000 base. This adjustment simply accounts for a change in accounting since 2000. If the costs of the equipment and software had been purchased by KAWC directly it would have resulted in additional capital cost and depreciation at KAWC. The Company's presentation of this adjustment on Exhibit MAM-6 correctly identifies this change in accounting methods as a reconciling difference in the shift of cost between KAWC and AWWSC.

For the electronic version, refer to KAW_R_AGDR1#119_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Sheila Miller

120. To the extent that any changes or revisions should be made to the filing data based on errors/omissions/revisions found after the Company filed its case, please provide a listing and description of these required changes/revisions, as well as the impact on the Company's filed revenue requirement.

Response:

Description	Revenue Requirement Adj.
Eliminated Owenton & Tri Village employees from Defined Contribution Plan	($14,943)
Eliminated Boonesboro UPAA from Rate Base – duplicate of deferred debits	($1,338)
Corrected ITC – Schedule B-6	(454)
Adjusted revenue lag days to 41.04	($64,680)
Adjusted chemical lag days to 30.49	($21,086)
Adjusted pension lead days (2.27)	(591)
Reduced forecast to maintenance expense Account 675000	($73,267)
Reduced janitorial expense account 575000.14 for duplication of office building cost	($36,006)
Reduced janitorial expense account 575000.13 for overstatement of forecast	($5,887)
Added 3" meters to OPA Classification on bill analysis for forecasted test year	($1,434)
Adjusted miscellaneous revenue category going level revenues – utilized 3 year average	($14,715)
Adjusted forecasted private fire determinants Using 13 month average	$7,966
Adjusted forecasted public fire determinants Using 13 month average	$37,167
Adjusted OWU City of Nicholasville – added Account 495378	($20,605)

For the electronic version, refer to KAW_R_AGDR1#120_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Linda C. Bridwell

121. For each of the years 1999 through 11/30/08, please provide the actual number of investment Budget Projects completed, and how many of these completed Budget Projects were completed ahead of schedule, on schedule and behind schedule (provide this information in the same format and detail as per the Company's response to AG-1-85 in Case No. 2000-120).

Response:

Year	Total No. of IPs Completed	IPs Completed Ahead of Schedule	IPs Completed On Schedule	IPs Completed Behind Schedule
1999	9	0	0	9
2000	7	3	1	3
2001	7	0	1	6
2002	7	0	2	5
2003	4	1	0	3
2004	4	1	0	3
2005	4	0	1	3
2006	4	1	1	2
2007	4	0	0	4
2008*	2	1	0	1

* Please note 2008 is based on as of 11/30/2008.

The same criteria were used for Investment Project Completion that were used in previous cases.

For the electronic version, refer to KAW_R_AGDR1#121_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Linda C. Bridwell

122. With regard to the response to PSC-1-9, please provide the following information:

a. Provide the construction variance analysis for the 12-month period ended 11/30//08.
b. Provide the average annual “slippage factor” separately for the “routine” construction and the Budget (Investment) Projects for the 10-year period 1999 through 2008. In addition, provide a workpaper showing how these 2 averages were computed.
c. Is it the Company’s position that the appropriate “slippage factor” for the routine construction should include or exclude the Item 80 Contributions (after 2003) and Item A Deposit Agreements (1999 – 2003). Also, explain why.

Response:

a. Kentucky American Water creates a construction budget in the third quarter of each year, and reforecasts the construction expenditures each quarter. Please see the attached 2008 year-to-day variance analysis through 11/30/08 based on the 2008 third quarter reforecast.
b. Kentucky American Water has calculated the average annual “slippage factor” separately for the “routine” construction and Investment Projects excluding the source of supply project as 123.41% and 99.89 % respectively. Please see the attached workpaper.
c. Kentucky American Water believes it is appropriate to exclude the developer advances (Item DV, Item 80, and Item A in separate budget years). Kentucky American Water has little control over the amount of work that actually occurs in any given year as requested by developers. Since these construction expenditures are based on deposits made by developers, any variance in the amount has little impact on the construction budget process. Excluding these amounts would be consistent with previously calculated amounts by the Public Service Commission.

For the electronic version, refer to KAW_R_AGDR1#122_122308.pdf.

STRATEGIC CAPITAL EXPENDITURE PLAN
Actual to Budget 2008
Kentucky
Units = $

	Project Code	Brief Description of Proposed Expenditures	Year to Date Actual (4)	Board Approved Budget 2008	Q3 Budget
80	**DV**	Projects Funded by Others (Contrib/Adv/Refunds)	3,947,938.19	**4,000,000**	**3,764,858**
82	**A**	Mains - New	54,986.91	**535,000**	**255,000**
81	**B**	Mains - Replaced / Restored	997,623.90	**1,886,000**	**1,200,000**
81	**C**	Mains - Unscheduled	200,510.32	**221,937**	**221,937**
81	**D**	Mains - Relocated	197,650.13	**0**	**300,000**
84	**E**	Hydrants, Valves, and Manholes - New	46,474.40	**427,992**	**125,000**
83	**F**	Hydrants, Valves, and Manholes - Replaced	114,818.48	**125,000**	**125,000**
86	**G**	Services and Laterals - New	966,653.96	**855,915**	**855,915**
85	**H**	Services and Laterals - Replaced	1,042,742.27	**641,603**	**904,618**
88	**I**	Meters - New	573,922.21	**1,149,930**	**1,349,930**
87	**J**	Meters - Replaced	1,625,285.71	**1,473,399**	**1,573,399**
89	**K**	ITS Equipment and Systems	258,862.75	**259,750**	**259,750**
	L	SCADA Equipment and Systems	45,303.39	**51,000**	**51,000**
	M	Security Equipment and Systems	31,946.39	**10,000**	**10,000**
90	**N**	Offices and Operations Centers	1,619,525.91	**146,300**	**1,752,359**
91	**O**	Vehicles	386,242.41	**500,000**	**500,000**
92	**P**	Tools and Equipment	116,803.53	**218,014**	**218,014**
93	**Q**	Process Plant Facilities and Equipment	706,273.15	**820,600**	**820,600**
96	**R**	Capitalized Tank Rehabilitation / Painting	91,540.71	**0**	**100,000**
97	**S**	Engineering Studies	92,063.89	**81,000**	**261,000**
		TOTAL RECURRING (80-97)	**13,117,168.61**	**13,403,440**	**14,648,380**
		TOTAL RECURRING (81-97)	**9,169,230.42**	**9,403,440**	**10,883,522**
1	12020204	Source of Supply Project Dev	319,228.10	**64,200**	**230,990**
2	12020402	Major Highway Relocations	286,052.05	**2,935,000**	**268,377**
3	12020506	Sludge Handling Improvement	172,653.36	**50,000**	**169,884**
4	12020508	Kentucky Reliability Improvemt	885,416.86	**1,210,964**	**1,400,364**
5	12020607	New WTP On Pool 3 of Kentucky	35,069,679.30	**33,310,430**	**31,600,000**
6	IP-1232-1	Owenton Chemical Bulk Storage	80,740.08	**824,836**	**767,402**
7	IP-1202-5	North Broadway Main Replacement	202,920.64	**2,350,000**	**535,000**
8	12020613	Highway Relocation-Clays Mill	0.00	**850,000**	
9	12020701	Kentucky Incline Car	139,235.11	**280,709**	**309,779**
10	12500503	Rockwell Villege WW Pipe	0.00	**399,750**	**399,750**
11	12020505	Replace Trac-Vac System	96,036.50	**0**	**137,648**
12	12020702	Major Highway Relocations	(103,800.20)	**0**	**670,994**
13	12300403	Owen County Main Extensions	316,584.40	**0**	**336,000**
14	IP-1202-6	Carrick Pike Main Extension	57,742.52	**0**	**1,000,000**
15	12020602	Yarnallton Main Extension	415,662.40	**0**	**300,000**
		Total IP	**37,938,151.12**	**42,275,889.00**	**38,126,187.09**

Kentucky American Water
Case No. 2008-00427
"Slippage" Calculation

Attorney General Data Request 1
Item Number 122 b

Witness Responsible:
Linda Bridwell

Year		Budget vs Actual Routine w/Developer Advances		Budget vs Actual Routine w/out Developer Advances		Actuals Ips	Budget Ips	Variance	Actual IPs less Source of Supply	Budget IPs less Source of Supply	Variance
2008		109.29%		115.74%		37,729,469	41,876,139	90.10%	$ 5,898,480.06	$ 8,501,509	69.38%
2007		92.89%		118.52%		16,352,802	11,907,707	137.33%	$ 12,665,769.53	$ 7,990,707	158.51%
2006		168.53%		186.99%		7,760,450	4,508,460	172.13%	$ 5,646,892.97	$ 4,266,730	132.35%
2005		134.60%		124.56%		6,568,291	8,063,435	81.46%	6,425,535	6,563,435	97.90%
2004		116.99%		131.39%		4,554,325	6,905,173	65.96%	4,505,215	6,663,443	67.61%
2003		110.88%		133.39%		5,104,819	4,427,300	115.30%	5,043,315	4,220,000	119.51%
2002		80.68%		95.15%		6,819,386	7,747,500	88.02%	6,734,112	7,747,500	86.92%
2001		96.77%		115.90%		7,027,385	7,497,220	93.73%	6,801,680	7,285,120	93.36%
2000		89.31%		105.36%		4,299,625	4,748,500	90.55%	3,939,590	4,478,500	87.97%
1999		130.21%		107.09%		8,443,796	9,534,202	88.56%	5,805,049	6,801,402	85.35%
Average		113.01%		123.41%				102.31%			99.89%

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Keith Cartier

RE: Pre-filed Direct Testimony of Keith Cartier. In discussing service line installation work (at page 5), Mr. Cartier indicates that KAW competitively bids the work to local contractors. With regard to this statement:

123. Provide a definition for the phrase "local contractors." (If "local" refers to a defined geographic area, then please identify the geographic area.)

  a. Provide a narrative explaining how KAW bids the work. (The narrative should include a discussion regarding how KAW provides notice of the opportunity to bid. For each method of notice, please provide an illustrative sample of that type of notice. For example, if KAW provides notice via a newspaper, then provide a photocopy of a newspaper notice. If KAW utilizes requests for proposals, then please provide a sample RFP.)
  b. Does KAW maintain a pre-qualified bidders' list? (If yes, then please answer the following.)
    a. Provide a narrative explaining how KAW compiles the list. (If KAW requires a potential bidder to submit a form, then please supply a sample copy of the form.)
    b. Identify any criteria, both objective such as insurance, bonding, etc., as well as subjective such reputation, friendliness, etc., used in compiling the list. For any factor that KAW utilizes, please provide the corresponding weight assigned to that factor.
    c. Provide a narrative explaining how KAW maintains the list. (The narrative should identify the intervals at which the list is reviewed to determine if each pre-qualified bidder on the list continues to meet the requirements for qualification, and the narrative should also explain the actions that KAW takes when removing a bidder from the list.)

Response:

Kentucky American Water maintains a list of pre-qualified pipeline contractors. "Local contractors" refers to this list of pre-qualified pipeline contractors.

  a. Kentucky American Water sends an Invitation to Bid to each of the pre-qualified pipeline contractors with an estimate of the number of services to be installed. Please see the attached Invitation and Bid Package.

b. Yes.

   a. In order to qualify, a contractor must fill out a detailed application that includes credit references, work references, lists experience, equipment, personnel, insurance and licenses. If the application demonstrates adequate work experience, and references vouch for financial stability and adequate work performance, the contractor is then interviewed individually. The contractor is given a set of pipeline specifications prior to the meeting, and the meeting is utilized to further discuss experiences and answer questions about Kentucky American Water expectations. A contractor is then granted a probationary status on the bid list for a period of six to twelve months depending on the work history of that contractor. Probationary contractors are generally limited in size of projects they may bid on and are limited in the number of bids they are awarded at any one time. If satisfactory work is performed, the contractor is granted qualified status although they may still be limited in the size of projects they may bid. Please see the attached Application for Contractor Pre-Qualification sample form.

   b. There is not a specific list of criteria for contractors to be qualified, however, all contractors are required to meet the minimum insurance requirement of $9 million of excess liability coverage. Each application is reviewed individually. All contractors are required to attend occasional meetings to review changes in work policies or regulations. The list itself is not formally reviewed at specific intervals, but reviewed on an annual basis.

      For the new services contract, all pre-qualified pipeline contractors are invited to bid. A pre-bid meeting is held prior to bid solicitation, and bids are due late in the year. Probationary contractors are not invited to bid on the new services contract. Kentucky American Water then awards one contract for all new services for the year in the Central Division. The contract is not exclusive, and Kentucky American Water reserves the right to include new services in a pipeline contract where cost feasible or install with company personnel. At the end of the year, if performance has been good and prices are reasonable, the contractor may be asked if they wish to extend the contract for an additional year.

c. Contractors may be removed from the bid list for poor performance, safety violations, or for not bidding on projects for an extended period. Construction inspectors may give a contractor a written notice of poor performance or violation of safety issues. The contractor will be called in to meet with the Project Manager in charge of New Development, who maintains and oversees the pre-qualified list of contractors. After review with the contractor, the Project Manager for New Development may elect to put the contractor on a probationary period or remove the contractor from the list. This is subjective depending on the nature of the issue and if it is a repeated issue. Occasionally a contractor will be asked to be removed from the list.

For the electronic version, refer to KAW_R_AGDR1#123_122308.pdf.

Kentucky American Water®

November 9, 2005

Dear Contractor:

Bids are requested by Kentucky American Water for installation of new services and settings as listed in the attached bid documents. The work is to be done in accordance with the rules and regulations as stated in our pipeline specifications. A mandatory **pre-bid meeting** will be held at 3:00 p.m. on **Monday, November 21, 2005** in our office at 2300 Richmond Road, Lexington, Kentucky. (At the present time, American Water is considering increasing its umbrella liability insurance requirement; we will inform you of what the requirement will be at the pre-bid meeting.)

Bids should be completed and submitted to my office no later than 3:00 p.m. **Thursday, December 1, 2005**. Bids received after the stated time will not be considered. The successful bidder will be required to execute a contract agreement for the faithful performance of the work.

Information regarding work history and experience of your foreman and crews will be required. Please furnish this information on the attached Exhibit 1 and submit with your bid. An exhibit reflecting terms of construction is also attached.

The bid package includes:

- **Bid Document**
- **Exhibit 1 – Experience Form**
- **Exhibit 2 – Terms of Construction**
- **Exhibit 3 – Procedure for Payment When Work is Not Complete**
- **Agreement**

If you have any questions or wish to discuss this information, you may contact me at 859/268-6362.

Sincerely,

Greg Tomko

Greg Tomko
Project Manager
New Development/Construction

GT/dm

Enclosures

c: Linda Bridwell, P.E.
Elizabeth (Bambi) Floyd

KENTUCKY AMERICAN WATER
BLANKET - NEW SERVICES
1/1/06 - 12/31/06

REQUEST FOR BIDS WERE SENT TO THE FOLLOWING ON 11/9/05:

Dix & Associates Pipeline Contractors, Inc.
210 Industry Road
Nicholasville KY 40356

C J Hughes Construction Company, Inc.
PO Box 7305
Huntington WV 25776-7305

McCord Engineering & Contracting, Inc.
1041 Eastland Drive
Lexington KY 40505

TFH, LLC
917 Contract Street
Lexington, KY 40505

Edward Hall Trucking & Excavating Company
110 Northland Estates
Corbin, KY 40701

Yates Pipeline Contractors, Inc.
641 Bluesky Parkway
Lexington, KY 40509

PIPELINE BID DOCUMENTS AND SPECIFICATIONS

BASE BID UNIT COST BASIS

Prepared By:

AMERICAN WATER WORKS SERVICE COMPANY, INC.
SYSTEM ENGINEERING
1025 LAUREL OAK ROAD
VOORHEES, NEW JERSEY 08043

December, 1990

REVISED BY KENTUCKY AMERICAN WATER

August, 1991
August, 1994
October, 1994
October, 2002

RE: Blanket Service New

INVITATION TO BID
FOR CONSTRUCTION OF

Blanket Service New

Sealed bids for furnishing all plant, labor, equipment and performing all work to construct the installation of **new services during 2006** will be opened at the office of Project Manager – New Development/Construction, Kentucky American Water, 2300 Richmond Road, Lexington, Kentucky 40502 at 3:00 p.m., local time on **December 1, 2005.**

One (1) set of Bidding Documents, including the Instructions to Bidders, Bid Form, Bid Bond Forms and Contract documents, will be provided at no charge to the CONTRACTORS who are invited to bid the project.

Subcontractors, manufacturers and material suppliers should obtain information and review the Bidding Documents by contacting potential bidders.

Each proposal shall be accompanied by a Bid Bond in an amount not less than ten percent (10%) of the bid total, payable to the OWNER, all in accordance with the provisions contained in the Bidding Documents.Applicable ________ Not Applicable ___X___

OWNER reserves its rights to waive any informality or deficiency in any BID, to accept any Bid, to negotiate modifications of any Bid with any BIDDER and accept any modified Bid, to reject any Bid, to reject all Bids, and to rebid the Project, all at the OWNER's sole discretion.

INSTRUCTION TO BIDDERS

1. Defined Terms

Terms used in these Instructions to Bidders which are defined in the General Conditions of the Contract Documents have the meanings assigned to them in the General Conditions. The term "Bidder" means one who submits a Bid directly to OWNER, as distinct from a subbidder, who submits a Bid to a Bidder. The term "Successful Bidder" means the lowest, qualified, responsible and responsive Bidder to whom OWNER (on the basis of OWNER's evaluation as hereinafter provided) makes an award. The term "Bidding Documents" includes the Invitation to Bid, Instructions to Bidders, the Bid Form, and the proposed Contract Documents (including all Addenda issued prior to receipt of Bids).

2. Copies of Bidding Documents

2.1 Complete sets of Bidding Documents must be used in preparing Bids; OWNER does not assume any responsibility for errors or misinterpretations resulting from the use of incomplete sets of Bidding Documents.

2.2 OWNER in making copies of Bidding Documents available on the above terms does so only for the purpose of obtaining Bids on the Work and do not confer a license or grant for any other use.

3. Qualifications of Bidders

Bidders must be prequalified.

4. Examination of Contract Documents and Site

4.1 It is the responsibility of each Bidder before submitting a Bid, to (a) examine the Contract Documents thoroughly, (b) consider Laws and Regulations that may affect cost, progress, performance or furnishing of the Work, (c) study and carefully correlate Bidder's observations with the Contract Documents, and (d) notify OWNER of all conflicts, errors or discrepancies in the Contract Documents.

4.2 Information and data reflected in all assigned work with respect to Underground Facilities at or contiguous to the site is based upon information and data furnished to OWNER by owners of such Underground Facilities or others, and OWNER does not assume responsibility for the accuracy or completeness thereof unless it is expressly provided otherwise.

4.3 Provisions concerning responsibilities for the adequacy of data furnished to prospective Bidders on subsurface conditions, Underground Facilities and other physical conditions, and possible changes in the Contract Documents due to differing conditions appear in Paragraphs 4.2 and 4.3 of the General Conditions.

4.4 Before submitting a Bid, each Bidder will, at Bidder's own expense, make or obtain any additional examinations, investigations, explorations, tests and studies and obtain any additional information and data which pertain to physical conditions (surface, subsurface and Underground Facilities) or otherwise which may affect cost, progress, performance or furnishing of the Work and which Bidder deems necessary to determine its Bid for performing and furnishing the Work in accordance with the time, price and other terms and conditions of the Contract Documents.

4.5 The lands upon which the Work is to be performed, rights-of-way and easements for access thereto and other lands designated for use by CONTRACTOR in performing the Work are as assigned. All additional lands and access thereto required for temporary construction facilities or storage of materials and equipment are to be provided by CONTRACTOR. Easements for permanent structures or permanent changes in existing structures are to be obtained and paid for by OWNER unless otherwise provided.

4.6 The submission of a Bid will constitute an incontrovertible representation by Bidder that Bidder has complied with every requirement of this Article 4, that without exception the Bid is premised upon performing and furnishing the Work required by the Contract Documents and such means, methods, techniques, sequences or procedures of construction as may be indicated in or required by the Contract Documents, and that the Contract Documents are sufficient in scope and detail to indicate and convey understanding of all terms and conditions for performance and furnishing of the Work.

5. **Interpretations and Addenda**

5.1 All questions about the meaning or intent of the Contract Documents are to be directed to OWNER. Interpretations or clarifications considered necessary by OWNER in response to such questions will be issued by Addenda mailed or delivered to all parties recorded by OWNER as having received the Bidding Documents. Only questions answered by formal written Addenda will be binding. Oral and other interpretations or clarifications will be without legal effect.

5.2 Addenda may also be issued to modify the Bidding Documents as deemed advisable by OWNER.

6. **Bid Security** (See Page I-1 to determine if Paragraph 6 is applicable).

6.1 Each Bid must be accompanied by Bid security made payable to OWNER in an amount of ten percent of the Bidder's maximum Bid price and in the form of a Bid Bond (on form attached), issued by a surety meeting the requirements of Paragraph 5.1 of the General Conditions.

6.2 The Bid security of the Successful Bidder will be retained until such Bidder has executed the Agreement and furnished the required contract security, whereupon the Bid security will be returned. If the Successful Bidder fails to execute and deliver the Agreement and furnish the required contract security within fifteen days after the Notice of Award, OWNER may annul the Notice of Award and the Bid security of that Bidder will be forfeited. The Bid security of other Bidders whom OWNER believes to have a reasonable chance of receiving the award may be retained by OWNER until the earlier of the seventh day after the Effective Date of the Agreement or the forty-sixth day after the Bid opening, whereupon Bid security furnished by such Bidders will be returned. Bid security with Bids which are not competitive will be returned within seven days after the Bid opening.

7. Contract Times

The Contract will exist from January 1, 2006 until December 31, 2006.

8. Liquidated Damages

Provisions for liquidated damages, if any, are set forth in the Agreement.

9. Substitute and "Or-Equal" Items

Substitute or "Or-Equal" items are subject to the requirements of Paragraph 6.7 of the General Conditions.

10. Subcontractors, Suppliers and Others

10.1 The apparent Successful Bidder, and any other Bidder so requested, shall within seven days after the Bid opening submit to OWNER a list of all such Subcontractors, Suppliers and other persons and organizations proposed for those portions of the Work for which such identification is required. Such list shall be accompanied by an experience statement with pertinent organization information if requested by OWNER. If OWNER or ENGINEER after due investigation has reasonable objection to any proposed Subcontractor, Supplier, other person or organization, OWNER or ENGINEER may before the Notice of Award is given request the apparent Successful Bidder to submit an acceptable substitute without an increase in Bid price.

If apparent Successful Bidder declines to make any such substitution, OWNER may award the contract to the next lowest Bidder that proposes to use acceptable Subcontractors, Suppliers and other persons and organizations. The declining to make requested substitutions will not constitute grounds for sacrificing the Bid security of any Bidder. Any Subcontractor, Supplier, other person or organization listed and to whom OWNER or ENGINEER does not make written objection prior to the giving of the Notice of Award will be deemed acceptable to OWNER and ENGINEER subject to revocation of such acceptance after the Effective Date of the Agreement as provided in Paragraph 6.8.2 of the General Conditions.

10.2 No CONTRACTOR shall be required to employ any Subcontractor, Supplier, other person or organization against whom CONTRACTOR has reasonable objection.

11. **Bid Form**

11.1 The Bid Form is included with the Bidding Documents.

11.2 All blanks on the Bid Form must be completed in ink or by typewriter.

11.3 Bids by corporations must be executed in the corporate name by the president or a vice-president (or other corporate officer accompanied by evidence of authority to sign) and the corporate seal must be affixed and attested by the secretary or an assistant secretary. The corporate address and state of incorporation must be shown below the signature.

11.4 Bids by partnerships must be executed in the partnership name and signed by a partner, whose title must appear under the signature and the official address of the partnership must be shown below the signature.

11.5 All names must be typed or printed below the signature.

11.6 The Bid shall contain an acknowledgment of receipt of all Addenda (the numbers of which must be filled in on the Bid Form).

11.7 The address and telephone number for communications regarding the Bid must be shown.

12. **Submission of Bids**

Bids shall be submitted at the time and place indicated in the Invitation to Bid and shall be enclosed in an opaque sealed envelope, marked with the Project title and name and address of the Bidder and accompanied by the Bid security and other required documents. If the Bid is sent through the mail or other delivery system the sealed envelope shall be enclosed in a separate envelope with the notation **"BID ENCLOSED"** on the face of it.

13. **Modification and Withdrawal of Bids**

Bids may be modified or withdrawn by an appropriate document duly executed (in the manner that a Bid must be executed) and delivered to the place where Bids are to be submitted at any time prior to the opening of Bids.

14. **Opening of Bids**

The opening of Bids may be public or private.

15. Bids to Remain Subject to Acceptance.

All Bids will remain subject to acceptance for 45 days after the day of the Bid opening, (unless otherwise specified in Paragraph 2.3 of the Supplementary Conditions), but OWNER may, in its sole discretion, release any Bid and return the Bid security prior to that date.

16. Award of Contract

16.1 OWNER reserves the right to reject any and all Bids, to waive any and all informalities and to negotiate contract terms with the Successful Bidder, and the right to disregard all nonconforming, nonresponsive, unbalanced or conditional Bids. Also, OWNER reserves the right to reject the Bid of any Bidder if OWNER believes that it would not be in the best interest of the Project to make an award to that Bidder, whether because the Bid is not responsive or the Bidder is unqualified or of doubtful financial ability or fails to meet any other pertinent standard or criteria established by OWNER. Discrepancies in the multiplication of units of Work and Unit Prices will be resolved in favor of the Unit Prices. Discrepancies between the indicated sum of any column of figures and the correct sum thereof will be resolved in favor of the correct sum.

16.2 In evaluating Bids, OWNER will consider the qualifications of the Bidders, whether or not the Bids comply with the prescribed requirements, and such alternates, Unit Prices or other data, as may be requested in the Bid Form or prior to the Notice of Award.

16.3 OWNER may consider the qualifications and experience of Subcontractors, Suppliers, and other persons and organizations proposed for those portions of the Work as to which the identity of Subcontractors, Suppliers, and other persons and organizations must be submitted as provided in the Supplementary Conditions. OWNER also may consider the operating costs, maintenance requirements, performance data and guarantees of major items of materials and equipment proposed for incorporation in the Work when such data is required to be submitted prior to the Notice of Award.

16.4 OWNER may conduct such investigations as OWNER deems necessary to assist in the evaluation of any Bid and to establish the responsibility, qualifications and financial ability of Bidders, proposed Subcontractors, Suppliers and other persons and organizations to perform and furnish the Work in accordance with the Contract Documents to OWNER's satisfaction within the prescribed time.

16.5 If the contract is to be awarded, it will be awarded on a non-exclusive basis to the lowest Bidder whose evaluation by OWNER indicates to OWNER that the award will be in the best interests of the OWNER.

16.6 If the contract is to be awarded, OWNER will give the Successful Bidder a Notice of Award within forty-five days after the day of the Bid opening.

17. Contract Security

Paragraph 5.1 of the General Conditions and the Supplementary Conditions set forth OWNER's requirements as to performance, maintenance and payment Bonds. When the Successful Bidder delivers the executed Agreement to OWNER, it must be accompanied by the required performance, maintenance and payment Bonds. Forms included only if applicable to Work being bid.

18. Signing of Agreement

When OWNER gives a Notice of Award to the Successful Bidder, it will be accompanied by the required number of unsigned counterparts of the Agreement with all other written Contract Documents attached. Within fifteen days thereafter CONTRACTOR shall sign and deliver the required number of counterparts of the Agreement and attached documents to OWNER with the required Bonds. Within ten days thereafter OWNER shall deliver one fully signed counterpart to CONTRACTOR. Each counterpart is to be accompanied by a complete set of the Drawings with appropriate identification.

19. Prebid Conference (If Applicable)

A pre-bid conference will be held at 3:00 p.m. on **November 21, 2005** at Kentucky American Water's office, 2300 Richmond Road, Lexington, KY.

Representatives of OWNER will be present. Bidders are required to attend and participate in the conference. OWNER will transmit to all prospective Bidders of record such Addenda as OWNER considers necessary in response to questions arising at the conference.

20. Sales and Use Taxes

OWNER is exempt from ____N/A____ State Sales and Use Taxes on certain materials and equipment to be incorporated in the Work. Said taxes shall not be included in the Contract Price. Refer to Supplementary Conditions SC-6.15 for additional information.

21. Retainage

Provisions concerning retainage are set forth in the Agreement.

BID

PROJECT IDENTIFICATION: **Blanket Services New**

THIS BID IS SUBMITTED TO: Mr. Nick O. Rowe
President
Kentucky American Water
2300 Richmond Road
Lexington, Kentucky 40502

1. The undersigned Bidder proposes and agrees, if this Bid is accepted, to enter into a non-exclusive Agreement with OWNER in the form included in the Contract Documents to perform and furnish all Work as specified or indicated in the Contract Documents for the Contract Price and within the Contract Times indicated in this Bid and in accordance with the other terms and conditions of the Contract Documents.

2. Bidder accepts all of the terms and conditions of the Invitation to Bid and Instructions to Bidders, including without limitation those dealing with the disposition of Bid security. This Bid will remain subject to acceptance for forty-five days after the day of Bid opening. Bidder will sign and submit the Agreement with the Bonds and other documents required by the Bidding Requirements within fifteen days after the date of OWNER's Notice of Award.

3. In submitting this Bid, Bidder represents, as more fully set forth in the Agreement:

(a) Bidder has examined copies of all the Bidding Documents and of the following Addenda (receipt of all which is hereby acknowledged):

Date	Number

(b) Bidder has familiarized itself with the nature and extent of the Contract Documents, Work, site, locality, and all local conditions and Laws and Regulations that in any manner may affect cost, progress, performance or furnishing of the work.

(c) Bidder has studied carefully all reports and drawings of subsurface conditions and drawings of physical conditions which are identified in the Supplementary Conditions as provided in Paragraph 4.2 of the General Conditions, and accepts the determination set forth in Paragraph GC-4.2.2 of the General Conditions, as may be amended by the Supplemental Conditions, of the extent the technical data contained in such reports and drawings upon which Bidder is entitled to rely.

(d) Bidder has obtained and carefully studied (or assumes responsibility for obtaining and carefully studying) all such examinations, investigations, explorations, tests and studies (in addition to or to supplement those referred to in (c) above) which pertain to the subsurface or physical conditions or otherwise may affect the cost, progress, performance or furnishing of the Work as Bidder considers necessary for the performance or furnishing of the Work at the Contract Price, within the Contract Times and in accordance with the other terms and conditions of the Contract Documents, including specifically the provisions of Paragraph 4.2 of the General Conditions; and no additional examinations, investigations, exploration, tests, reports or similar information or data are or will be required by Bidder for such purposes.

(e) Bidder has correlated the results of all such observations, examinations, investigations, explorations, tests, reports and studies with the terms and conditions of the Contract Documents.

(f) Bidder has given OWNER written notice of all conflicts, errors or discrepancies that it has discovered in the Contract Documents and the written resolution thereof by OWNER is acceptable to Bidder.

(g) This Bid is genuine and not made in the interest of or on behalf of any undisclosed person, firm or corporation and is not submitted in conformity with any agreement or rules of any group, association, organization or corporation; Bidder has not directly or indirectly induced or solicited any other Bidder to submit a false or sham Bid; Bidder has not solicited or induced any person, firm or corporation to refrain from bidding; and Bidder has not sought by collusion to obtain for itself any advantage over any other Bidder or over OWNER.

(h) Bidder has made such examination to represent, and does hereby represent to OWNER, that it has no claims, demands, causes of action or litigation, asserted or unasserted, against the OWNER, nor does it know of any facts or conditions which, through the passage of time or otherwise, could arise to a claim, demand, cause of action or litigation against the OWNER.

4. Bidder will complete the Work for the price(s) shown.

The prices provided herein are for installation only.

KENTUCKY AMERICAN WATER
BLANKET SERVICES/SETTINGS
PRICE SCHEDULE

The following unit prices shall be used to determine the amount of payment to the contractor for the actual work completed. Quantities shown for 2006 are estimates only; payment will be made on actual quantities.

Description	Unit Bid	2006 Estimated Quantities	Totals
Installation of ¾" " & 1" services – short		900 each	
Installation of ¾" " & 1" services – long		700 each	
Installation of 2" services – short		40 each	
Installation of 2" services – long		20 each	
Price per foot in excess of 60', 3/4", 1", 2" services		2,000 L.F.	
Installation of 5/8" x ¾" & 1" meter settings		2,500 each	
Installation of additional meter box & top for dual PRV type ¾" & 1" settings		50 each	
Install 2" meter settings (incl. vault construction material)		2 each	
Install 2" pre-fabricated meter setting (including vault construction material)		3 each	
Install 2" pre-fabricated meter setting with pre-fabricated box & top furnished		50 each	
Install 5/8" x 3/4" and 1" meters (regular read)		200 each	
Open cut 1" and 2" long blind services in rock areas where required		40 each	
Install 5/8" x 3/4" and 1" meter settings on existing blind services at a later date		60 each	
Install 5/8" x 3/4", 1" and 2" encoder meters – (radio read) (all 2" encoder)		2,000 each	
Tap in street		30 each	
	TOTAL		

5. Bidder agrees that the Work will be complete within ____ working days after the date assigned, when the Contract Times commence to run as provided in Paragraph 2.3 of the General Conditions.

Bidder accepts the provisions of the Agreement as to liquidated damages in the event of failure to complete the Work on time.

6. The following documents are attached to and made a condition of this Bid: (If Applicable)

a) Required Bid Security in the form of a Bid Bond.

b) A tabulation of subcontractors, suppliers and other persons and organizations required to be identified in this Bid, if required by Paragraph 6.8.2 of the Supplementary Conditions.

c) Evidence of Bidder's qualification to do business in the State where the project is located.

d) Bidder's contractor's license number if required to work in the State where the project is to be constructed.

7. The terms used in this Bid which are defined in the General Conditions of the Contract Documents have the meanings assigned to them in the General Conditions.

SUBMITTED on ______________________________
(Date)

IF BIDDER IS:

<u>An Individual</u>:By:______________________________Seal)
(Individual's Name)
Doing business as ______________________________
Business address: ______________________________
____
Phone No.: ______________________________

<u>A Partnership</u>:By:______________________________(Seal)
(Firm Name)
____
(General Partner)
Business address: ______________________________
____
Phone No.: ______________________________

<u>A Corporation</u>:By:______________________________
(Corporation Name)
____
(State of Incorporation)
By:______________________________
(Name of Person Authorized to Sign)
____
(Title)

(Corporate Seal)
Attest______________________________
(Secretary)
Business address: ______________________________
____
Phone No:______________________________

<u>A Joint Venture:</u>By:______________________________
(Name)
____
(Address)
By:______________________________
(Name)
____
(Address)

(Each joint venture must sign. The manner of signing for each individual, partnership and corporation that is a party to the joint venture should be in the manner indicated above).

EXHIBIT NO. 1

NAME	EXPERIENCE	2-YR EMPLOYMENT HISTORY
Foreman:		
____________	____________	____________
1st Crew:		
1. ____________	____________	____________
2. ____________	____________	____________
3. ____________	____________	____________
2nd Crew:		
1. ____________	____________	____________
2. ____________	____________	____________
3. ____________	____________	____________
3rd Crew:		
1. ____________	____________	____________
2. ____________	____________	____________
3. ____________	____________	____________

EXHIBIT NO. 1

4th Crew:

1. ______	______	______
2. ______	______	______
3. ______	______	______

5th Crew:

1. ______	______	______
2. ______	______	______
3. ______	______	______

EXHIBIT NO. 2

CONSTRUCTION OF SERVICES AND SETTINGS INSTALLATIONS ¾-INCH THROUGH 2-INCH JANUARY 1, 2006 THROUGH DECEMBER 31, 2006

1. Contractor agrees that he will perform all the work and provide all of the labor, tools, equipment necessary to install the following:

   For the **installation of new** ¾-inch, 1-inch and 2-inch service lines at such times and locations designated by the Water Company in its sole discretion, in the Water Company's service area, the Water Company will furnish service material for the 2006 contract. The Contractor will furnish his own tools and equipment for making installations, including tapping machine and combined drills and taps. The Contractor will also furnish materials required to restore street openings and disturbed areas to their original condition, or as required by law, whichever standard is higher.

   Contractor also agrees to comply with all urban county, city, county and state highway requirements in restoring street openings or any disturbed areas immediately to their original condition, using the same type of materials or better, to the satisfaction of the various requirements.

2. The Contractor agrees that personnel and equipment necessary to perform work will be available to commence said work upon approval of contract.

3. The Contractor agrees to maintain sufficient personnel so that the total backlog of tap orders approved for installation will never exceed 30 days. (Sufficient personnel means keeping backlog less than 30 with 5-day workweek, not working Saturday and Sunday.)

4. The Contractor agrees that all tap orders will be installed within 5 working days after receipt of tap order from Water Company.

5. The Contractor agrees that if the backlog of tap orders ready for installation exceeds 30, or if tap orders are not installed within 5 working days, the Water Company reserves the right to use whatever means necessary to bring the tap orders up to date and any additional costs will be paid by the Contractor.

6. The Contractor agrees to furnish accurate measurements and a diagram showing the location of the corporation stops, service lines and meter boxes. All dimensions included on tap orders will be accurately measured by tape. Measurements on tap orders should be from closest intersecting streets, curb lines, centerlines and from corners of houses. Tap orders will be prepared on the job site. (See attached sample of completed tap orders.)

7. The Contractor will furnish a list of materials used for the installation of each service and meter box location. All materials used will be measured accurately with a tape. All materials shall be listed by proper size and code numbers.

8. The Water Company will furnish a tap service order (P-14) for each service installed by the Contractor; all measurements, diagram and material shall be shown on the tap service

EXHIBIT 3

PROCEDURE FOR PAYMENT OF NEW SERVICES INSTALLATION WHEN STREET CUT REPAIR CANNOT BE MADE IN A TIMELY MANNER JANUARY 1, 2006 THROUGH DECEMBER 31, 2006

The Water Company is often required to install a water service during the winter months that require excavation in the roadway. When such services are installed during the winter, street repairs cannot be made once the service is installed because concrete and paving plants generally close during the winter months. In order to allow for accounting of the installation of these services, the following procedure should be used:

1. When a service is installed requiring roadway excavation and material necessary for permanent repair is not available, the contractor may invoice the Water Company for installing this service even though all repair work has not been completed. Invoices for this work must be kept separate from normal invoices where the service has been installed and work completed. Invoicing in this fashion will allow tracking of the locations where work is not complete until permanent repairs can be made. It will also allow for a retainage to be withheld on this amount of work that will cover the cost of the unfinished work.

2. In calculating the amount of retainage, consideration should be given to the amount of unfinished work, cost of repairs at Water Company cost and percentage of retainage amount. Currently, street cut repairs average 50 square feet in size. Based on current Water Company costs to make repairs to roadways, retainage amounts should be 50% of the cost of installing a long service. This may change as contract amounts and the area of repairs change. Under no conditions should the amount of retainage withheld be less than the cost to repair at Water Company's estimated cost.

3. This procedure applies only when conditions beyond the Contractor's control prevent repairs from being made. It is still the Contractor's responsibility to make repairs in a timely manner. The Contractor will be responsible to place and maintain temporary repairs until permanent repairs can be made. The Contractor also will be liable for any claims made as a result of the uncompleted work, if they occur.

4. This procedure does not allow the Contractor invoicing for uncompleted work when reasons for the uncompleted work are within Contractor's control. Heavy workloads, reduced available personnel, short periods of inclement weather and other similar reasons do not qualify as reasons to bill for work not complete. According to the policy as set forth in the new services contract, Contractor is to bill only for work that is complete. There must be no deviation from this policy if at all possible.

These same guidelines may be followed in other areas of the new services contract when conditions beyond the Contractor's control do not allow completion of all work.

The Water Company reserves the right of sole discretion in the application of this procedure, including the right to change the above procedure.

Notwithstanding this Exhibit 3, Contractor agrees to abide by any governmental repair or restoration requirements of any city, county, urban-county or state, as such may change from time to time.

Kentucky American Water®

November 23, 2005

RE: ADDENDUM TO 2006 NEW SERVICE LINE CONTRACT

Dear Contractor:

Kentucky American Water's policy has been changed to require a higher degree of contractor insurance coverage than was previously required. In addition to the $1,000,000 limit for General Liability, Automobile Liability and Worker's Compensation, an additional $9,000,000 of Excess Liability insurance to follow form for each of those categories will be required.

Enclosed is an amended Page 4 (Item 11) to replace the one in the sample *Service Agreement* recently mailed to you in the Invitation to Bid for the above referenced contract.

Also enclosed is a sample insurance certificate indicating the proper levels of coverage. Please make sure that your certificate includes the same language as in the Description of Operations section of the certificate.

Should you have questions, I can be reached at (859) 268-6362.

Sincerely,

Greg Tomko /dm

Greg Tomko
Project Manager
New Development/Construction

GT/dm

Enclosures

American Water
2300 Richmond Road
Lexington, KY 40502
T 859.269.2386
F 859.268.6327
I www.amwater.com

RWE Group

ACORD CERTIFICATE OF INSURANCE

ISSUE DATE (MM/DD/YY)

PRODUCER
Contractor Insurance Broker
555 Water Street
Charleston West, WV

Phone No.
Fax No.

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW.

COMPANIES AFFORDING COVERAGE

COMPANY LETTER	
A	XYZ Insurance Company
B	One Two Three Insurance Company
C	
D	
E	

INSURED
Construction Contractor I $10MM, Vendor I,
AJAX Electrical Contracting
1 Main Street
Charleston, WV

COVERAGES

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED, NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

CO LTR	TYPE OF INSURANCE	POLICY NUMBER	POLICY EFFECTIVE DATE (MM/DD/YY)	POLICY EXPIRATION DATE (MM/DD/YY)	LIMITS	
A	**GENERAL LIABILITY** ☒ COMMERCIAL GENERAL LIABILITY ☐ CLAIMS MADE ☒ OCCUR. ☐ OWNER'S & CONTRACTOR'S PROT. ☐ ☐	GLSA260T331702	01/01/2006	12/31/2006	GENERAL AGGREGATE PRODUCTS-COMP/OP AGG. PERSONAL & ADV. INJURY EACH OCCURRENCE FIRE DAMAGE (ANY ONE FIRE) MED. EXPENSE (ANY ONE PERSON)	$ 1,000,000 $ 1,000,000 $ 1,000,000 $ 1,000,000 $ 1,000,000 $ 5,000
A	**AUTOMOBILE LIABILITY** ☒ ANY AUTO ☐ ALL OWNED AUTOS ☐ SCHEDULED AUTOS ☐ HIRED AUTOS ☐ NON-OWNED AUTOS ☐ GARAGE LIABILITY	987654321	01/01/2006	12/31/2006	COMBINED SINGLE LIMIT BODILY INJURY (PER PERSON) BODILY INJURY (PER ACCIDENT) PROPERTY DAMAGE	$ 1,000,000 $ $ $
B	**EXCESS LIABILITY** ☐ UMBRELLA FORM ☒ OTHER THAN UMBRELLA FORM	L0CX045	01/01/2006	12/31/2006	EACH OCCURRENCE AGGREGATE	$ 9,000,000 $ 9,000,000
A	**WORKER'S COMPENSATION AND EMPLOYERS LIABILITY**	AEIOU	01/01/2006	12/31/2006	☒ STATUTORY LIMITS EACH ACCIDENT DISEASE-POLICY LIMIT DISEASE-EACH EMPLOYEE	 $ 1,000,000 $ 1,000,000 $ 1,000,000
	OTHER					

DESCRIPTION OF OPERATIONS/LOCATIONS/VEHICLES/SPECIAL ITEMS

Project Location:
Certificate holder is included as additional insured with respect to liability arising out of the named insured's operations performed on behalf of holder. Excess policy follows form for Employers Liability, General Liability and Auto Liability Policies without exception. Waiver of Subrogation endorsement must accompany certificate of insurance.

(Note: General Liability per occurrence limit and Auto policy per occurrence limit, combined with the Excess policies, must not be less than $10,000,000.00 Combined Total Limit of Liability.)

CERTIFICATE HOLDER

American Water
800 W. Hersheypark Drive
Hershey, PA 17033

CANCELLATION

SHOULD ANY OF THE ABOVE DESCRIBED POLICIES BE CANCELLED BEFORE THE EXPIRATION DATE THEREOF, THE ISSUING COMPANY WILL XXXXXXXX TO MAIL 30 DAYS WRITTEN NOTICE TO THE CERTIFICATE HOLDER NAMED TO THE LEFT, BUT FAILURE TO MAIL SUCH NOTICE SHALL IMPOSE NO OBLIGATION OR LIABILITY OF ANY KIND UPON THE COMPANY, ITS AGENTS OR REPRESENTATIVES.

AUTHORIZED REPRESENTATIVE 28

11. INSURANCE:

(a) The CONTRACTOR shall submit with this signed AGREEMENT two (2) copies of a "Certificate of Insurance." The certificates are to be completed by the CONTRACTOR'S insurance carrier(s) and signed by an authorized agent(s) of the insurance company(s). The CONTRACTOR shall not commence any work under this AGREEMENT until such "Certificate of Insurance" is in the hands of and approved by the WATER COMPANY.

(b) Workers' Compensation and Employer's Liability Insurance:

The CONTRACTOR shall carry Workers' Compensation Insurance during the life of this AGREEMENT to insure his statutory liability to his employees in the State in which the WORK under this AGREEMENT is to be performed plus not less than $1,000,000 Employer's Liability Insurance coverage.

(c) Comprehensive General Liability and Property Damage:

The CONTRACTOR shall carry the Comprehensive Form of General Liability and Property Damage Insurance during the life of this AGREEMENT covering the risks itemized in the form for "Certificate of Insurance" provided for in this AGREEMENT. The limits shall be not less than $1,000,000 for bodily injury and $1,000,000 for property damage.

(d) Comprehensive Automobile Liability and Property Damage:

The CONTRACTOR shall carry the Comprehensive Form of Automobile Liability and Property Damage Insurance during the life of this AGREEMENT covering the risks itemized in the form for "Certificate of Insurance" provided for in this AGREEMENT. The limits shall be not less than $1,000,000 for bodily injury and $1,000,000 for property damage.

(e) Umbrella and/or Excess Liability:

The CONTRACTOR shall carry umbrella and/or excess liability insurance during the life of this AGREEMENT covering the risk involved in subparagraph (c) and (d) above with a combined single limit which shall be not less than $9,000,000.

KENTUCKY-AMERICAN WATER COMPANY

Application for Contractor Pre-Qualification

No invitation to bid will be offered nor will any bid be accepted until this questionnaire has been completed and accepted by Kentucky-American Water Company (KAWC).

Any information herein may be investigated by KAWC and any misrepresentation of the facts will automatically disqualify the potential applicant.

All information in this questionnaire will remain strictly confidential.

1. Name of Applicant____

   Address____

   Telephone Number(s)____________________________________

2. Is this a new business? Yes_________ No_________

3. If not, how many years has your organization been in business as a contractor under:

   (a) your *present* name? __________

   (b) *another name*? ____________________________ years? _____

4. How many years experience in water utility type construction work has your organization had:

   (a) as a general contractor __________ (b) as a subcontractor __________

5. If this is a new business, please identify all persons involved in the management of the company and attach a resume' of their relevant work experience in water utility construction.

6. Have you ever failed to complete any work awarded to you? ______If so, please explain why.

7. Give a brief description of the equipment that you would have available for KAWC work.

____

____

____

____

8. Give a brief description of the crew(s) that you would have available for KAWC work, i.e. number of men to a crew, foreman with each, number of operators, etc.

____

____

____

____

9. (a) Please list those employees within your organization with a blasting license, their position with the company, and years of experience.

(Name) *(Position)* *(Yrs Experience)*

____

____

____

____

(b) Insurance including blasting will be required and must be in effect for the duration of any contract where blasting is anticipated. (See Item 13, Insurance.)

10. Are you certified for asbestos removal? Yes __________ No __________

11. Please list any other relevant certifications held by your company or individual employees.

____

____

____

____

12. As a KAWC contractor, you will be required to provide a means of maintaining 24-hour contact in the event of problems stemming from work performed and still under the maintenance warranty. This contact should preferably live within an area whereby any such problems could be handled in a quick and efficient manner to minimize the potential disruption to any existing customer.

Contact Name ______________________________ Telephone ____________________

Address ____

13. All insurance requirements must conform to the attached sample Certificate of Insurance form *(Attachment A)* prior to the initiation of any contract.

14. Provide information required on the attached Work Experience Schedule *(Attachment B)*. List a sufficient number of projects to indicate to KAWC your experience with various sizes and types of pipe in this field of work.

15. KAWC renders payment 30 days from receipt of an approved invoice for work completed. Please provide credit references on the attached form *(Attachment C)* that will attest to your solvency under those terms. Include the name of the bank with which your organization does business.

16. Please identify at least three references who are familiar with your previous work. (This may include KAWC employees.)

(Name)	*(Address)*	*(Phone Number)*

Company: ______________________________

By: ______________________________
(print name) *(title)*

____
(signature)

Attachment A

KENTUCKY AMERICAN WATER

CONTRACTOR INSURANCE REQUIREMENTS

(a) The CONTRACTOR shall submit with the application one (1) copy of a Certificate of Insurance. The certificate is to be completed by the CONTRACTOR's insurance carrier(s) and signed by an authorized agent(s) of the insurance company(s). The CONTRACTOR shall not commence any work until such Certificate of Insurance is in the hands of and approved by KAW.

(b) Workers' Compensation and Employer's Liability Insurance: The CONTRACTOR shall carry Workers' Compensation Insurance to insure his statutory liability to his employees in the State in which the work is to be performed, plus not less than **$1,000,000** Employer's Liability Insurance coverage.

(c) Comprehensive General Liability and Property Damage: The CONTRACTOR shall carry the Comprehensive Form of General Liability and Property Damage Insurance covering the risks itemized in the form for Certificate of Insurance. The limits shall be not less than **$1,000,000** for bodily injury and **$1,000,000** for property damage.

(d) Comprehensive Automobile Liability and Property Damage: The CONTRACTOR shall carry the Comprehensive Form of Automobile Liability and Property Damage Insurance covering the risks itemized in the form for Certificate of Insurance. The limits shall be not less than **$1,000,000** for bodily injury and property damage.

(e) Umbrella and/or Excess Liability: The CONTRACTOR shall carry umbrella and/or excess liability insurance covering the risks involved in paragraphs (c) and (d) above with a combined single limit which shall be not less than **$9,000,000**.

Attachment B (page 1 of 2)

WORK EXPERIENCE SCHEDULE

Owner's Name/Address/Telephone____

____

____

Engineer's Name/Telephone____

Contract Amount $______________________Year Project Completed ______________

Project Title and Brief Description of Work Performed______________________________

____

____

____

Owner's Name/Address/Telephone____

____

____

Engineer's Name/Telephone____

Contract Amount $______________________Year Project Completed ______________

Project Title and Brief Description of Work Performed______________________________

____

____

____

Owner's Name/Address/Telephone____

____

____

Engineer's Name/Telephone____

Contract Amount $______________________Year Project Completed ______________

Project Title and Brief Description of Work Performed______________________________

____

____

____

Attachment B (page 2 of 2)

WORK EXPERIENCE SCHEDULE

Owner's Name/Address/Telephone____

Engineer's Name/Telephone____

Contract Amount $____________________Year Project Completed ____________

Project Title and Brief Description of Work Performed________________________

Owner's Name/Address/Telephone____

Engineer's Name/Telephone____

Contract Amount $____________________Year Project Completed ____________

Project Title and Brief Description of Work Performed________________________

Owner's Name/Address/Telephone____

Engineer's Name/Telephone____

Contract Amount $____________________Year Project Completed ____________

Project Title and Brief Description of Work Performed________________________

Attachment C

CREDIT REFERENCES

Company Name____

Address____

Contact Person______________________Telephone______________

Company Name____

Address____

Contact Person______________________Telephone______________

Company Name____

Address____

Contact Person______________________Telephone______________

Company Name____

Address____

Contact Person______________________Telephone______________

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Keith Cartier

124. Provide a narrative explaining how KAW reviews, scores, and awards service line installation work that it has bid. (The narrative should include a discussion regarding how KAW communicates information concerning the award of the bid to all bidders.)

Response:

Kentucky American Water receives bids and tabulates the bids based on the estimated number of units of the components bid. Please refer to the attachment to the response to Item 123 of this same request in the Invitation to Bid for a listing of the individual components.

The tabulation of the bids is reviewed by the Director of Engineering and the bid is awarded based on the lowest overall bid cost. A letter is then sent to all contractors who submitted an unsuccessful bid. The apparent successful bidder is notified by telephone and a letter with an agreement for execution.

For the electronic version, refer to KAW_R_AGDR1#124_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Keith Cartier

125. Identify all other aspects of KAW's operations (aside from service line installation work) that are competitively bid. To the extent that the bidding process for these other aspects differ from the bidding process for service line installation work, identify the difference and explain why there is a differe

Response:

A contract for renewal service line installation work is competitively bid under a blanket contract with the same process as the new service line installation work. All new and replacement pipeline installations, fire hydrant installations not associated with specific pipeline projects, and fire service installations are competitively bid to the pre-qualified pipeline contractors. There is not a pre-bid meeting unless the project is unusual, and contractors are allowed to witness the bid opening if they wish.

Other construction projects are bid to pre-qualified contractors based on the nature of the project. Larger projects or projects that are unique in nature may have a pre-bid meeting and a formal process for submitting qualifications. Smaller projects may be bid to a pre-qualified group of contractors based on previous work history with Kentucky American Water. Kentucky American Water utilizes a goal of a minimum of three qualified bids on each project to maintain competitive pricing on all construction work. A standard agreement developed by American Water is executed with the contractor.

Other non-construction work related to operations that is competitively bid includes janitorial services, property mowing, waste disposal and maintenance work on equipment as needed. Procurement of services is guided under American Water policy and procedure. Prior to contract execution, the contract including bid tabulation is reviewed by Kentucky American Water counsel, American Water Procurement, and the supervisor of the appropriate project manager at Kentucky American Water.

The purchase of materials including pipe, vehicles, and chemicals is bid through American Water Procurement on an annual national contract.

For the electronic version, refer to KAW_R_AGDR1#125_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

126. Please provide the per books capital structure of Kentucky-American Water Company at December 31, 2007, March 31, June 30, and September 30, 2008, as well as December 31, 2008, as soon as available. For the purposes of this data request, please provide the information as follows:

a) Long-term Debt (including that maturing within one year)
b) Short-term Debt
c) Other Debt (specify)
d) Preferred or Preference Stock
e) Common Stock
f) Additional Paid-in Capital
g) Retained Earnings
h) Total Common Equity (total common equity as well as common equity attributable to unregulated operations, if any)

Please also provide balance sheet support for each of the above-requested capital structures.

Response:

Please see the attached balance sheets for December 2007, and March, June and September 2008.

For the electronic version, refer to KAW_R_AGDR1#126_122308.pdf.

REVISED 1/18/08

83500 American Water Works Company 1
GL012BSYGP Kentucky-American Water-Co 12 01/21/08
0001R Total Company (USGAAP) 11:50:57

Comparative Balance Sheet
For the Period Ending 12/31/2007

Kentucky-American Water Co.

Description	Current Year	Prior Year
ASSETS		
1 Utility Plant	345,341,374	327,533,086
2 Construction work in progress	21,309,716	11,763,310
3 Accumulated depreciation	80,434,539-	75,828,389-
4 Utility plant acquisition adjustment	326,777	347,966
5 Other utility plant adjustments		
6 Sub-total Utility Plant	286,543,328	263,815,973
7 Non-Utility property	249,738	249,738
8 Other investments		
Current Assets		
10 Cash and cash equivalents	398,277	904,169
11 Temporary investments		
12 Customer accounts receivable	1,928,082	2,453,029
13 Allowance for uncollectible accounts	223,309-	261,097-
14 Unbilled revenues	2,562,043	2,510,264
15 FIT refund due from assoc. companies	388,038	4,096,177
16 Miscellaneous receivables	196,269	602,980
17 Materials and supplies	634,634	515,515
19 Other	118,800	93,346
20 Sub-total	6,002,834	10,914,383
22 Deferred debits		
23 Debt and preferred stock	845,867	462,792
24 Expense of rate proceeding	485,893	421,207
25 Prelim survey & invest charges	125,657	125,657
26 Reg Asset-income tax recovery	6,385,438	6,484,464
27 Other	5,364,534	5,109,490
29 Sub-total	13,207,389	12,603,610
30 Total Assets	306,003,289	287,583,704
32 CAPITAL AND LIABILITIES		
33 Common Stock	36,568,777	36,568,777
34 Paid in capital	8,056,319	8,056,319
35 Retained Earnings	30,159,867	28,349,083
36 Unearned Compensation		
37 Reacquired C/S & Accum Comp Inc		
38 Total common equity	74,784,963	72,974,179
39 Preferred stock	1,466,700	1,466,100
40 Long term debt	84,300,000	54,400,000
41 Total capitalization	160,551,663	128,840,279
42 Current liabilities		
43 Bank debt	18,115,917	3,297,056
44 Current portion of LTD	3,100,000	27,100,000
45 Accounts Payable	6,507,358	7,353,989
46 Taxes accrued	4,862,016	8,267,526
47 Interest accrued	1,143,224	611,746
48 Customer deposits		
49 Dividends declared		
51 Other	3,267,524	5,699,322
52 Sub-total	36,996,039	52,329,639
54 Deferred credits		
55 Customer adv. for construction	14,653,091	16,492,638
56 Deferred income taxes	33,072,254	35,314,486
57 Deferred investment tax credits	1,217,811	1,302,648
58 Reg.liab-inc.tax.refund thru rates	12,254,027	10,470,383
59 Other	3,673,089	2,998,399
60 Sub-total	64,870,272	66,578,554
62 Contributions in aid of construction	43,585,315	39,835,232
Total capital and liabilities	306,003,289	287,583,704

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American Water Works Company
Kentucky-American Water-Co 12
Total Company (USGAAP)
Comparative Balance Sheet
For the Period Ending 03/31/2008

1
04/10/08
15:39:04

Kentucky-American Water Co.

Description	Current Year	Prior Year
ASSETS		
1 Utility Plant	347,276,372	329,698,696
2 Construction work in progress	22,330,528	11,570,945
3 Accumulated depreciation	81,492,494-	77,691,062-
4 Utility plant acquisition adjustment	321,480	342,667
5 Other utility plant adjustments		
6 Sub-total Utility Plant	288,435,886	263,921,246
7 Non-Utility property	270,193	249,738
8 Other investments		
Current Assets		
10 Cash and cash equivalents	384,921	411,744
11 Temporary investments		
12 Customer accounts receivable	1,834,684	2,234,840
13 Allowance for uncollectible accounts	118,340-	271,568-
14 Unbilled revenues	2,571,396	2,149,500
15 FIT refund due from assoc. companies	362,268	566,182
16 Miscellaneous receivables	209,949	385,865
17 Materials and supplies	597,115	617,647
19 Other	380,555	986,276
20 Sub-total	6,222,548	7,080,486
22 Deferred debits		
23 Debt and preferred stock	823,999	444,573
24 Expense of rate proceeding	396,325	370,037
25 Prelim survey & invest charges	125,657	125,657
26 Reg Asset-income tax recovery	6,372,273	6,437,294
27 Other	5,213,680	4,877,213
29 Sub-total	12,931,934	12,254,774
30 Total Assets	307,860,561	283,506,244
32 CAPITAL AND LIABILITIES		
33 Common Stock	36,568,777	36,568,777
34 Paid in capital	16,056,319	8,056,319
35 Retained Earnings	30,349,101	27,981,828
36 Unearned Compensation		
37 Reacquired C/S & Accum Comp Inc		
38 Total common equity	82,974,197	72,606,924
39 Preferred stock	1,466,700	1,466,700
40 Long term debt	81,200,000	51,300,000
41 Total capitalization	165,640,897	125,373,624
42 Current liabilities		
43 Bank debt	18,261,635	15,864,490
44 Current portion of LTD	3,100,000	27,100,000
45 Accounts Payable	2,799,321	236,684
46 Taxes accrued	4,102,288	2,948,719
47 Interest accrued	1,849,352	995,205
48 Customer deposits		
49 Dividends declared		
51 Other	3,197,879	3,975,896
52 Sub-total	33,310,475	51,120,994
54 Deferred credits		
55 Customer adv. for construction	14,309,181	17,008,114
56 Deferred income taxes	33,456,185	35,416,437
57 Deferred investment tax credits	1,196,612	1,281,449
58 Reg.liab-inc.tax.refund thru rates	12,520,130	10,711,153
59 Other	3,143,238	2,651,946
60 Sub-total	64,625,346	67,069,099
62 Contributions in aid of construction	44,283,843	39,942,524
Total capital and liabilities	307,860,561	283,506,241

83500 — American Water Works Company — 1
GL012BSYGP — Kentucky-American Water-Co 12 — 07/10/08
0001R — Total Company (USGAAP) — 08:25:52

Comparative Balance Sheet
For the Period Ending 06/30/2008

Kentucky-American Water Co.

Description	Current Year	Prior Year
ASSETS		
1 Utility Plant	356,868,588	331,385,475
2 Construction work in progress	22,092,873	21,054,366
3 Accumulated depreciation	83,631,673-	79,779,805-
4 Utility plant acquisition adjustment	316,183	337,370
5 Other utility plant adjustments		
6 Sub-total Utility Plant	295,645,971	272,997,406
7 Non-Utility property	270,193	249,738
8 Other investments		
Current Assets		
10 Cash and cash equivalents	407,634	329,391
11 Temporary investments		
12 Customer accounts receivable	2,608,312	2,633,846
13 Allowance for uncollectible accounts	246,902-	333,876-
14 Unbilled revenues	2,873,017	2,472,173
15 FIT refund due from assoc. companies		630,182
16 Miscellaneous receivables	424,291	251,153
17 Materials and supplies	638,382	555,021
19 Other	312,610	722,566
20 Sub-total	7,017,344	7,260,456
22 Deferred debits		
23 Debt and preferred stock	805,509	426,409
24 Expense of rate proceeding	359,539	516,219
25 Prelim survey & invest charges	125,657	125,657
26 Reg Asset-income tax recovery	6,448,358	6,413,477
27 Other	5,349,321	5,240,766
29 Sub-total	13,088,384	12,722,528
30 Total Assets	316,021,892	293,230,128
32 CAPITAL AND LIABILITIES		
33 Common Stock	36,568,777	36,568,777
34 Paid in capital	24,099,422	8,056,319
35 Retained Earnings	31,239,496	29,015,928
36 Unearned Compensation		
37 Reacquired C/S & Accum Comp Inc		
38 Total common equity	91,907,695	73,641,024
39 Preferred stock	1,458,100	1,466,700
40 Long term debt	81,200,000	51,300,000
41 Total capitalization	174,565,795	126,407,724
42 Current liabilities		
43 Bank debt	13,859,800	42,271,357
44 Current portion of LTD	3,100,000	3,100,000
45 Accounts Payable	4,574,326	5,196,237
46 Taxes accrued	3,174,643	3,224,507
47 Interest accrued	1,149,643	622,592
48 Customer deposits		
49 Dividends declared		
51 Other	3,179,500	3,919,629
52 Sub-total	29,037,912	58,334,322
54 Deferred credits		
55 Customer adv. for construction	14,195,400	16,091,000
56 Deferred income taxes	36,032,783	35,611,666
57 Deferred investment tax credits	1,175,413	1,260,250
58 Reg.liab-inc.tax.refund thru rates	12,816,237	10,865,284
59 Other	2,817,820	2,912,820
60 Sub-total	67,037,653	66,741,020
62 Contributions in aid of construction	45,380,533	41,747,062
Total capital and liabilities	316,021,893	293,230,128

83500 | American Water Works Company | 1
GL012BSYGP | Kentucky-American Water-Co 12 | 10/08/08
0001R | Total Company (USGAAP) | 17:39:25

Comparative Balance Sheet
For the Period Ending 09/30/2008

Kentucky-American Water Co.

Description	Current Year	Prior Year
ASSETS		
1 Utility Plant	362,163,349	334,748,679
2 Construction work in progress	37,898,820	23,404,867
3 Accumulated depreciation	83,724,360-	81,637,413-
4 Utility plant acquisition adjustment	316,194	332,073
5 Other utility plant adjustments		
6 Sub-total Utility Plant	316,654,003	276,848,206
7 Non-Utility property	270,193	249,738
8 Other investments		
Current Assets		
10 Cash and cash equivalents	292,130	714,867
11 Temporary investments		
12 Customer accounts receivable	2,906,666	3,119,493
13 Allowance for uncollectible accounts	255,159-	260,792-
14 Unbilled revenues	3,059,801	2,484,558
15 FIT refund due from assoc. companies		758,067
16 Miscellaneous receivables	289,451	476,856
17 Materials and supplies	575,109	605,825
19 Other	295,981	369,771
20 Sub-total	7,163,979	8,268,645
22 Deferred debits		
23 Debt and preferred stock	817,581	408,320
24 Expense of rate proceeding	361,972	576,692
25 Prelim survey & invest charges	125,657	125,657
26 Reg Asset-income tax recovery	6,375,990	6,385,797
27 Other	5,129,047	5,354,875
29 Sub-total	12,810,247	12,851,341
30 Total Assets	336,898,422	298,217,930
32 CAPITAL AND LIABILITIES		
33 Common Stock	36,568,777	36,568,777
34 Paid in capital	24,116,930	8,056,319
35 Retained Earnings	33,084,830	30,604,115
36 Unearned Compensation		
37 Reacquired C/S & Accum Comp Inc		
38 Total common equity	93,770,537	75,229,211
39 Preferred stock	1,455,600	1,466,700
40 Long term debt	81,200,000	51,300,000
41 Total capitalization	176,426,137	127,995,911
42 Current liabilities		
43 Bank debt	22,680,041	43,792,355
44 Current portion of LTD	3,100,000	3,100,000
45 Accounts Payable	9,295,376	3,895,325
46 Taxes accrued	4,822,578	7,308,158
47 Interest accrued	1,909,605	1,099,416
48 Customer deposits		
49 Dividends declared		
51 Other	3,809,328	3,832,091
52 Sub-total	45,616,928	63,027,345
54 Deferred credits		
55 Customer adv. for construction	14,297,558	14,952,710
56 Deferred income taxes	37,405,457	32,970,310
57 Deferred investment tax credits	1,154,214	1,239,051
58 Reg.liab-inc.tax.refund thru rates	13,111,544	11,810,156
59 Other	2,683,443	2,896,268
60 Sub-total	68,652,216	63,868,495
62 Contributions in aid of construction	46,203,143	43,326,178
Total capital and liabilities	336,898,424	298,217,929

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

127. For the same time periods referenced in the preceding interrogatory, please provide the following information for Kentucky-American Water Company:

a) Embedded cost rates for long-term debt, short-term debt other debt and preferred or preference stock
b) Computation of embedded cost rates of long-term debt
c) Computation of embedded cost rates of short-term debt
d) Computation of embedded cost rates of preferred or preference stock

Note: Schedules should include date of issue, maturity date, dollar amount, coupon rate, net proceeds, annual interest paid, and balance of principal, where applicable.

Response:

Please see the attached schedules. The Company does not posses the average short-term debt interest rate for each 12-month period, but does have an average short-term interest rate for each month. The schedules attached contain the short-term interest rate for the month ending each requested 12-month period.

For the electronic version, refer to KAW_R_AGDR1#127_122308.pdf.

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
COST OF CAPITAL SUMMARY
As of December 2007

Line No.	Class of Capital	Reference	Amount	% of Total	Add (1)	Adjusted Capital	Cost Rate	Terminal Weighted Cost
1								
2	Short-Term Debt	J-2, Page 2	$18,115,917	10.013%	$ -	$18,115,917	5.282%	0.530%
3								
4	Long-Term Debt	J-3, Page 2	82,076,425	45.366%	0	82,076,425	6.930%	3.140%
5								
6	Preferred Stock	J-4, Page 2	5,944,409	3.286%	0	5,944,409	7.750%	0.250%
7								
8	Common Equity		74,784,963	41.336%	0	74,784,963	11.500%	4.750%
9								
10	Total Capital		$180,921,714	100.001%	$ -	$180,921,714		8.670%
11								
12								
13	Note: ST debt rate is avg. for December 2007							
14								

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF LONG-TERM DEBT
As of December 2007

Line No.	Debt Issue Type & Rate	Issue Date	Maturity Date	Amount Outstanding	Cost Rate at Issue	Cost Rate at Maturity	Bond Rating at Issue	Annualized Interest	Principal Amount	Annual Amort. of Issue Expense	Unamortized Discount or Premium	Unamortized Debt Expense	Unamortized Gain/Loss	Carrying Value
1														
2														
3	General Mortgage Bonds:													
4														
5	Series 6.87%	03/30/01	03/29/11	12,400,000	6.870%	7.374%	N/A	914,376	12,400,000	62,496	0	217,955	0	12,182,045
6	Series 6.96%	12/01/93	12/01/23	7,000,000	6.960%	7.006%	N/A	490,420	7,000,000	3,240	0	36,653	0	6,963,347
7	Series 7.15%	02/14/97	02/01/27	7,500,000	7.150%	7.182%	N/A	538,650	7,500,000	2,424	0	46,554	0	7,453,446
8	Series 6.99%	09/01/98	06/01/28	9,000,000	6.990%	7.026%	N/A	632,340	9,000,000	3,264	0	66,815	0	8,933,185
9	Series 6.59%	06/12/02	06/12/37	47,000,000	6.590%	6.623%	N/A	3,112,810	47,000,000	15,406	0	455,598	0	46,544,402
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24														
25														
26	Total Long-Term Debt and Annualized Cost			$82,900,000				$5,688,596	$82,900,000	$86,830	$0	$823,575	$0	$82,076,425
27														
28														
29	Annualized Cost Rate			6.930%										
30														
31														
32														

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF PREFERRED STOCK
As of December 2007

Line No.	Dividend Rate, Type & Par Value	Date Issued	Amount Outstanding	Premium or Discount	Unamortized Issue Expense	Gain or Loss on Reaquired Stock	Net Proceeds	Annual Amort. of Issue Expense	Cost Rate at Issue	Cost Rate at Maturity	Annualized Dividends
1											
2											
3											
4											
5	Series B, 5 3/4%, $100 Par	11/21/57	391,800	0	0	0	391,800	0	5.750%	5.750%	22,529
6											
7	Series C, 5 1/2%, $100 Par	11/22/63	488,300	0	0	0	488,300	0	5.500%	5.500%	26,857
8											
9	Series D, 5%, $100 Par	05/10/63	586,600	0	0	0	586,600	0	5.000%	5.000%	29,330
10											
11											
12											
13	8.47% Series, $100 Par	01/24/92	4,500,000	0	22,291	0	4,477,709	768	8.470%	8.529%	381,904
14											
15											
16											
17											
18	TOTAL		$5,966,700	$0	$22,291	$0	$5,944,409	$768			$460,620
19											
20											
21	Annualized Cost Rate		7.750%								
22											

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
COST OF CAPITAL SUMMARY
As of March 2008

Line No.	Class of Capital	Reference	Amount	% of Total	Add (1)	Adjusted Capital	Cost Rate	Terminal Weighted Cost
1								
2	Short-Term Debt	J-2, Page 2	$18,261,635	9.809%	$ -	$18,261,635	3.470%	0.340%
3								
4	Long-Term Debt	J-3, Page 2	78,998,100	42.431%	0	78,998,100	6.930%	2.940%
5								
6	Preferred Stock	J-4, Page 2	5,944,601	3.193%	0	5,944,601	7.750%	0.250%
7								
8	Common Equity		82,974,197	44.567%	0	82,974,197	11.500%	5.130%
9								
10	Total Capital		$186,178,533	100.000%	$ -	$186,178,533		8.660%
11								
12								
13	Note: ST debt rate is avg. for March 2008							
14								
15								

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF LONG-TERM DEBT
As of March 2008

Line No.	Debt Issue Type & Rate	Issue Date	Maturity Date	Amount Outstanding	Cost Rate at Issue	Cost Rate at Maturity	Bond Rating at Issue	Annualized Interest	Principal Amount	Annual Amort. of Issue Expense	Unamortized Discount or Premium	Unamortized Debt Expense	Unamortized Gain/Loss	Carrying Value
1														
2														
3	General Mortgage Bonds:													
4														
5	Series 6.87%	03/30/01	03/29/11	9,300,000	6.870%	7.542%	N/A	701,406	9,300,000	62,496	0	202,098	0	9,097,902
6	Series 6.96%	12/01/93	12/01/23	7,000,000	6.960%	7.006%	N/A	490,420	7,000,000	3,240	0	35,936	0	6,964,064
7	Series 7.15%	02/14/97	02/01/27	7,500,000	7.150%	7.182%	N/A	538,650	7,500,000	2,424	0	45,745	0	7,454,255
8	Series 6.99%	09/01/98	06/01/28	9,000,000	6.990%	7.026%	N/A	632,340	9,000,000	3,264	0	65,780	0	8,934,220
9	Series 6.59%	06/12/02	06/12/37	47,000,000	6.590%	6.623%	N/A	3,112,810	47,000,000	15,406	0	452,341	0	46,547,659
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25														
26	Total Long-Term Debt and Annualized Cost			$79,800,000				$5,475,626	$79,800,000	$86,830	$0	$801,900	$0	$78,998,100
27														
28														
29	Annualized Cost Rate			6.930%										
30														

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF PREFERRED STOCK
As of March 2008

Line No.	Dividend Rate, Type & Par Value	Date Issued	Amount Outstanding	Premium or Discount	Unamortized Issue Expense	Gain or Loss on Reaquired Stock	Net Proceeds	Annual Amort. of Issue Expense	Cost Rate at Issue	Cost Rate at Maturity	Annualized Dividends
1											
2											
3											
4											
5	Series B, 5 3/4%, $100 Par	11/21/57	391,800	0	0	0	391,800	0	5.750%	5.750%	22,529
6											
7	Series C, 5 1/2%, $100 Par	11/22/63	488,300	0	0	0	488,300	0	5.500%	5.500%	26,857
8											
9	Series D, 5%, $100 Par	05/10/63	586,600	0	0	0	586,600	0	5.000%	5.000%	29,330
10											
11											
12											
13	8.47% Series, $100 Par	01/24/92	4,500,000	0	22,099	0	4,477,901	768	8.470%	8.529%	381,920
14											
15											
16											
17											
18	TOTAL		$5,966,700	$0	$22,099	$0	$5,944,601	$768			$460,636
19											
20											
21	Annualized Cost Rate		7.750%								
22											

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
COST OF CAPITAL SUMMARY
As of June 2008

Line No.	Class of Capital	Reference	Amount	% of Total	Add (1)	Adjusted Capital	Cost Rate	Terminal Weighted Cost
1								
2	Short-Term Debt	J-2, Page 2	$13,859,800	7.267%	$ -	$13,859,800	3.040%	0.220%
3								
4	Long-Term Debt	J-3, Page 2	79,016,397	41.430%	0	79,016,397	6.930%	2.870%
5								
6	Preferred Stock	J-4, Page 2	5,936,194	3.113%	0	5,936,194	7.750%	0.240%
7								
8	Common Equity		91,907,695	48.190%	0	91,907,695	11.500%	5.540%
9								
10	Total Capital		$190,720,086	100.000%	$ -	$190,720,086		8.870%
11								
12								
13	Note: ST debt rate is avg. for June 2008							
14								
15								

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF LONG-TERM DEBT
As of June 2008

Line No.	Debt Issue Type & Rate	Issue Date	Maturity Date	Amount Outstanding	Cost Rate at Issue	Cost Rate at Maturity	Bond Rating at Issue	Annualized Interest	Principal Amount	Annual Amort. of Issue Expense	Unamortized Discount or Premium	Unamortized Debt Expense	Unamortized Gain/Loss	Carrying Value
1														
2														
3	General Mortgage Bonds:													
4														
5	Series 6.87%	03/30/01	03/29/11	9,300,000	6.870%	7.542%	N/A	701,406	9,300,000	62,496	0	186,241	0	9,113,759
6	Series 6.96%	12/01/93	12/01/23	7,000,000	6.960%	7.006%	N/A	490,420	7,000,000	3,240	0	35,363	0	6,964,637
7	Series 7.15%	02/14/97	02/01/27	7,500,000	7.150%	7.182%	N/A	538,650	7,500,000	2,424	0	45,137	0	7,454,863
8	Series 6.99%	09/01/98	06/01/28	9,000,000	6.990%	7.026%	N/A	632,340	9,000,000	3,264	0	64,965	0	8,935,035
9	Series 6.59%	06/12/02	06/12/37	47,000,000	6.590%	6.623%	N/A	3,112,810	47,000,000	15,406	0	451,897	0	46,548,103
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25														
26	Total Long-Term Debt and Annualized Cost			$79,800,000				$5,475,626	$79,800,000	$86,830	$0	$783,603	$0	$79,016,397
27														
28														
29	Annualized Cost Rate			6.930%										
30														
31														

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF PREFERRED STOCK
As of June 2008

Line No.	Dividend Rate, Type & Par Value	Date Issued	Amount Outstanding	Premium or Discount	Unamortized Issue Expense	Gain or Loss on Reaquired Stock	Net Proceeds	Annual Amort. of Issue Expense	Cost Rate at Issue	Cost Rate at Maturity	Annualized Dividends
1											
2											
3											
4											
5	Series B, 5 3/4%, $100 Par	11/21/57	388,800	0	0	0	388,800	0	5.750%	5.750%	22,356
6											
7	Series C, 5 1/2%, $100 Par	11/22/63	488,300	0	0	0	488,300	0	5.500%	5.500%	26,857
8											
9	Series D, 5%, $100 Par	05/10/63	581,000	0	0	0	581,000	0	5.000%	5.000%	29,050
10											
11											
12											
13	8.47% Series, $100 Par	01/24/92	4,500,000	0	21,906	0	4,478,094	768	8.470%	8.529%	381,937
14											
15											
16											
17											
18	TOTAL		$5,958,100	$0	$21,906	$0	$5,936,194	$768			$460,200
19											
20											
21	Annualized Cost Rate		7.750%								
22											

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
COST OF CAPITAL SUMMARY
As of September 2008

Line No.	Class of Capital	Reference	Amount	% of Total	Add (1)	Adjusted Capital	Cost Rate	Terminal Weighted Cost
1								
2	Short-Term Debt	J-2, Page 2	$22,680,041	11.262%	$ -	$22,680,041	3.270%	0.370%
3								
4	Long-Term Debt	J-3, Page 2	79,004,133	39.230%	0	79,004,133	6.930%	2.720%
5								
6	Preferred Stock	J-4, Page 2	5,933,887	2.946%	0	5,933,887	7.750%	0.230%
7								
8	Common Equity		93,770,537	46.562%	0	93,770,537	11.500%	5.350%
9								
10	Total Capital		$201,388,598	100.000%	$ -	$201,388,598		8.670%
11								
12								
13	Note: ST debt rate is avg. for September 2008							
14								
15								

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF LONG-TERM DEBT
As of September 2008

Line No.	Debt Issue Type & Rate	Issue Date	Maturity Date	Amount Outstanding	Cost Rate at Issue	Cost Rate at Maturity	Bond Rating at Issue	Annualized Interest	Principal Amount	Annual Amort. of Issue Expense	Unamortized Discount or Premium	Unamortized Debt Expense	Unamortized Gain/Loss	Carrying Value
1														
2														
3	General Mortgage Bonds:													
4														
5	Series 6.87%	03/30/01	03/29/11	9,300,000	6.870%	7.542%	N/A	701,406	9,300,000	62,496	0	170,384	0	9,129,616
6	Series 6.96%	12/01/93	12/01/23	7,000,000	6.960%	7.006%	N/A	490,420	7,000,000	3,240	0	34,789	0	6,965,211
7	Series 7.15%	02/14/97	02/01/27	7,500,000	7.150%	7.182%	N/A	538,650	7,500,000	2,424	0	44,530	0	7,455,470
8	Series 6.99%	09/01/98	06/01/28	9,000,000	6.990%	7.026%	N/A	632,340	9,000,000	3,264	0	64,150	0	8,935,850
9	Series 6.59%	06/12/02	06/12/37	47,000,000	6.590%	6.623%	N/A	3,112,810	47,000,000	15,406	0	482,014	0	46,517,986
10														
11														
12														
13														
14														
15														
16														
17														
18														
19														
20														
21														
22														
23														
24														
25														
26	Total Long-Term Debt and Annualized Cost			$79,800,000				$5,475,626	$79,800,000	$86,830	$0	$795,867	$0	$79,004,133
27														
28														
29	Annualized Cost Rate			6.930%										
30														
31														

KENTUCKY-AMERICAN WATER COMPANY
CASE NO: 2008-00427
EMBEDDED COST OF PREFERRED STOCK
As of September 2008

Line No.	Dividend Rate, Type & Par Value	Date Issued	Amount Outstanding	Premium or Discount	Unamortized Issue Expense	Gain or Loss on Reaquired Stock	Net Proceeds	Annual Amort. of Issue Expense	Cost Rate at Issue	Cost Rate at Maturity	Annualized Dividends
1											
2											
3											
4											
5	Series B, 5 3/4%, $100 Par	11/21/57	388,800	0	0	0	388,800	0	5.750%	5.750%	22,356
6											
7	Series C, 5 1/2%, $100 Par	11/22/63	486,000	0	0	0	486,000	0	5.500%	5.500%	26,730
8											
9	Series D, 5%, $100 Par	05/10/63	580,800	0	0	0	580,800	0	5.000%	5.000%	29,040
10											
11											
12											
13	8.47% Series, $100 Par	01/24/92	4,500,000	0	21,713	0	4,478,287	768	8.470%	8.528%	381,908
14											
15											
16											
17											
18	TOTAL		$5,955,600	$0	$21,713	$0	$5,933,887	$768			$460,034
19											
20											
21	Annualized Cost Rate		7.750%								
22											
23											

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

128. Please provide the following:

a. Please list all of American Water Works Company, Inc.'s subsidiaries, providing a short description of the business of each and indicate whether or not the subsidiary is active or inactive.
b. Please list all of Kentucky-American Water Company's subsidiaries, providing a short description of the business of each and indicate whether or not the subsidiary is active or inactive.
c. Please provide a consolidat<u>ing</u> (not consolidat<u>ed</u>) balance sheet for American Water Works Company, Inc. at December 31, 2007, or the most recent date available
d. Please provide a consolidat<u>ing</u> (not consolidat<u>ed</u>) balance sheet for Kentucky-American Water at December 31, 2007, or the most recent date available, if one is prepared.

Response:

a. See attached.
b. The Company has no subsidiaries.
c. The Company objects to question on the grounds that the requested information is not relevant to this proceeding, is not in the possession or control of the Company, and is not part of the publicly available information of AWW
d. The Company has no subsidiaries; therefore there is no consolidating balance sheet. Please see the balance sheets for December 2007, and March, April, and September 2008 attached to the response to KAW_R_AGDR1#126. Also refer to Exhibit 28 of the Company's original filing.

   For the electronic version, refer to KAW_R_AGDR1#128_122308.pdf.

EX-21.1 5 dex211.htm SUBSIDIARIES OF AMERICAN WATER WORKS COMPANY, INC.

Exhibit 21.1

American Water Works Company, Inc. and its Subsidiaries Ownership Schedule

As of October 2008

Subsidiaries of American Water	Nature of Legal Organization	Jurisdiction of Incorporation or Formation	Percentage of Equity Interest held directly or indirectly by American Water	Line of Business
American Water Capital Corp.	Corporation	Delaware	100%	Funding vehicle for American Water and its subsidiaries
American Water Resources, Inc.	Corporation	Virginia	100%	Water and/or wastewater treatment, products and services
Laurel Oak Properties Corporation	Corporation	Delaware	100%	Real property owner/ developer
AmericanAnglian Canada Company	Corporation	Canada	100% held through American Water Resources, Inc.	Inactive
American Water Enterprises, Inc.	Corporation	Delaware	100%	Water and/or wastewater management and operating services
American Lake Water Company	Corporation	Illinois	100%	Water pipeline company
AAET, Inc.	Corporation	Delaware	100% held through American Water Enterprises, Inc.	General Partner of AAET, LP
AAET, L.P.	Limited Partnership	Delaware	100% held through AAET, Inc.	Water and/or wastewater management and operating services
EA2 Systems, L.L.C.	Limited Liability Company	Missouri	100% held through AAET L. P.	Water and/or wastewater management and operating services
American Water Works Service Company, Inc.	Corporation	Delaware	100%	Professional water and/or wastewater services
American Water Services, LLC	Limited Liability Company	Delaware	100%	Utility management and operating services
Arizona – American Water Company	Corporation	Arizona	100%	Water and/ or wastewater utility
California – American Water Company	Corporation	California	100%	Water and/or wastewater utility
Hawaii – American Water Company	Corporation	Nevada	100%	Water and/or wastewater utility
Illinois – American Water Company	Corporation	Illinois	100%	Water and/or wastewater utility

Subsidiaries of American Water	Nature of Legal Organization	Jurisdiction of Incorporation or Formation	Percentage of Equity Interest held directly or indirectly by American Water	Line of Business
Indiana – American Water Company	Corporation	Indiana	100%	Water and/or wastewater utility
Iowa – American Water Company	Corporation	Delaware	95.84% (4.16% outside preferred stock)	Water and/or wastewater utility
Kentucky – American Water Company	Corporation	Kentucky	100%	Water and/or wastewater utility
Long Island Water Corporation	Corporation	New York	100%	Water and/or wastewater utility
Maryland – American Water Company	Corporation	Maryland	100%	Water and/or wastewater utility
Michigan – American Water Company	Corporation	Michigan	100%	Water and/or wastewater utility
Missouri – American Water Company	Corporation	Missouri	100%	Water and/or wastewater utility
New Jersey – American Water Company, Inc.	Corporation	New Jersey	100%	Water and/or wastewater utility
New Mexico – American Water Company	Corporation	New Mexico	100%	Water and/or wastewater utility
Ohio – American Water Company	Corporation	Ohio	100%	Water and/or wastewater utility
Pennsylvania – American Water Company	Corporation	Pennsylvania	96.5% held through American Water (3.5% outside preferred stock)	Water and/or wastewater utility
Tennessee – American Water Company	Corporation	Tennessee	99.89% (0.11% outside preferred stock)	Water and/or wastewater utility
Texas – American Water Company	Corporation	Texas	100%	Water and/or wastewater utility
Virginia – American Water Company	Corporation	Virginia	100%	Water and/or wastewater utility
United Water Virginia, Inc.	Corporation	Virginia	100% held through Virginia-American Water Company	Water and/or wastewater utility

Subsidiaries of American Water	Nature of Legal Organization	Jurisdiction of Incorporation or Formation	Percentage of Equity Interest held directly or indirectly by American Water	Line of Business
West Virginia – American Water Company	Corporation	West Virginia	99.97% (0.03% outside common stock)	Water and/or wastewater utility
Bluefield Valley Water Works Company	Corporation	Virginia	100% held through West Virginia-American Water Company	Water and/or wastewater utility
American Water-Acciona Agua, LLC	Limited Liability Company	Delaware	50% held through American Water Enterprises, Inc.	Remedy, operate and manage the Tampa Bay Seawater Desalination Plant
American Water Enterprises Holding, Inc.	Corporation	Delaware	100% held through held through American Water Enterprises, Inc.	Holding company
American Water Industrials, Inc.	Corporation	Delaware	100% held through held through American Water Enterprises, Inc.	Water and/or wastewater services
American Water Industrial Operations, Inc.	Corporation	Delaware	100% held through American Water Industrials, Inc.	Operations and engineering support to industrial facilities
American Water Canada Corp.	Corporation	Ontario	100% held through American Water Enterprises Holding, Inc.	Operations and maintenance of water and/or wastewater facilities
American Water Services Underground Infrastructure Corp.	Corporation	Ontario	100% held through American Water Canada Corp.	Closed circuit television inspection of water and/or wastewater pipes
Terratec Environmental Ltd.	Corporation	Ontario	100% held through American Water Canada Corp.	Biosolids management and recycling
Prism Berlie (Windsor) Limited	Corporation	Ontario	100% held through Terratec Environmental Ltd.	Operates pelitizing facility in Windsor, Ontario
Uniflo Limited	Corporation	Ontario	100% held through Terratec Environmental Ltd.	Holding company
Braemar Acres Limited	Corporation	Ontario	100% held through Uniflo Limited	Owns real property; no operations
Mobile Residuals Management Inc.	Corporation	Ontario	100% held through American Water Canada Corp.	Mobile biosolids and residuals management and recycling
American Water Carbon Services Corp.	Corporation	Ontario	100% held through American Water Canada Corp.	Operates carbon regeneration facilities
Horseshoe Carbons Incorporated	Corporation	Ontario	80% held through American Water Carbon Services Corp. (20% outside common shares)	Operates carbon regeneration facilities

Subsidiaries of American Water	Nature of Legal Organization	Jurisdiction of Incorporation or Formation	Percentage of Equity Interest held directly or indirectly by American Water	Line of Business
American Water (USA), Inc.	Corporation	Delaware	100% held through American Water Enterprises Holding, Inc.	Holding company
Philip Automated Management Controls, Inc.	Corporation	Georgia	100% held through American Water (USA), Inc.	No active operations, currently collecting accounts receivables
Mobile Residuals Management (USA), Inc.	Corporation	Delaware	100% held through American Water (USA), Inc.	Mobile biosolids and residuals management
American Water Operations and Maintenance, Inc.	Corporation	Texas	100% held through American Water (USA), Inc.	Design, building and/or operation of water and wastewater facilities and operations, maintenance and management of water and wastewater facilities
American Water Services CDM, Inc.	Corporation	Washington	80% held through American Water (USA), Inc. (20% outside common stock)	Joint venture operating the Tolt water treatment facility located in Seattle, WA
American Water Engineering, Inc.	Corporation	New Jersey	100% held through American Water (USA), Inc.	Designs and builds plant processes
Utility Management and Engineering, Inc.	Corporation	New Jersey	100% held through American Water Engineering, Inc.	Inactive
TWH LLC	Limited Liability Company	Delaware	100%	Holding company
TWNA, Inc.	Corporation	Delaware	100%	Water and/or wastewater services
OMI/Thames Water Stockton, Inc.	Corporation	Delaware	50% held through TWNA, Inc. and 50% held through Operations and Management, Inc.	Water and/or wastewater services
ACUS Corporation	Corporation	Texas	100% held through TWH LLC	Designing, manufacturing wastewater equipment (IA)
Hydro-Aerobics, Inc.	Corporation	Texas	100% held through TWH LLC	Designing, manufacturing wastewater equipment (IA)
PWT Waste Solutions, Inc.	Corporation	Texas	100% held through TWH LLC	Water and/or wastewater services (IA)

E'town LLC	Limited Liability Company	Delaware	100% held through TWH LLC	Holding company
E'town Properties, Inc.	Corporation	Delaware	100%	Real estate company
Edison Water Company	Corporation	New Jersey	100% held through American Water Enterprises, Inc.	Manage water contract for Township of Edison, NJ

Subsidiaries of American Water	Nature of Legal Organization	Jurisdiction of Incorporation or Formation	Percentage of Equity Interest held directly or indirectly by American Water	Line of Business
Liberty Water Company	Corporation	New Jersey	100% held through American Water Enterprises, Inc.	Manage water contract for City of Elizabeth, NJ
Applied Water Management, Inc.	Corporation	New Jersey	100% held through Thames Water Holdings	Engineering, construction operations and services primarily in wastewater
Applied Wastewater Services, Inc.	Corporation	New Jersey	100% held through Applied Water Management, Inc.	Operations primarily in wastewater, wastewater pumping and hauling
Applied Water Management of Delaware, Inc.	Corporation	New Jersey	100% held through Applied Water Management, Inc.	Water and/or wastewater services
Applied Wastewater Management, Inc.	Corporation	New Jersey	100% held through E'town LLC	Regulated wastewater company
UESG Holdings, Inc.	Corporation	New Jersey	100% held through TWH LLC	Holding company
Elizabethtown Water Services, LLC	Limited Liability Company	New Jersey	100% held through American Water Enterprises, Inc.	Provides water and sewer line protection contracts to former E'town Corp. customers in NJ
E'town Services, LLC	Limited Liability Company	New Jersey	100% held through American Water Enterprises, Inc.	Holds wastewater services contract among E'town Corp, Elizabeth, NJ and the Union County Improvement Authority

KENTUCKY-AMERICAN WATER COMPANY
CASE NO. 2008-00427
ATTORNEY GENERAL'S FIRST REQUEST FOR INFORMATION

Witness: Michael A. Miller

129. Please provide all S.E.C. Form 10-Qs issued by American Water Works Company, Inc. since January 1, 2007. In addition, please provide the parent company's S.E.C. Form 10-K and Annual Report to Shareholders (including any and all statistical supplements available to investors) as soon as they are filed.

Response:

Please see attached. The parent Company SEC Form 10-K for 2008 and Annual Report for Shareholders for 2008 will not be available until late in the first quarter of 2009.

For the electronic version, refer to KAW_R_AGDR1#129_122308.pdf.

AMERICAN WATER WORKS COMPANY, INC.

FORM 10-Q
(Quarterly Report)

Filed 05/14/08 for the Period Ending 03/31/08

Address	1025 LAUREL OAK ROAD VOORHEES, NJ 08043
Telephone	856-346-8200
CIK	0001410636
Symbol	AWK
SIC Code	4941 - Water Supply
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______to ______

Commission file: number 001-34028

AMERICAN WATER WORKS COMPANY, INC.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**51-0063696** **(I.R.S. Employer Identification No.)**
1025 Laurel Oak Road, Voorhees, NJ **(Address of principal executive offices)**	**08043** **(Zip Code)**

(856) 346-8200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☐ Yes ☒ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

☐ Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). ☐ Yes ☒ No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at May 14, 2008
Common Stock, $0.01 par value per share	160,000,000 shares

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AMERICAN WATER WORKS COMPANY, INC.
REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2008
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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

	(Unaudited) March 31, 2008	December 31, 2007
ASSETS		
Property, plant and equipment		
Utility plant - at original cost, net of accumulated depreciation of $2,829,045 at March 31 and $2,776,950 at December 31	$ 9,296,315	$ 9,199,909
Nonutility property, net of accumulated depreciation of $63,207 at March 31 and $60,587 at December 31	119,740	118,052
Total property, plant and equipment	9,416,055	9,317,961
Current assets		
Cash and cash equivalents	9,202	13,481
Restricted funds	2,149	3,258
Utility customer accounts receivable	136,261	147,640
Allowance for uncollectible accounts	(17,576)	(20,923)
Unbilled utility revenues	122,431	134,326
Non-regulated trade and other receivables, net	62,812	66,540
Taxes receivable, including federal income	23,111	23,111
Materials and supplies	28,961	27,458
Other	47,523	35,463
Total current assets	414,874	430,354
Regulatory and other long-term assets		
Regulatory assets	626,093	628,039
Restricted funds	8,997	10,252
Goodwill	1,706,952	2,456,952
Other	95,033	90,514
Total regulatory and other long-term assets	2,437,075	3,185,757
TOTAL ASSETS	$12,268,004	$12,934,072

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
(In thousands, except per share data)

	(Unaudited) March 31, 2008	December 31, 2007
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stockholder’s equity	$ 3,809,423	$ 4,542,046
Preferred stock without mandatory redemption requirements	4,568	4,568
Long-term debt		
Long-term debt	4,642,315	4,674,837
Redeemable preferred stock at redemption value	24,296	24,296
Total capitalization	8,480,602	9,245,747
Current liabilities		
Short-term debt	368,137	220,514
Current portion of long-term debt	90,188	96,455
Accounts payable	119,209	168,886
Taxes accrued, including federal income	56,536	56,002
Interest accrued	85,248	50,867
Other	152,156	181,765
Total current liabilities	871,474	774,489
Regulatory and other long-term liabilities		
Advances for construction	652,536	655,375
Deferred income taxes	644,343	638,918
Deferred investment tax credits	34,957	35,361
Regulatory liability-cost of removal	202,019	192,650
Accrued pension expense	275,536	290,722
Accrued postretirement benefit expense	156,178	158,552
Other	116,596	123,871
Total regulatory and other long-term liabilities	2,082,165	2,095,449
Contributions in aid of construction	833,763	818,387
Commitments and contingencies	—	—
TOTAL CAPITALIZATION AND LIABILITIES	$12,268,004	$12,934,072

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 (Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Operating revenues	$ 506,815	$ 468,544
Operating expenses		
Operation and maintenance	311,261	282,613
Depreciation and amortization	63,916	64,627
General taxes	52,066	47,880
(Gain) loss on sale of assets	(70)	106
Impairment charge	750,000	—
Total operating expenses, net	1,177,173	395,226
Operating (loss) income	(670,358)	73,318
Other income (deductions)		
Interest, net	(69,968)	(72,207)
Allowance for other funds used during construction	2,541	1,658
Allowance for borrowed funds used during construction	1,368	1,093
Amortization of debt expense	(1,318)	(1,219)
Preferred dividends of subsidiaries	(56)	(56)
Other, net	1,205	1,572
Total other income (deductions)	(66,228)	(69,159)
(Loss) income from continuing operations before income taxes	(736,586)	4,159
Provision for income taxes	(4,102)	1,730
(Loss) income from continuing operations	(732,484)	2,429
Income from discontinued operations, net of tax	—	256
Net (loss) income	$ (732,484)	$ 2,685
Basic earnings per common share:		
(Loss) income from continuing operations	$ (4.58)	$ 0.02
Income from discontinued operations, net of tax	$ —	$ 0.00
Net (loss) income	$ (4.58)	$ 0.02
Diluted earnings per common share:		
(Loss) income from continuing operations	$ (4.58)	$ 0.02
Income from discontinued operations, net of tax	$ —	$ 0.00
Net (loss) income	$ (4.58)	$ 0.02
Average common shares outstanding during the period:		
Basic	160,000	160,000
Diluted	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 (Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$(732,484)	$ 2,685
Adjustments		
Depreciation and amortization	63,916	64,627
Impairment charge	750,000	—
Amortization of removal costs net of salvage	10,553	9,018
Provision for deferred income taxes	5,474	4,736
Amortization of deferred investment tax credits	(404)	(406)
Provision for losses on utility accounts receivable	836	2,657
Allowance for other funds used during construction	(2,541)	(1,658)
(Gain) loss on sale of assets	(70)	106
Gain on early extinguishment of debt	—	(7,064)
Other, net	(31,033)	(15,579)
Changes in assets and liabilities		
Receivables and unbilled utility revenues	22,819	18,950
Other current assets	(13,563)	(24,370)
Accounts payable	(13,595)	(17,122)
Taxes accrued, including federal income	485	5,039
Interest accrued	34,381	11,375
Other current liabilities	(9,383)	1,217
Net cash provided by operating activities	85,391	54,211
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction expenditures	(188,437)	(166,115)
Proceeds from sale of assets and securities	82	1,145
Removal costs from property, plant and equipment retirements, net	(1,714)	(1,880)
Net restricted funds released	2,364	1,633
Net cash used in investing activities	(187,705)	(165,217)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	—	617,253
Repayment of long-term debt	(35,915)	(266,553)
Net borrowings (repayments) under short-term debt agreements	166,740	(555,578)
Advances and contributions for construction, net of refunds	(13,673)	13,097
Change in cash overdraft position	(19,117)	—
Capital contributions	—	550,000
Debt issuance costs	—	(3,054)
Redemption of preferred stock	—	(150)
Net cash provided by financing activities	98,035	355,015
Net (decrease) increase in cash and cash equivalents	(4,279)	244,009
Cash and cash equivalents at beginning of period	13,481	29,754
Cash and cash equivalents at end of period	$ 9,202	$ 273,763
Non-cash investing activity:		
Capital expenditures acquired on account but unpaid at quarter-end	$ 58,848	$ 40,378
Non-cash financing activity:		
Advances and contributions	$ 11,283	$ 17,434
Capital contribution	$ —	$ 100,000

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 Changes in Common Stockholder's Equity and Comprehensive Income (Loss)
(Unaudited)
(In thousands, except per share data)

	Common Stock, $.01 Par Value: 500,000 Shares Authorized and 160,000 Shares Issued and Outstanding		Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Common Stockholder's Equity	Comprehensive Income (Loss)
	Shares	Par Value					
Balance at December 31, 2007	160,000	$ 1,600	$5,637,947	$(1,079,118)	$ (18,383)	$4,542,046	
Net loss	—	—	—	(732,484)	—	(732,484)	$ (732,484)
Pension plan amortized to periodic benefit cost:							
Prior service cost	—	—	—	—	6	6	6
Foreign currency translation	—	—	—	—	(145)	(145)	(145)
Total comprehensive loss							$ (732,623)
Balance at March 31, 2008	160,000	$ 1,600	$5,637,947	$(1,811,602)	$ (18,522)	$3,809,423	

	Common Stock, $.01 Par Value: 500,000 Shares Authorized and 160,000 Shares Issued and Outstanding		Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Common Stockholder's Equity	Comprehensive Income (Loss)
	Shares	Par Value					
Balance at December 31, 2006	160,000	$ 1,600	$4,570,855	$ (736,292)	$ (18,766)	$3,817,397	
Net income	—	—	—	2,685	—	2,685	$ 2,685
Equity investment by RWE	—	—	650,000	—	—	650,000	
Pension plan amortized to periodic benefit cost:							
Prior service cost	—	—	—	—	9	9	9
Actuarial loss	—	—	—	—	18	18	18
Foreign currency translation	—	—	—	—	(222)	(222)	(222)
Total comprehensive income							$ 2,490
Balance at March 31, 2007	160,000	$ 1,600	$5,220,855	$ (733,607)	$ (18,961)	$4,469,887	

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

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

Note 1: Basis of Presentation

The accompanying consolidated balance sheet of American Water Works Company, Inc. and Subsidiary Companies (the "Company") at March 31, 2008, the consolidated statements of operations for the three months ended March 31, 2008 and 2007, the consolidated statements of cash flows for the three months ended March 31, 2008 and 2007, and the consolidated statements of changes in common stockholder's equity and comprehensive income (loss) for the three months ended March 31, 2008 and 2007, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in common stockholder's equity, the consolidated results of operations, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual consolidated financial statements for the year ended December 31, 2007. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

Note 2: New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("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 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. 157, "Fair Value Measurements" ("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. In February 2008, the FASB issued FASB Staff Position FAS 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 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 will be required to measure the assets of its defined benefit pension and other post retirement welfare plans pursuant to SFAS 157 at the next measurement date, which will be December 31, 2008.

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

Note 3: Goodwill

In April of 2008, as a result of the pricing of the Company's initial public offering ("IPO") (See Note 13), management determined that an interim triggering event occurred and that 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 as of March 31, 2008. The Company concluded that the carrying value of its goodwill was impaired as a result of the current market price and trading levels of its common stock. The Company believes the offering price was indicative of the value of the Company at March 31, 2008 and accordingly, based on those factors, the Company recorded an impairment charge to goodwill related to its Regulated Businesses of $750,000. The Company has reflected the tax effect of the impairment as a discrete item for purposes of calculating its tax provision as the charge is considered an infrequently occurring or unusual item. The impairment charge was primarily due to the market price of the Company's common stock (both the IPO price and the market price during subsequent trading) being less than what was anticipated during the Company's 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).

In developing the estimated fair value of the Company's reporting units, significant judgment was required. The Company determined the estimated fair value of the reporting units utilizing a methodology consistent with its 2007 annual test. Whenever possible, market information including the initial public offering price of the Company's common stock and subsequent trading price was used to update the Company's assumptions. The methodology utilized a combination of the trading price of the Company's common stock, an estimated control premium, trading price market multiples of peer companies (regulated water utilities) and the Company's discounted cash flow analysis based on the Company's five-year business plan, each of which has differing weights. The majority of the weighting is applied to the traded price as this represents the market objective evidence of fair value with minimal weight applied to the discounted cash flow analysis.

The following table summarizes the changes in the Company's goodwill by reporting unit:

	Regulated Unit	Non-regulated Units	Consolidated
Balance at December 31, 2007	$2,327,270	$ 129,682	$2,456,952
Impairment	(750,000)	—	(750,000)
Balance at March 31, 2008	$1,577,270	$ 129,682	$1,706,952

The Company may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in the valuation multiples of comparable water utilities, a decline over a period of time of the Company's stock price or the lack of appreciation of the Company's stock price to a level consistent with peer companies or increases in equity value. A decline in the forecasted results in the Company's business plan, such as changes in rate case results or capital investment budgets or changes in the Company's interest rates may also result in an incremental impairment charge.

As a result of the impairment RWE transferred $245,000 to the Company on May 13, 2008. This cash will be used to reduce debt.

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

Note 4: Long-Term Debt

The Company primarily incurs long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt at March 31, 2008 and December 31, 2007 were:

	Rate	Maturity Date	March 31, 2008	December 31, 2007
Long-term debt of American Water Capital Corp. ("AWCC")				
Private activity bonds and government funded debt				
Floating rate (a)	2.55%-3.20%	2018-2032	$ 86,860	$ 86,860
Senior notes				
Fixed rate	5.39%-6.87%	2011-2037	2,684,000	2,712,000
Long-term debt of other subsidiaries				
Private activity bonds and government funded debt				
Fixed rate	0%-6.88%	2009-2038	941,439	942,941
Floating rate (b)	2.40%-10.00%	2015-2032	178,145	178,145
Mortgage bonds				
Fixed rate	6.31%-9.71%	2008-2034	725,300	731,340
Senior debt				
Fixed rate	5.60%-9.10%	2008-2025	45,386	45,473
Mandatory redeemable preferred stock	4.60%-9.75%	2013-2036	24,644	24,644
Notes payable and other (c)	5.76%-11.77%	2008-2026	3,156	3,442
Long-term debt			4,688,930	4,724,845
Unamortized debt discount, net (d)			67,869	70,743
Total long-term debt			$4,756,799	$4,795,588

(a) Tax-exempt bonds which are remarketed as money market bonds 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.
(b) $169,585 of the total represents tax-exempt bonds which are sold at auction rates that are reset every 7 to 35 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. (See Note 13) The remaining $8,560 represents tax-exempt bonds remarketed as money market bonds. See (a) above.
(c) Includes capital lease obligations of $1,946 and $1,982 at March 31, 2008 and December 31, 2007, respectively.
(d) Includes fair value adjustments from acquisition purchase accounting.

The following debt was 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		0%-9.87%	2008-2034	7,879
Total retirements & redemptions				$35,879

Gains from early extinguishment of debt included in Interest, net amounted to $0 and $7,064 at March 31, 2008 and 2007, respectively.

Interest, net includes interest income of approximately $1,658 and $1,821 at March 31, 2008 and 2007, respectively.

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

Note 5: Short-Term Debt

The components of short-term debt are as follows:

	March 31, 2008	December 31, 2007
Commercial paper, net of $381 and $680 discount	$338,619	$ 169,267
Book overdraft	23,081	42,198
Other short-term debt	6,437	9,049
Total short-term debt	$368,137	$ 220,514

Note 6: Income Taxes

The Company's estimated annual effective tax rate for the three months ended March 31, 2008 is 39.1% compared to 41.1%, excluding various discrete items, for the three months ended March 31, 2007. The change is primarily attributable to the favorable impact of tax permanent income and expense items in 2008 as compared to 2007. The Company recorded an effective rate for the first quarter 2008 of (0.6%) which reflects the tax effect of the goodwill impairment as a discrete item as the Company considers this charge an infrequently occurring or unusual event.

Note 7: Employee Benefits

The following table provides the components of net periodic benefit costs:

	Three Months Ended March 31, 2008	2007
Components of net periodic pension benefit cost		
Service cost	$ 6,551	$ 6,403
Interest cost	14,549	13,322
Expected return on plan assets	(12,925)	(11,763)
Amortization of:		
Prior service cost	45	32
Actuarial loss	1	66
Periodic pension benefit cost	8,221	8,060
Special termination pension benefit charge	—	93
Net periodic pension benefit cost	$ 8,221	$ 8,153

	Three Months Ended March 31, 2008	2007
Components of net periodic other postretirement benefit cost		
Service cost	$ 3,106	$ 3,171
Interest cost	7,049	6,346
Expected return on plan assets	(5,751)	(5,266)
Amortization of:		
Transition obligation	43	43
Prior service credit	203	(295)
Actuarial loss	(295)	—
Net periodic other postretirement benefit cost	$ 4,355	$ 3,999

The Company contributed $23,000 to its defined benefit pension plan in the first three months of 2008 and expects to contribute $53,000 during the balance of 2008. In addition, the Company contributed $6,838 for the funding of its other postretirement plans in the first three months of 2008 and expects to contribute $20,514 during the balance of 2008.

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

Note 8: 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 has agreed to provide a limited twelve month warranty relating to certain components of the facilities that OMI/TW constructed (the "WW39 Plant"), 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 design defects in the WW39 Plant. Also, 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, the Company has a loss reserve of approximately $4,000 at March 31, 2008 and December 31, 2007.

In 2007, the Company, through a subsidiary and an indirect 50% owned joint venture, completed construction of two water filtration plants for total construction costs of approximately $229,000 and $32,000, respectively. As part of the general contractual terms of the construction contracts, the Company provides a one-year construction warranty period. As of March 31, 2008, no claims have been made related to these warranties.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At March 31, 2008, the Company had accrued approximately $5,000 as probable losses and it is reasonably possible that additional losses could range up to $31,000 for these matters. For certain matters, the Company is unable to estimate any 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.

Note 9: Guarantees

A subsidiary holds a 50% interest in American Water-Pridesa LLC ("AW-Pridesa"), a Delaware limited liability company. Acciona Agua Corporation also holds a 50% interest. AW-Pridesa has contracted with Tampa Bay Water ("Tampa Bay"), an interlocal governmental agency of the State of Florida, to remedy and operate the Tampa Bay Seawater Desalination Plant. The Company entered into a guarantee with Tampa Bay in November 2004 for the full and prompt performance of certain contractual obligations limited to a total aggregate liability of $35,000. Contractual obligations call for certain construction activities and management services to be completed satisfactorily. AW-Pridesa took over operation of the plant in January 2005. At December 31, 2007, the plant was fully operational and successful performance testing of the construction activities had been completed.

The Company provides financial guarantees or deposits to ensure performance of certain of its obligations on its non-regulated military agreements and Operations & Maintenance agreements. These guarantees and deposits totaled $474,727 and $475,278 at March 31, 2008 and December 31, 2007, respectively.

Note 10: Environmental Matters

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. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to approximately $11,000 at March 31, 2008 and December 31, 2007. At March 31, 2008, $10,100 of the reserve relates to a conservation agreement entered

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

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.

Note 11: Stockholder's Equity and Net Income (Loss) per Common Share

Basic net income (loss) per common share, income (loss) from continuing operations per common share and income (loss) from discontinued operations, net of tax per common share are based on the weighted average number of common shares outstanding. Diluted net income (loss) per common share, income (loss) from continuing operations per common share and income (loss) from discontinued operations, net of tax per common share are based on the weighted average number of common shares outstanding and potentially dilutive shares. The Company had no potentially dilutive shares at March 31, 2008 or December 31, 2007. All common shares at March 31, 2008 and December 31, 2007 were held by a wholly-owned subsidiary of RWE. (See Note 13)

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 March 31, 2008 there are no shares outstanding.

Note 12: 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.

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

The following table includes the Company's summarized segment information:

	As of or for the Three Months Ended March 31, 2008			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 449,534	$ 61,172	$ (3,891)	$ 506,815
Depreciation and amortization	60,292	1,408	2,216	63,916
Impairment charges	—	—	750,000	750,000
Total operating expenses, net	378,215	57,525	741,433	1,177,173
Adjusted EBIT (1)	71,900	4,582		
Total assets	10,238,503	269,265	1,760,236	12,268,004
Capital expenditures	187,655	782	—	188,437

	As of or for the Three Months Ended March 31, 2007			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 419,276	$ 53,301	$ (4,033)	$ 468,544
Depreciation and amortization	61,571	2,653	403	64,627
Impairment charges	—	—	—	—
Total operating expenses, net	351,191	50,771	(6,736)	395,226
Adjusted EBIT (1)	69,114	3,701		
Total assets	9,549,539	284,419	3,290,563	13,124,521
Capital expenditures	165,146	969	—	166,115

(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.

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

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

	For the Three Months Ended March 31, 2008		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 71,900	$ 4,582	$ 76,482
Add:			
Allowance for other funds used during construction	2,541	—	2,541
Allowance for borrowed funds used during construction	1,368	—	1,368
Less:			
Interest, net	(56,736)	636	(56,100)
Preferred dividends of subsidiaries	(56)	—	(56)
Amortization of debt expense	(1,318)	—	(1,318)
Segments' income from continuing operations before income taxes	$ 17,699	$ 5,218	22,917
Impairment charges			(750,000)
Interest, net			(13,868)
Other			4,365
Loss from continuing operations before income taxes			$(736,586)

	For the Three Months Ended March 31, 2007		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 69,114	$ 3,701	$ 72,815
Add:			
Allowance for other funds used during construction	1,658	—	1,658
Allowance for borrowed funds used during construction	1,093	—	1,093
Less:			
Interest, net	(54,390)	(3,096)	(57,486)
Preferred dividends of subsidiaries	(56)	—	(56)
Amortization of debt expense	(1,219)	—	(1,219)
Segments' income from continuing operations before income taxes	$ 16,200	$ 605	16,805
Interest, net			(14,721)
Other			2,075
Income from continuing operations before income taxes			$ 4,159

Note 13: Subsequent Events

On April 28, 2008, the Company completed the initial public offering of its common stock ("IPO"). RWE Aqua Holdings GmbH, the Company's selling stockholder, sold 58,000 shares of its common stock at a price of $21.50 per share. 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. The Company did not receive any proceeds from the sale of shares. Prior to the IPO, the Company was a wholly-owned subsidiary of RWE. After the IPO, and assuming no exercise of the underwriters' option, RWE owns approximately 64% of the Company's common shares (or approximately 58% if the underwriters' option to purchase additional shares is exercised in full).

On April 22, 2008, 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 unvested stock options. The awards were issued to the Company's employees and certain non-employee directors under its 2007 Omnibus Equity Compensation Plan.

In April and May 2008, the Company redeemed $144,725 of long-term auction rate debt of subsidiaries with interest rates ranging from 6.48% to 10.00% and maturities ranging from 2021 to 2032. These redemptions were financed through the issuance of additional commercial paper.

In May 2008, AWCC plans to issue in private placements additional senior notes in the principal amounts of $110,000 at 6.25% due in 2018 and $90,000 at 6.55% due in 2023. The Company intends to use the proceeds to repay outstanding short-term indebtedness of AWCC.

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American Water Works Company, Inc. and Subsidiary Companies
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On May 12, 2008, the Company commenced an offer to exchange $750,000 principal amount of its 6.085% Senior Notes due in 2017 and $750,000 principal amount of its 6.593% Senior Notes due in 2037 which are both registered under the Securities Act of 1933 (the "Exchange Notes") for all $750,000 of its currently outstanding 6.085% Senior Notes due in 2017 and all $750,000 of its currently outstanding 6.593% Senior Notes due in 2037, which have not been registered under the Securities Act of 1933 (the "Original Notes"). The Company will not receive any proceeds from the exchange offer, nor will the Company's debt level change as a result of the exchange offer. The terms of the Exchange Notes and the Original Notes are substantially identical in material respects.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain matters within this Quarterly Report on Form 10-Q include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as "may," "should," "will," "could," "estimates," "predicts," "potential," "continue," "anticipates," "believes," "plans," "expects," "future" and "intends" and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the "Risk Factors" section or other sections in the Company's Form 424(b)(4) prospectus filed April 24, 2008 with the Securities and Exchange Commission, as well as in Item IA of Part II of this Quarterly Report. All forward-looking statements are expressly qualified in their entirety by such risk factors. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

GENERAL

American Water Works Company, Inc. (herein referred to as "American Water" or the "Company") is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. The businesses that provide these services are generally subject to economic regulation by state regulatory agencies in the states in which they operate. We report these results in our Regulated Businesses segment. We also provide services that are not subject to regulation by the state commissions. We report these results in our Non-regulated Businesses segment. For further description of our businesses see the "Business" section found in our Form 424(b)(4) prospectus filed on April 24, 2008 with the Securities and Exchange Commission.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Prospectus filed with the SEC on April 24, 2008 and with the information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Form 424(b)(4) prospectus filed with the Securities and Exchange Commission on April 24, 2008.

OVERVIEW

Financial Results. American Water had net loss of $732.5 million for the first quarter of 2008, compared to net income of $2.7 million for the first quarter of 2007. Loss from continuing operations was $732.5 million for the first quarter of 2008, compared to income from continuing operations of $2.4 million for the first quarter of 2007. Revenues for the first quarter of 2008 increased by $38.3 million compared to the same period in the prior year primarily due to increased revenues in our Regulated Businesses of $30.3 million which is largely attributable to rate increases and higher revenues in our Non-regulated Businesses of $7.9 million. Offsetting the increased revenues were $781.9 million higher operating expenses for the three months ended March 31, 2008. These expenses primarily resulted from the impairment charge of $750.0 million which is discussed below, increased expenses in our Regulated Businesses of $27.0 million in first quarter of 2008 compared to 2007, mainly driven by higher employee related costs due to an increase in the number of employees, as well as higher wages and benefits and increased operating expenses in our Non-regulated Businesses of $6.8 million which corresponds with their increased revenues.

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Other items affecting income from continuing operations for the three months ended March 31, 2008 as compared to the same period in the prior year include lower interest expense of $2.2 million, as a result of the repayment of outstanding debt, and lower income tax expense of $5.8 million.

Financing Activities. During the three months ended March 31, 2008, we met our capital resource requirements primarily with internally generated cash as well as funds from external sources, primarily commercial paper.

Regulatory Developments. In the first three months of 2008 we received authorizations for additional annualized revenues from general rate cases of $26.0 million, assuming constant sales volumes. As of March 31, 2008 we were awaiting final orders for one general rate case that was filed in 2006, requesting $7.0 million in total additional annual revenues and five general cases that were filed in 2007, requesting $58.2 million in total additional annual revenues. We filed general rate cases in five additional states in the first quarter of 2008 that would provide $231.1 million of additional revenues, if approved as filed. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted.

Initial Public Offering. On April 28, 2008, the Company completed its initial public offering ("IPO"). RWE Aqua Holdings GmbH, the Company's selling stockholder, sold 58.0 million shares of the Company's common stock at a price of $21.50 per share. The selling stockholder granted the underwriters a 30 day option to purchase up to an additional 8.7 million shares of the Company's stock at a price of $21.50. The Company did not receive any proceeds from the sale of shares. Prior to the IPO, the Company was a wholly-owned subsidiary of RWE. After the IPO, and assuming no exercise of the underwriters' option, RWE owns approximately 64% of the Company's common shares (or approximately 58% if the underwriters' option to purchase additional shares is exercised in full).

On April 22, 2008, RWE contributed approximately 89.9 thousand shares of the Company's common stock to the Company and the Company granted approximately 89.9 thousand restricted stock awards, 269.3 thousand restricted stock units and 2.1 million unvested stock options. The awards were issued to the Company's employees and certain non-employee directors under our 2007 Omnibus Equity Compensation Plan.

Impairment Charge. As previously disclosed in our free writing and final prospectuses, filed April 22, 2008 and April 24, 2008, respectively, the Company determined that it was reasonably likely based in large part on an initial public offering price of our common stock of $21.50, that the current carrying value of our goodwill which the Company recorded as a result of the 2003 acquisition of American Water by RWE and acquisition of E'Town Corporation in 2001, was impaired. At the time the Company's initial public offering price of $21.50 was established, we were unable to determine if there was any goodwill impairment or to provide a reliable estimate of the amount of any goodwill impairment, if any.

In light of the initial public offering price and trading levels in our stock since the date of IPO, we performed an interim impairment test and on May 9, 2008, we concluded that the current carrying value of our goodwill was impaired as a result of the current market price and trading levels of our common stock. We believe the offering price was indicative of the value of the Company at March 31, 2008 and accordingly, based on those factors, we recorded an impairment charge to goodwill related to our Regulated Businesses of $750.0 million in our financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less than what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of our debt (due to increased market interest rates).

In developing our estimated fair value of the Company's reporting units, significant judgment was required. We determined the estimated fair value of the reporting units utilizing a methodology consistent with its 2007 annual test. Whenever possible, market information including the initial public offering price of the Company's common stock and subsequent trading price was used to update our modeling assumptions. Our methodology utilized a combination of the trading price of the Company's common stock, an estimated control premium, trading price market multiples of peer companies (regulated water utilities) and the Company's discounted cash flow analysis based on our five-year business plan were used, each of which has differing weights. The majority of the weighting is applied to the traded price as this represents the market objective evidence of fair value with minimal weight applied to the discounted cash flow analysis.

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We may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in valuation multiples of comparable water utilities, a decline over a period of time of the Company's stock price or the lack of appreciation of the Company's stock price to a level consistent with peer companies or increases in equity value. 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, may also result in an incremental impairment charge. Further recognition of impairments of a significant portion of goodwill would negatively affect our results of operations and total capitalization, the effect of which could be material and could make it more difficult for us to secure financing on attractive terms and maintain compliance with our debt covenants.

As a result of the impairment, RWE transferred $245.0 million on May 13, 2008. This cash will be used to reduce debt.

Results of Operations

Three Months Ended March 31, 2008 Compared To Three Months Ended March 31, 2007

(Dollars in thousands)	For the three months ended March 31, 2008 (unaudited)	2007 (unaudited)	Favorable (Unfavorable) Change
Operating revenues	$ 506,815	$468,544	$ 38,271
Operating expenses			
Operation and maintenance	311,261	282,613	(28,648)
Depreciation and amortization	63,916	64,627	711
General taxes	52,066	47,880	(4,186)
(Gain) loss on sale of assets	(70)	106	176
Impairment charge	750,000	—	(750,000)
Total operating expenses, net	1,177,173	395,226	(781,947)
Operating (loss) income	(670,358)	73,318	(743,676)
Other income (deductions)			
Interest, net	(69,968)	(72,207)	2,239
Allowance for other funds used during construction	2,541	1,658	883
Allowance for borrowed funds used during construction	1,368	1,093	275
Amortization of debt expense	(1,318)	(1,219)	(99)
Preferred dividends of subsidiaries	(56)	(56)	—
Other, net	1,205	1,572	(367)
Total other income (deductions)	(66,228)	(69,159)	2,931
Income (loss) from continuing operations before income taxes	(736,586)	4,159	(740,745)
Provision for income taxes	(4,102)	1,730	5,832
Income (loss) from continuing operations	(732,484)	2,429	(734,913)
Income (loss) from discontinued operations, net of tax	—	256	(256)
Net income (loss)	$ (732,484)	$ 2,685	$ (735,169)

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The following table summarizes certain financial information for our Regulated and Non-regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

	For the three months ended March 31,			
	2008		2007	
	Regulated Businesses	Non-regulated Businesses	Regulated Businesses	Non-regulated Businesses
	(In thousands)			
Operating revenues	$449,534	$ 61,172	$419,276	$ 53,301
Adjusted EBIT [1]	$ 71,900	$ 4,582	$ 69,114	$ 3,701

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. 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 the 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.

Operating revenues Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues (assuming constant sales volumes) resulting from rate authorizations, including infrastructure charges, which were granted and became effective in 2008.

	Annualized Rate Increases Granted (*) (In millions)
State	
New York	$ 4.6
Iowa	4.3
Arizona	2.4
West Virginia	14.5
Illinois	1.1
Other	0.2
Total	$ 27.1

(*) Includes infrastructure charges

Operating revenues increased by $38.3 million, or 8.2% for the three months ended March 31, 2008 compared to the three months ended March 31, 2007. Regulated Businesses revenues increased by $30.3 million, or 7.2% for the three months ended March 31, 2008 compared to the same period in the prior year. The Non-regulated Businesses' revenues for the three months ended March 31, 2008 increased by $7.9 million, or 14.8% compared to the three months ended March 31, 2007.

The increase in the Regulated Businesses revenues for the three months ended March 31, 2008 compared to the three months ended March 31, 2007 was primarily due to rate increases obtained through general rate cases in New Jersey, Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $33.0 million. This increase was offset by a $4.7 million decrease in revenues related to customer consumption, mainly in our states in the Western region of the United States, for the three months ended March 31, 2008 compared to the same period in the prior year.

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The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

	For the three months ended March 31,			
	Operating Revenues		Water Sales Volume	
Customer Class	2008	2007	2008	2007
Water service:				
Residential	57.2%	57.4%	51.7%	52.0%
Commercial	18.4%	18.8%	21.8%	21.7%
Industrial	5.3%	5.3%	10.9%	11.4%
Public and other	12.9%	12.9%	15.6%	14.9%
Other water revenues	2.0%	1.2%	—	—
Total water revenues	95.8%	95.6%	100.0%	100.0%
Wastewater service	4.2%	4.4%		
	100.0%	100.0%		

Water Services - Water service operating revenues from residential customers for the three months ended March 31, 2008 totaled $257.2 million, a $16.6 million increase, or 6.9%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 2.4% for the three months ended March 31, 2008 to 45.2 billion gallons, from 46.3 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California.

Water service operating revenues from commercial water customers for the three months ended March 31, 2008 increased by $4.2 million, or 5.4%, to $82.9 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2007. The volume of water sold to commercial customers decreased by 3.1% for the three months ended March 31, 2008, to 18.9 billion gallons, from 19.5 billion gallons for the three months ended March 31, 2007.

Water service operating revenues from industrial customers totaled $23.8 million for the three months ended March 31, 2008, an increase of $1.5 million, or 6.7%, over those recorded for the same period of 2007 mainly due to rate increases and increased sales volume. The volume of water sold to industrial customers totaled 9.9 billion gallons in the three months ended March 31, 2008, an increase of 1.0% over the 9.8 billion gallons for the three months ended March 31, 2007.

Water service operating revenues from public and other customers increased $3.8 million, or 7.0%, for the three months ended March 31, 2008 to $57.8 million from $54.1 million for the three months ended March 31, 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $25.7 million for the three months ended March 31, 2008, an increase of $1.1 million over the same period of 2007. Revenues generated by sales to governmental entities and resale customers for the three months ended March 31, 2008 totaled $32.2 million, an increase of $2.7 million from the three months ended March 31, 2007.

Wastewater services - Our subsidiaries provide wastewater services in 11 states. Revenues from these services increased by $0.2 million, or 1.1%, to $18.8 million for the three months ended March 31, 2008, from $18.6 million for the same period of 2007. The increase was attributable to increases in rates charged to customers in states where we have wastewater operations (principally Arizona, Hawaii, and New Jersey).

Non-regulated Businesses operating revenues increased by $7.9 million, or 14.8% for the three months ended March 31, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $8.7 million in our Contract Operations Group and $1.7 million in our Homeowner Services Group, partially offset by decreased revenues of $3.0 million in our Applied Water Group. The increase in Contract Operations Group revenues was primarily due to both new contracts and incremental revenues associated with design and build contracts, as well as increased military project revenues. The increase from our Homeowner Service Group represented expansion into new geographic markets. Applied Water Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

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Operation and maintenance. Operation and maintenance expense increased $28.6 million, or 10.1%, for the three months ended March 31, 2008 compared to the same period in the prior year.

Operation and maintenance expenses for the three months ended March 31, 2008 and 2007, by major expense category, were as follows:

	For the three months ended March 31,	
	2008	2007
	(In thousands)	
Production costs	$ 64,228	$ 61,144
Employee-related costs	126,833	109,767
Operating supplies and services	69,495	63,809
Maintenance materials and services	34,947	30,149
Customer billing and accounting	7,410	8,269
Other	8,348	9,475
Total	$ 311,261	$ 282,613

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by $3.1 million, or 5.0%, for the three months ended March 31, 2008 compared to the same period in 2007. The increase was primarily the result of increased costs in our Regulated Businesses of $2.7 million. Fuel and power costs were higher by $1.6 million which can be attributed to increases in electricity prices. Chemical costs also increased by $0.5 million primarily due to rising chemical costs and waste disposal costs were also higher by $0.6 million.

Employee-related costs including wage and salary, group insurance, and pension expense increased $17.1 million or 15.5%, for the three months ended March 31, 2008 compared to the same period in the prior year. These costs represented 40.7% and 38.8% of operation and maintenance expenses for the three months ended March 31, 2008 and 2007, respectively. The increase was due to higher wage and salary expenses of $10.2 million and $2.2 million in our Regulated and Non-regulated Businesses, respectively, primarily resulting from an increase in the number of employees and wage rate increases. In addition, our Regulated Businesses' pension expense increased by 33.9% for the three months ended March 31, 2008 compared to the same period in the prior year. Pension expense in excess of the amount contributed to the pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" (SFAS 87) remained relatively unchanged, pension expense increased for the three months ended March 31, 2008 due to increased contributions in certain of our regulated operating companies whose costs are recovered based on the Company's funding, rather than the SFAS 87 expense.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the three months ended March 31, 2008, these costs increased by $5.7 million or 8.9%, compared to the same period in 2007. Factors contributing to this increase include an overall increase in general office costs of $1.0 million mainly due to inflation, higher legal costs of $0.7 million in one of our operating companies in the Midwest region of the United States due to eminent domain proceedings, increased materials and supplies of $0.5 million and higher fuel and other transportation costs of $0.5 million. Partially offsetting these increases was a decrease of $1.8 million in remediation costs in connection with the Sarbanes-Oxley Act. Corresponding with the increase in revenues, the Non-regulated Businesses operating supplies and service expenses increased by $2.7 million for the three months ended March 31, 2008 compared to the same period in the prior year. The increase is mainly attributable to additional expense in the Contract Operations group associated with several operating contracts (including a design, build and operate project in Fillmore, California), partially offset by lower contracted services costs in the Applied Water Management Group due to the downturn in new home construction.

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Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased $4.8 million or by 15.9%, for the three months ended March 31, 2008 compared to the same period in the prior year. Regulated Businesses' maintenance materials and service costs increased by $4.4 million in the first quarter of 2008 due to costs of $2.8 million associated with a project in Illinois to maintain valves and higher cost of removal expenses in certain of our operating companies. These increases were offset by lower main break costs in 2008 compared to higher than normal main breaks in a number of our operating companies due to winter weather conditions in the first quarter of 2007.

Customer billing and accounting expenses decreased by $0.9 million or 10.4%, for the three months ended March 31, 2008 compared to the same period in the prior year. The decrease was the result of lower uncollectible accounts expense by our regulated subsidiaries as a result of an increased focus on collection of past due accounts.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by $1.1 million or 11.9%, in 2008 primarily due to decreased insurance costs of $0.7 million for the three months ended March 31, 2008 due to more favorable claims experience compared to the three months ended March 31, 2007, as well as decreased regulatory expenses of $0.4 million.

Depreciation and amortization. Depreciation and amortization expense decreased by $0.7 million, or 1.1%, for the three months ended March 31, 2008 compared to the same period in the prior year. This decrease was primarily due to depreciation rate adjustments, particularly in our Pennsylvania subsidiary offset by increased expense due to additional utility plant placed in service.

General taxes. General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by $4.2 million, or 8.7%, in the first quarter of 2008 compared to the first quarter of 2007. This increase is primarily due to increased gross receipts taxes of $1.9 million in New Jersey and higher property taxes expense in Ohio of $1.4 million.

(Gain) loss on sale of assets. Our gain on sale of assets was $0.1 million for the three months ended March 31, 2008 compared to a loss of $0.1 million for the three months ended March 31, 2007 due to non-recurring sales of assets not needed in our utility operations.

Impairment charge. Our impairment charge was $750.0 million for the three months ended March 31, 2008. The first quarter 2008 impairment charge was primarily due 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 what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased interest rates). There was no impairment charge for the three months ended March 31, 2007.

Other income (deductions). Interest, the primary component of our other income (deductions), decreased by $2.2 million, or 3.1% for the three months ended March 31, 2008 compared to the same period in the prior year. The decline is primarily due to the repayment of outstanding debt with the 2007 equity contributions from RWE that were made to establish a capital structure that is consistent with other regulated utilities and also to meet the capital structure expectations of various state regulatory commissions.

Provision for income taxes. Our consolidated provision for income taxes decreased $5.8 million or 337.1%, to a tax benefit of $4.1 million for the three months ended March 31, 2008 from a tax expense of $1.7 million for the three months ended March 31, 2007. The Company recorded an effective tax rate for the first quarter 2008 of (0.6%) which reflects the tax effect of the goodwill impairment as a discrete item as we consider this charge an infrequently occurring or unusual event.

Net income (loss). Net income decreased $735.2 million, to a net loss of $(732.5) million for the three months ended March 31, 2008 from net income of $2.7 million for the three months ended March 31, 2007. The decrease is the result of the aforementioned changes.

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Liquidity and Capital Resources

Our business is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary we obtain funds from external sources in the capital markets and through bank borrowings. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to support our commercial paper programs and to issue letters of credit. See the “Credit Facilities and Short-Term Debt” section below for further discussion.

In addition, our regulated utility subsidiaries 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, which vary according to state regulations, as new customers begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from rate base. Generally, we depreciate contributed property and amortize contributions at the composite rate of the related property. Some of our subsidiaries do not depreciate contributed property, based on regulatory guidelines.

We use capital resources, including cash, to fund capital requirements, including construction expenditures, pay off maturing debt, pay dividends, fund pension and postretirement welfare obligations and invest in new and existing businesses. We spend a significant amount of cash on construction projects that have a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. As a result of these factors, our working capital, defined as current assets less current liabilities, was in a net deficit position at March 31, 2008.

We expect to fund future maturities of long-term debt through a combination of external debt and cash flow from operations. We have no plans to reduce debt significantly.

Cash Flows from Operating Activities

Cash flows from operating activities primarily result from the sale of water and wastewater services and due to the seasonality of operations are weighted toward the third quarter of each fiscal year. Our future cash flows from operating activities will be affected by changes in the rate regulatory environments; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; declining per customer usage of water; and weather and seasonality. Cash flows from operating activities for the three months ended March 31, 2008 were $85.4 million compared to $54.2 million for the three months ended March 31, 2007.

The following table provides a summary of the major items affecting our cash flows from operating activities for the three months ended March 31, 2008 and 2007:

	For the three months ended March 31,	
	2008	**2007**
	(In thousands)	
Net income (loss)	$(732,484)	$ 2,685
Add (subtract):		
Non-cash operating activities (1)	826,569	81,890
Changes in working capital (2)	21,144	(4,911)
Pension and postretirement healthcare contributions	(29,838)	(25,453)
Net cash flows provided by operations	$ 85,391	$ 54,211

(1) Includes depreciation and amortization, impairment charges, removal costs net of salvage, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, (gain) loss on sale of assets, and other non-cash items, net less pension and postretirement healthcare contributions.

(2) Changes in working capital include changes to accounts receivable and unbilled utility revenue, taxes receivable (including federal income), other current assets, accounts payable, taxes accrued (including federal income), interest accrued and other current liabilities.

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Cash Flows from Investing Activities

Cash flows used in investing activities for the three months ended March 31, 2008 and 2007 were $187.7 million and $165.2 million, respectively. Construction expenditures increased $22.3 million to $188.4 million for the three months ended March 31, 2008 from $166.1 million for the three months ended March 31, 2007 as a result of continuing to increase our investment in regulated utility plant projects. Construction expenditures for the periods noted above included customer advances and contributions for construction (net of refunds) of ($13.7) million and $13.1 million for the three months ended March 31, 2008 and 2007, respectively.

Our construction program consists of both infrastructure renewal programs, where we replace infrastructure, as needed, and construction of facilities to meet new customer growth. Also, an integral aspect of our strategy is to seek growth through tuck-ins and other acquisitions which are complementary to our existing business and support the continued geographical diversification and growth of our operations. Generally, acquisitions will be funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

Included in the 2008 planned construction expenditures is an amount to construct a new water treatment plant on the Kentucky River of approximately $26 million. On April 25, 2008, the Kentucky Public Service Commission approved Kentucky American Water's application for a certificate of convenience and necessity to construct a 20.0 to 25.0 million gallon per day treatment plant on the Kentucky River and a 30.6 mile pipeline to meet Central Kentucky's water supply deficit. The Kentucky project is expected to be completed by 2010 with an estimated cost of between $162 million and $168 million.

On December 21, 2007, New Jersey-American Water, our subsidiary, signed an agreement with the City of Trenton, New Jersey to purchase the assets of the city's water system located in Ewing, Hamilton, Hopewell and Lawrence townships for $100.0 million. The agreement was approved by the Trenton City Council but requires approval by various regulatory agencies, including the New Jersey Board of Public Utilities. We can provide no assurances that the agreement will be approved.

Cash Flows from Financing Activities

Our financing activities include the issuance of long-term and short-term debt, primarily through our wholly-owned financing subsidiary, American Water Capital Corp. ("AWCC"). In addition, we have received capital contributions from RWE and intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in our registration right agreement with RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of ($13.7) million and $13.1 million for the three months ended March 31, 2008 and 2007, respectively. In connection with the RWE divestiture, we have made and will continue to make significant changes to our capital structure through debt refinancing and equity offerings.

The following long-term debt was retired through optional redemption or payment at maturity during the first quarter of 2008:

Company	Type	Interest Rate	Maturity	Amount (In Thousands)
American Water Capital Corp.	Senior notes-fixed rate	6.87%	2011	$ 28,000
Other subsidiaries		0%-9.87%	2008-2034	7,879
Total retirements & redemptions				$ 35,879

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In April and May 2008, the Company redeemed $144.7 million of long-term auction rate debt of subsidiaries with interest rates ranging from 6.48 % to 10.00% and maturities ranging from 2021 to 2032. These redemptions were financed through the issuance of additional commercial paper.

In May 2008, AWCC plans to issue in private placements additional Senior Notes in the principal amount of $110.0 million at 6.25% due in 2018 and $90.0 million at 6.55% due in 2023. The Company intends to use the proceeds to repay outstanding short-term indebtedness of AWCC.

On May 12, 2008, the Company commenced an offer to exchange $750,000 principal amount of its 6.085% Senior Notes due in 2017 and $750,000 principal amount of its 6.593% Senior Notes due in 2037 which are both registered under the Securities Act of 1933 (the "Exchange Notes") for all $750,000 of its currently outstanding 6.085% Senior Notes due in 2017 and all $750,000 of its currently outstanding 6.593% Senior Notes due in 2037, which have not been registered under the Securities Act of 1933 (the "Original Notes"). The Company will not receive any proceeds from the exchange offer, nor will the Company's debt level change as a result of the exchange offer. The terms of the Exchange Notes and the Original Notes are substantially identical in all material respects.

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 sheet.

Dividends. There were no dividend payments made for the three months ended March 31, 2008 or 2007. Our board of directors has adopted a dividend policy, effective upon the consummation of the IPO, to distribute to our stockholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Our policy will be to distribute 50% to 70% of our annual net income.

Contributions from RWE. There were no contributions from RWE for the three months ended March 31, 2008. Contributions from RWE were $650.0 million for the three months ended March 31, 2007.

As a result of the impairment charges recorded for the three months ended March 31, 2008, RWE transferred $245.0 million on May 13, 2008. This cash will be used to reduce debt.

Credit Facilities and Short Term Debt

The components of short-term debt were as follows:

	March 31,2008 (In Thousands)
Commercial paper	$ 338,619
Book overdraft	23,081
Other short-term debt	6,437
Total short-term debt	$ 368,137

Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to support our commercial paper programs and to issue letters of credit.

AWCC has entered into a one-year $10.0 million committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2008 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 25 basis points. As of March 31, 2008, $6.4 million was outstanding under this revolving line of credit.

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On September 15, 2006, AWCC entered into an $800.0 million unsecured revolving credit facility syndicated among a group of ten banks. This revolving credit facility, which terminates on September 15, 2012 unless extended, is principally used to support the $700 million commercial paper program at AWCC and to provide up to $150.0 million in letters of credit. AWCC had no loans outstanding under the net $800.0 million unsecured revolving credit facility as of March 31, 2008.

At March 31, 2008, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper.

Letter of Credit Sublimit (In thousands)	Available Capacity (In thousands)	Outstanding Commercial Paper (In thousands)
$ 150,000	$ 71,219	$ 338,619

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. As of March 31, 2008, our ratio was 0.53 and therefore we were in compliance with the ratio.

The average interest rate on commercial paper for the three months ended March 31, 2008 was approximately 4.2 %.

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 reporting covenants as of March 31, 2008.

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 March 31, 2008:

Securities	Moody’s Investors Service	Standard & Poor’s Ratings Service
Senior unsecured debt	Baa2	A–
Commercial paper	P2	A2

The Standard & Poor’s ratings on American Water and AWCC remain on CreditWatch with negative implications. Moody’s 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.

None of our 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 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 our 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.

Current Credit Market Position

The liquidity crisis that began in 2007 as a result of the collapse of the subprime mortgage market has adversely impacted global credit markets and, if it continues, could increase our cost of capital or impair our ability to access the capital markets.

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As of March 31, 2008, the Company had issued $169.6 million of auction rate tax-exempt long-term debt (including $24.9 million of variable rate demand bonds, which are periodically repriced to reflect auction rates) that are insured by AAA-rated insurers Ambac Assurance Corporation and MBIA Insurance Corporation. Due to the exposure that these bond insurers have in connection with recent developments in the subprime credit market, rating agencies have put these insurers on review for possible downgrade. Fitch has lowered the credit rating of Ambac Assurance Corporation from AAA to AA. While these debt instruments are long-term in nature, and only the variable rate demand bonds can be put back to the Company prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In late February 2008, the Company began to experience failed auctions for a portion of these instruments, which had interest rates of 3.65% to 4.90% as of December 31, 2007. When a failed auction occurs on a series of this debt, the Company is required to begin paying a failed-auction rate on the instruments. The failed auction interest rate for the majority of the auction rate debt is 10%. Payment of the failed-auction rate interest rates will continue until the Company is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. In April and May 2008, the Company redeemed $144.7 million of long-term auction rate debt of subsidiaries with interest rates ranging from 6.48 % to 10.00% and maturities ranging from 2021 to 2032.

At this time, the Company does not believe recent market developments significantly impact its ability to obtain financing and expects to have access to liquidity in the capital markets on favorable terms. In addition, the Company has access to unsecured revolving credit facilities, which are not as dependent upon general market conditions, with aggregate bank commitments of $810 million, of which a portion is currently committed primarily to backstop the Company’s commercial paper program and letters of credit.

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 March 31, 2008 a hypothetical 10% increase in interest rates associated with variable rate debt would result in $1.1 million decrease in our pre-tax earnings. Our risks associated with price increase for chemicals, electricity and other commodities are reduced through long-term contracts and the ability to recover price increases through rates.

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.

Application of Critical Accounting Policies and Estimates

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates,” in our Form 424(b)(4) prospectus filed on April 24, 2008 with the Securities and Exchange Commission for a discussion of the critical accounting policies.

Recent Accounting Pronouncements

See Part I, Item 1 *Financial Statements (Unaudited)- Note 2- New Accounting Pronouncements* in this Quarterly Report on Form 10-Q for a discussion of new accounting standards recently adopted or pending adoption.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. For further discussion of market risks see "Market Risk" in Part I, Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934, as amended ("Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the Commission's rules and forms and that such information is accumulated and communicated to the Company's management including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company's management evaluated the effectiveness of the design and operation of disclosure controls and procedures pursuant to Rule 13a-15(b) of the Exchange Act. This evaluation was done under the supervision and with the participation of management, including our President and Chief Executive Officer and our Chief Financial Officer.

Based on this evaluation and because of the material weaknesses described below, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of March 31, 2008. Notwithstanding these material weaknesses, management concluded that the financial statements included in this Form 10-Q for the period ended March 31, 2008 fairly present in all material respects their financial position, results of operations and cash flows for the periods presented in conformity with GAAP.

Material Weaknesses in Internal Control over Financial Reporting

A material weakness is a control deficiency or a combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 to April 28, 2008, we were an indirect wholly-owned subsidiary of RWE and, as a privately owned company, were not required to maintain a system of internal control consistent with the requirements of the SEC and the Sarbanes-Oxley Act, or to prepare our own financial statements. As a public reporting company, we will be required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting.

In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants identified the following material weaknesses in our internal control over financial reporting:

- Inadequate internal staffing and skills;
- Inadequate controls over financial reporting processes;
- Inadequate controls over month-end closing processes, including account reconciliations;
- Inadequate controls over maintenance of contracts and agreements;
- Inadequate controls over segregation of duties and restriction of access to key accounting applications; and
- Inadequate controls over tax accounting and accruals.

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Remediation of Material Weaknesses

Since joining the Company in 2006, Donald L. Correll, our Chief Executive Officer, and Ellen C. Wolf, our Chief Financial Officer, have assigned a high priority to the evaluation and remediation of our internal controls, and have taken numerous steps to remediate these material weaknesses and to evaluate and strengthen our other internal controls over financial reporting. Some of the actions taken include:

- Increasing our internal financial staff numbers and skill levels, and using external resources to
- supplement our internal staff when necessary;
- Implementing detailed processes and procedures related to our period end financial closing processes,
- key accounting applications and our financial reporting processes;
- Implementing or enhancing systems used in the financial reporting processes and month-end close processes;
- Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;
- Enhancing our internal audit staff;
- Hiring a director of internal control and a director of taxes;
- Implementing a tracking mechanism and new policy and procedure for approval of all contracts and agreements; and
- Retaining a nationally recognized accounting and auditing firm to assist management in developing policies and procedures surrounding internal controls over financial reporting, to evaluate and test these internal controls and to assist in the remediation of internal control deficiencies.

With respect to the material weaknesses described above, we have initiated a process to clearly delineate our control weaknesses and formulated a remediation plan. We believe that we have made significant progress in remediating several of the identified material weaknesses; however, as our testing procedures have not yet been completed, we can make no assurances as to the success of our remediation efforts. As of March 31, 2008, the Company had incurred $54.9 million to remediate these material weaknesses and to document and test key financial reporting controls. We will need to allocate additional resources to enhance the quality of our staff and to carry out the remediation of these material weaknesses. Based upon our current assessment, we expect to complete the remediation of these material weaknesses during 2008 with an estimated additional cost of approximately $3.4 million. The Company cannot indicate with certainty that the material weaknesses will be remediated or what additional costs may be incurred. The Company needs to initiate additional controls and test the effectiveness of controls prior to concluding controls are effective. As a condition to state Public Utility Commissions' approval of the RWE Divestiture, we agreed that costs incurred in connection with our initial internal control and remediation initiatives would not be recoverable in rates charged to our customers. Elements of our remediation activities can only be accomplished over time, and our initiatives provide no assurances that they will result in an effective internal control environment. Our board of directors, in coordination with our audit committee, will continually assess the progress and sufficiency of these initiatives and make adjustments, as necessary.

The Company believes the additional control procedures as designed, when implemented, will fully remediate the above material weaknesses.

Changes in Internal Control Over Financial Reporting

Except as described above, there were no changes in internal control over financial reporting during the quarter ended March 31, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Previously reported under "Business – Legal Proceedings" in the Company's Form 424(b)(4) prospectus filed April 24, 2008.

ITEM 1A. RISK FACTORS

There have been no material changes from risk factors previously disclosed in "Risk Factors" in the Company's Form 424(b)(4) prospectus filed April 24, 2008, other than as described below.

We have recorded a significant amount of goodwill, and we may never realize the full value of our intangible assets causing us to record impairments that may negatively affect our results of operations.

Our total assets include substantial goodwill. At March 31, 2008, our goodwill totaled $1,707.0 million. The goodwill is associated primarily with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E'Town Corporation in 2001. Goodwill represents the excess of the purchase price the purchaser paid over the fair value of the net tangible and intangible assets acquired. Goodwill is recorded at fair value on the date of an acquisition and, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," or SFAS No. 142, 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 and interim reviews are performed when management determines that a triggering event has occurred. We have been required to reflect, as required by SFAS No. 142 and other applicable accounting rules, a non-cash charge to operating results for goodwill impairment in the amounts of $396.3 million, $227.8 million, and $509.3 million for the years ended December 31, 2005, 2006 and 2007, respectively. These amounts include impairments relating to discontinued operations. Also, for the three months ended March 31, 2008 we recorded a goodwill impairment in the amount of $750.0 million.

Our annual goodwill impairment test is conducted during the fourth quarter. We have processes to monitor for interim triggering events. During the third quarter of 2007 management determined that it was appropriate to update its valuation analysis as a result of our debt being placed on review for a possible downgrade and the anticipated sale of a portion of the Company in the IPO. As a result of that update, we recorded an impairment charge to goodwill of our Regulated Businesses in the amount of $243.3 million in the third quarter of 2007. That decline in the value of our goodwill 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.

When we completed our annual goodwill impairment test for 2007 we determined that an impairment had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, recorded an additional goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007.

In April of 2008, we determined that it was probable based in large part on the initial public offering price of our common stock of $21.50, that the current carrying value of our goodwill which the Company recorded as a result of the 2003 acquisition of American Water by RWE and acquisition of E'Town Corporation in 2001 was impaired. At the time the Company's initial public offering price of $21.50 was established, we were unable to determine if there was any goodwill impairment or to provide a reliable estimate of the amount of goodwill impairment, if any. In light of the initial public offering price and trading levels in our stock since the date of the IPO, we performed an interim impairment test and on May 9, 2008, we concluded that the current carrying value of our goodwill was impaired as a result of the current market price and trading levels of our common stock. We believe the 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 goodwill related to our Regulated Businesses in the amount of $750.0 million in our financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less

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than what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of our debt (due to increased market interest rates).

We may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in valuation multiples of comparable water utilities, a decline over a period of time of the Company's stock price or the lack of appreciation of the Company's stock price to a level consistent with peer companies or increases in equity value. 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, may also result in an incremental impairment charge. Further recognition of impairments of a significant portion of goodwill would negatively affect our results of operations and total capitalization, the effect of which could be material and could make it more difficult for us to secure financing on attractive terms and maintain compliance with our debt covenants.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
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 Registration Statement on Form S-1, File No. 333-145725, filed March 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 Registration Statement on Form S-1, File No. 333-145725, filed March 26, 2008).
10.1	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).
10.2	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).

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10.3	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).
*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.

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Signatures

Pursuant to the requirements 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.

	American Water Works Company, Inc. (Registrant)
May 14, 2007 (Date)	/s/ Donald L. Correll Donald L. Correll President and Chief Executive Officer (Principal Executive Officer)
May 14, 2007 (Date)	/s/ Ellen C. Wolf Ellen C. Wolf Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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*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.

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

(Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Donald L. Correll, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Water Works Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2008

By: /s/ Donald L. Correll
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER AND CHIEF ACCOUNTING OFFICER

(Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Ellen C. Wolf, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Water Works Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 14, 2008

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

Exhibit 32.1

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of American Water Works Company, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Donald L. Correll , President and Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Donald L. Correll
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer)

May 14, 2008

Exhibit 32.2

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of American Water Works Company, Inc. (the "Company") on Form 10-Q for the period ended March 31, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ellen C. Wolf, Senior Vice President and Chief Financial Officer, of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

May 14, 2008

AMERICAN WATER WORKS COMPANY, INC.

FORM 10-Q
(Quarterly Report)

Filed 08/12/08 for the Period Ending 06/30/08

Address	1025 LAUREL OAK ROAD VOORHEES, NJ 08043
Telephone	856-346-8200
CIK	0001410636
Symbol	AWK
SIC Code	4941 - Water Supply
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2008

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _______to ______

Commission file: number 001-34028

AMERICAN WATER WORKS COMPANY, INC.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**51-0063696** **(I.R.S. Employer Identification No.)**
1025 Laurel Oak Road, Voorhees, NJ **(Address of principal executive offices)**	**08043** **(Zip Code)**

(856) 346-8200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). ☐ Yes ☒ No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at August 12, 2008
Common Stock, $0.01 par value per share	159,960,765 shares

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AMERICAN WATER WORKS COMPANY, INC.
REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2008
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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

	(Unaudited) June 30, 2008	December 31, 2007
ASSETS		
Property, plant and equipment		
Utility plant—at original cost, net of accumulated depreciation of $2,891,826 at June 30 and $2,776,950 at December 31	$ 9,497,176	$ 9,199,909
Nonutility property, net of accumulated depreciation of $75,275 at June 30 and $67,538 at December 31	124,415	118,052
Total property, plant and equipment	9,621,591	9,317,961
Current assets		
Cash and cash equivalents	5,914	13,481
Restricted funds	1,874	3,258
Utility customer accounts receivable	158,886	147,640
Allowance for uncollectible accounts	(18,144)	(20,923)
Unbilled utility revenues	141,043	134,326
Non-regulated trade and other receivables, net	62,528	66,540
Federal income taxes receivable	23,908	23,111
Materials and supplies	31,679	27,458
Other	50,984	35,463
Total current assets	458,672	430,354
Regulatory and other long-term assets		
Regulatory assets	631,497	628,039
Restricted funds	8,983	10,252
Goodwill	1,706,675	2,456,952
Other	99,264	90,514
Total regulatory and other long-term assets	2,446,419	3,185,757
TOTAL ASSETS	$12,526,682	$12,934,072

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
(In thousands, except per share data)

	(Unaudited) June 30, 2008	December 31, 2007
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stockholders' equity	$ 4,102,902	$ 4,542,046
Preferred stock without mandatory redemption requirements	4,560	4,568
Long-term debt		
Long-term debt	4,696,260	4,674,837
Redeemable preferred stock at redemption value	24,333	24,296
Total capitalization	8,828,055	9,245,747
Current liabilities		
Short-term debt	243,418	220,514
Current portion of long-term debt	80,534	96,455
Accounts payable	137,303	168,886
Taxes accrued, including income taxes of $3,546 at June 30 and $8,086 at December 31	58,174	56,002
Interest accrued	53,720	50,867
Other	168,090	181,765
Total current liabilities	741,239	774,489
Regulatory and other long-term liabilities		
Advances for construction	656,914	655,375
Deferred income taxes	658,481	638,918
Deferred investment tax credits	34,553	35,361
Regulatory liability-cost of removal	209,963	192,650
Accrued pension expense	260,391	290,722
Accrued postretirement benefit expense	153,975	158,552
Other	116,631	123,871
Total regulatory and other long-term liabilities	2,090,908	2,095,449
Contributions in aid of construction	866,480	818,387
Commitments and contingencies	—	—
TOTAL CAPITALIZATION AND LIABILITIES	$12,526,682	$12,934,072

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 (Unaudited)
(In thousands, except per share data)

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Operating revenues	$ 589,369	$ 558,733	$1,096,184	$1,027,277
Operating expenses				
Operation and maintenance	330,575	299,385	641,837	581,999
Depreciation and amortization	67,307	68,137	131,223	132,764
General taxes	49,629	45,940	101,694	93,819
Gain on sale of assets	(800)	(6,219)	(870)	(6,113)
Impairment charge	—	—	750,000	—
Total operating expenses, net	446,711	407,243	1,623,884	802,469
Operating income (loss)	142,658	151,490	(527,700)	224,808
Other income (deductions)				
Interest, net	(70,066)	(70,763)	(140,034)	(142,970)
Allowance for other funds used during construction	3,387	1,511	5,928	3,169
Allowance for borrowed funds used during construction	1,725	419	3,093	1,512
Amortization of debt expense	(1,441)	(1,178)	(2,759)	(2,397)
Preferred dividends of subsidiaries	(56)	(56)	(113)	(113)
Other, net	(543)	1,210	663	2,783
Total other income (deductions)	(66,994)	(68,857)	(133,222)	(138,016)
Income (loss) from continuing operations before income taxes	75,664	82,633	(660,922)	86,792
Provision for income taxes	30,166	32,648	26,064	34,378
Income (loss) from continuing operations	45,498	49,985	(686,986)	52,414
Income (loss) from discontinued operations, net of tax	—	(807)	—	(551)
Net income (loss)	$ 45,498	$ 49,178	$(686,986)	$ 51,863
Basic earnings per common share (1):				
Income (loss) from continuing operations	$ 0.28	$ 0.31	$ (4.29)	$ 0.33
Income (loss) from discontinued operations, net of tax	$ —	$ (0.01)	$ —	$ —
Net income (loss)	$ 0.28	$ 0.31	$ (4.29)	$ 0.32
Diluted earnings per common share (1):				
Income (loss) from continuing operations	$ 0.28	$ 0.31	$ (4.29)	$ 0.33
Income (loss) from discontinued operations, net of tax	$ —	$ (0.01)	$ —	$ —
Net income (loss)	$ 0.28	$ 0.31	$ (4.29)	$ 0.32
Average common shares outstanding during the period:				
Basic	159,932	160,000	159,966	160,000
Diluted	159,976	160,000	159,966	160,000

(1) amounts may not add due to round up.

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 (Unaudited)
(In thousands, except per share data)

	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$(686,986)	$ 51,863
Adjustments		
Depreciation and amortization	131,223	132,764
Impairment charge	750,000	—
Amortization of removal costs net of salvage	21,214	15,811
Provision for deferred income taxes	21,960	15,821
Amortization of deferred investment tax credits	(808)	(813)
Provision for losses on utility accounts receivable	6,368	6,554
Allowance for other funds used during construction	(5,928)	(3,169)
Gain on sale of assets	(870)	(6,113)
Other, net	(58,841)	(17,233)
Changes in assets and liabilities		
Receivables and unbilled utility revenues	(23,098)	(45,435)
Other current assets	(20,539)	(31,088)
Accounts payable	(3,996)	(31,580)
Taxes accrued, including income taxes	2,172	31,317
Interest accrued	2,853	1,487
Other current liabilities	6,551	15,995
Net cash provided by operating activities	141,275	136,181
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction expenditures	(425,960)	(304,557)
Acquisitions	(248)	(217)
Proceeds from sale of assets and securities	798	15,200
Proceeds from sale of discontinued operations	—	9,660
Removal costs from property, plant and equipment retirements, net	(4,857)	(488)
Net restricted funds released	2,653	961
Net cash used in investing activities	(427,614)	(279,441)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	201,546	617,450
Repayment of long-term debt	(191,519)	(437,883)
Net borrowings (repayments) under short-term debt agreements	36,773	(578,578)
Advances and contributions for construction, net of refunds of $38,735 and $17,720 at June 30, 2008 and 2007	2,169	15,742
Change in cash overdraft position	(13,869)	—
Capital contributions	245,000	551,092
Debt issuance costs	(1,314)	(2,696)
Redemption of preferred stock	(14)	(176)
Net cash provided by financing activities	278,772	164,951
Net increase (decrease) in cash and cash equivalents	(7,567)	21,691
Cash and cash equivalents at beginning of period	13,481	29,754
Cash and cash equivalents at end of period	$ 5,914	$ 51,445
Non-cash investing activity:		
Capital expenditures acquired on account but unpaid at quarter-end	$ 67,192	$ 52,869
Non-cash financing activity:		
Advances and contributions	$ 12,578	$ 35,838
Capital contribution	$ —	$ 100,000

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 Statement of Changes in Common Stockholders' Equity
(Unaudited)
(In thousands, except per share data)

	Common Stock, $.01 Par Value: 500,000 Shares Authorized				Accumulated Other Comprehensive	Treasury Stock		Common Stockholders'
	Shares	Par Value	Paid-in Capital	(Accumulated Deficit)	Income (Loss)	Shares	At Cost	Equity
Balance at December 31, 2007	160,000	$ 1,600	$5,637,947	$(1,079,118)	$ (18,383)	—	$ —	$4,542,046
Net loss	—	—	—	(686,986)	—	—	—	(686,986)
Equity investment by RWE	—	—	245,000	—	—	—	—	245,000
Contribution of common stock by RWE	—	—	1,933	—	—	(90)	(1,933)	—
Stock-based compensation activity	—	—	2,992	—	—	—	—	2,992
Pension plan amortized to periodic benefit cost:								
Prior service cost	—	—	—	—	13	—	—	13
Foreign currency translation	—	—	—	—	(163)	—	—	(163)
Balance at June 30, 2008	160,000	$ 1,600	$5,887,872	$(1,766,104)	$ (18,533)	(90)	$(1,933)	$4,102,902

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

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

Note 1: Basis of Presentation

The accompanying consolidated balance sheet of American Water Works Company, Inc. and Subsidiary Companies (the "Company") at June 30, 2008, the consolidated statements of operations for the three months and six months ended June 30, 2008 and 2007, the consolidated statements of cash flows for the six months ended June 30, 2008 and 2007, and the consolidated statement of changes in common stockholders' equity for the six months ended June 30, 2008, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in common stockholders' equity, the consolidated results of operations, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual consolidated financial statements for the year ended December 31, 2007. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

Note 2: New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("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 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. 157, "Fair Value Measurements" ("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. In February 2008, the FASB issued FASB Staff Position 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 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 will be required to measure the assets of its defined benefit pension and other post retirement welfare plans pursuant to SFAS 157 at the next measurement date, which will be December 31, 2008.

Note 3: Goodwill

In April of 2008, as a result of the pricing of the Company's initial public offering ("IPO") (See Note 4), management determined that an interim triggering event occurred and that 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 as of March 31, 2008. The Company concluded that the carrying value of its goodwill was impaired as a result of the current market price and trading levels of its common stock. The Company believes the offering price was indicative of the value of the Company at March 31, 2008 and accordingly, based on those factors, the Company recorded an impairment charge to goodwill related to its Regulated Businesses of $750,000. The Company has reflected the tax effect of the impairment as a discrete item for purposes of calculating its tax provision as the charge is considered an infrequently occurring or unusual item. The impairment charge was primarily due to the market price of the Company's common

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stock (both the IPO price and the market price during subsequent trading) being less than what was anticipated during the Company's 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).

In developing the estimated fair value of the Company's reporting units, significant judgment was required. The Company determined the estimated fair value of the reporting units utilizing a methodology consistent with its 2007 annual test. Whenever possible, market information including the initial public offering price of the Company's common stock and subsequent trading price was used to update the Company's assumptions. The methodology utilized a combination of the trading price of the Company's common stock, an estimated control premium, trading price market multiples of peer companies (regulated water utilities) and the Company's discounted cash flow analysis based on the Company's five-year business plan, each of which has differing weights. The majority of the weighting is applied to the traded price as this represents the market objective evidence of fair value with minimal weight applied to the discounted cash flow analysis.

The following table summarizes the changes in the Company's goodwill by reporting unit:

	Regulated Unit	Non-regulated Units	Consolidated
Balance at December 31, 2007	$2,327,270	$ 129,682	$2,456,952
Impairment	(750,000)	—	(750,000)
Other activity	(277)	—	(277)
Balance at June 30, 2008	$1,576,993	$ 129,682	$1,706,675

The Company may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in the valuation multiples of comparable water utilities, a decline over a period of time of the Company's stock price or the lack of appreciation of the Company's stock price to a level consistent with peer companies or increases in equity value. A decline in the forecasted results in the Company's business plan, such as changes in rate case results or capital investment budgets or changes in the Company's interest rates may also result in an incremental impairment charge.

As a result of the impairment RWE transferred $245,000 to the Company on May 13, 2008. This cash was used to reduce debt.

Note 4: Stockholders' Equity

Common Stock

On April 28, 2008, RWE Aqua Holdings GmbH completed the partial divestiture of its investment in the Company in an initial public offering ("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 June 30, 2008 there are no shares outstanding.

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.

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The following table presents stock-based compensation expense for the three and six months ended June 30, 2008 and 2007:

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Stock Options	$ 470	$ —	$ 470	$ —
Restricted stock units	218	170	436	340
Restricted stock	1,406	—	1,406	—
Stock-based compensation in operation and maintenance expense	2,094	170	2,312	340
Income tax benefit	(817)	(66)	(902)	(133)
After-tax stock-based compensation expense	$ 1,277	$ 104	$ 1,410	$ 207

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 June 30, 2008, 630 stock option and 82 restricted stock awards are not considered probable to meet performance conditions.

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

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 June 30, 2008 ranged from 1.5 years to 2.5 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 June 30, 2008.

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	Outstanding Shares	Exercise Price (per share)
Nonvested at December 31, 2007	—	—
Granted	2,078	$ 21.50
Vested	—	—
Forfeited	—	—
Nonvested at June 30, 2008	2,078	$ 21.50

There are zero options awards vested and no option awards have been exercised as of June 30, 2008.

As of June 30, 2008, $4,990 of total unrecognized compensation costs related to the nonvested stock options is expected to be recognized over the remaining average weighted-average period of 2.1 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.

The following table presents information with respect to restricted stock unit activity as of June 30, 2008.

	Outstanding Shares	Grant Date Fair Value (per share)
Nonvested at December 31, 2007	—	—
Granted	269	$ 21.50
Vested	—	—
Forfeited	—	—
Nonvested at June 30, 2008	269	$ 21.50

As these restricted stock units would have paid-out in cash if the IPO was not 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 June 30, 2008, $2,641 of total unrecognized compensation costs related to the nonvested restricted stock units is expected to be recognized over the remaining weighted-average period of 2.2 years.

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 June 30, 2008.

	Outstanding Shares	Grant Date Fair Value (per share)
Nonvested at December 31, 2007	—	—
Granted	90	$ 21.50
Vested	—	—
Forfeited	—	—
Nonvested at June 30, 2008	90	$ 21.50

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As of June 30, 2008, $428 of total unrecognized compensation costs related to the nonvested restricted stock units is expected to be recognized in the third quarter of 2008.

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 a discount. The Company's ESPP is considered compensatory under SFAS 123(R). No compensation costs were recognized for the three or six months ended June 30, 2008.

Note 5: Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2008	2007	2008	2007
Net income (loss)	$45,498	$49,178	$(686,986)	$51,863
Pension plan amortized to periodic benefit cost:				
Prior service cost	7	9	13	18
Actuarial loss	—	18	—	36
Foreign currency translation adjustment	(18)	(35)	(163)	(257)
Total comprehensive income (loss)	$45,487	$49,170	$(687,136)	$51,660

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Note 6: Long-Term Debt

The Company primarily incurs long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt are as follows;

	Rate	Maturity Date	June 30, 2008	December 31, 2007
Long-term debt of American Water Capital Corp. ("AWCC")				
Private activity bonds and government funded debt				
Floating rate (a)	1.85%-2.00%	2018-2032	$ 86,860	$ 86,860
Senior notes				
Fixed rate	5.39%-6.87%	2011-2037	2,884,000	2,712,000
Long-term debt of other subsidiaries				
Private activity bonds and government funded debt				
Fixed rate	0.00%-6.88%	2009-2038	941,800	942,941
Floating rate (b)	1.75%-6.85%	2015-2032	33,420	178,145
Mortgage bonds				
Fixed rate	6.31%-9.71%	2008-2034	715,800	731,340
Senior debt				
Fixed rate	5.60%-9.10%	2008-2025	45,296	45,473
Mandatory redeemable preferred stock	4.60%-9.75%	2013-2036	24,637	24,644
Notes payable and other (c)	5.76%-11.91%	2012-2026	3,053	3,442
Long-term debt			4,734,866	4,724,845
Unamortized debt discount, net (d)			66,261	70,743
Total long-term debt			$4,801,127	$4,795,588

(a) Tax-exempt bonds which are remarketed as money market bonds 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.

(b) $24,860 of the total represents tax-exempt bonds which are sold at auction rates that are reset every 7 to 35 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. The remaining $8,560 represents tax-exempt bonds remarketed as money market bonds. See (a) above.

(c) Includes capital lease obligations of $1,909 and $1,982 at June 30, 2008 and December 31, 2007, respectively.

(d) Includes fair value adjustments from acquisition purchase accounting.

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
Other subsidiaries	State financing authority loans and other	1.00%	2024	1,546
Total Issuances				$201,546

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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	State financing authority loans and other	0.00%-9.87%	2008-2034	18,721
Preferred stock with mandatory redemption requirements				
Other subsidiaries		4.75%-5.75%	2017-2019	6
Total retirements & redemptions				$191,452

Gains from early extinguishment of debt included in Interest, net amounted to $0 for the three and six months ended June 30, 2008 and $1,101 and $8,164 for the three and six months ended June 30, 2007, respectively.

Interest, net includes interest income of approximately $2,961 and $4,619 for the three and six months ended June 30, 2008, respectively and $3,271 and $5,093 for the three and six months ended June 30, 2007, respectively.

Note 7: Short-Term Debt

The components of short-term debt are as follows:

	June 30, 2008	December 31, 2007
Commercial paper, net of $165 and $680 discount	$205,835	$ 169,267
Book overdraft	28,329	42,198
Other short-term debt	9,254	9,049
Total short-term debt	$243,418	$ 220,514

Note 8: Income Taxes

The Company’s estimated annual effective tax rate for 2008 is 39.5% compared to 39.6% for 2007, excluding various discrete items. The Company’s actual effective tax rate for the three months ended June 30, 2008 and 2007 was 39.9% and 39.5%, respectively. The Company’s actual effective rate for the six months ended June 30, 2008 and 2007 of (3.9%) and 39.6%, respectively, reflects the tax effect of the goodwill impairment as a discrete item as the Company considers this charge an infrequently occurring or unusual event.

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Note 9: Pension and Other Postretirement Benefits

The following table provides the components of net periodic benefit costs:

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Components of net periodic pension benefit cost				
Service cost	$ 6,551	$ 6,403	$ 13,102	$ 12,806
Interest cost	14,549	13,322	29,098	26,644
Expected return on plan assets	(12,925)	(11,763)	(25,850)	(23,526)
Amortization of:				
Prior service cost	45	32	90	64
Actuarial loss	1	66	2	132
Periodic pension benefit cost	8,221	8,060	16,442	16,120
Special termination pension benefit charge	—	—	—	93
Net periodic pension benefit cost	$ 8,221	$ 8,060	$ 16,442	$ 16,213

	Three Months Ended June 30, 2008	Three Months Ended June 30, 2007	Six Months Ended June 30, 2008	Six Months Ended June 30, 2007
Components of net periodic other postretirement benefit cost				
Service cost	$ 3,106	$ 3,171	$ 6,212	$ 6,342
Interest cost	7,049	6,346	14,098	12,692
Expected return on plan assets	(5,751)	(5,266)	(11,502)	(10,532)
Amortization of:				
Transition obligation	43	43	86	86
Prior service credit	203	(295)	406	(590)
Actuarial loss	(295)	—	(590)	—
Net periodic other postretirement benefit cost	$ 4,355	$ 3,999	$ 8,710	$ 7,998

The Company contributed $46,000 to its defined benefit pension plan in the first six months of 2008 and expects to contribute $30,000 during the balance of 2008. In addition, the Company contributed $13,676 for the funding of its other postretirement plans in the first six months of 2008 and expects to contribute $13,676 during the balance of 2008.

Note 10: 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 has agreed to provide a limited twelve month warranty relating to certain components of the facilities that OMI/TW constructed (the “WW39 Plant”), 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, the Company has a loss reserve of approximately $4,000 at June 30, 2008 and December 31, 2007.

In 2007, the Company, through a subsidiary and an indirect 50% owned joint venture, 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 June 30, 2008, no claims have been made related to this warranty.

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The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At June 30, 2008, the Company had accrued approximately $6,500 as probable losses and it is reasonably possible that additional losses could range up to $30,000 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.

Note 11: Guarantees

The Company, through a subsidiary, holds a 50% interest in American Water-Pridesa LLC ("AW-Pridesa"), a Delaware limited liability company. Acciona Agua Corporation (USA) holds the remaining 50% interest. AW-Pridesa has contracted with Tampa Bay Water ("Tampa Bay"), an interlocal governmental agency of the State of Florida, to remedy and operate the Tampa Bay Seawater Desalination Plant. The Company entered into a guarantee with Tampa Bay in November 2004 for the full and prompt performance of certain contractual obligations limited to a total aggregate liability of $35,000. Contractual obligations call for certain construction activities and management services to be completed satisfactorily. AW-Pridesa took over operation of the plant in January 2005. At December 31, 2007, the plant was fully operational and successful performance testing of the construction activities had been completed.

The Company provides financial guarantees or deposits to ensure performance of certain of its obligations on its non-regulated military agreements and Operations & Maintenance agreements. These guarantees and deposits totaled $475,148 and $475,278 at June 30, 2008 and December 31, 2007, respectively.

At June 30, 2008 and December 31, 2007, no accruals have been made related to these guarantees.

Note 12: Environmental Matters

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. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to approximately $11,000 at June 30, 2008 and December 31, 2007. At June 30, 2008, $10,100 of the reserve relates 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.

Note 13: Net Income (Loss) per Common Share

Basic net income (loss) per common share, income (loss) from discontinued operations, net of tax, per common share and income (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 income (loss) per common share, income (loss) from discontinued operations, net of tax, per common share and income (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 and stock options. The dilutive effect of restricted stock, restricted stock units and stock options is calculated using the treasury stock method and expected proceeds on vesting of the restricted stock and restricted stock units and exercise of the stock options. 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:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Numerator				
Income (loss) from continuing operations	$ 45,498	$ 49,985	$(686,986)	$ 52,414
Income (loss) from discontinued operations, net of tax	—	(807)	—	(551)
Net Income (loss)	$ 45,498	$ 49,178	$(686,986)	$ 51,863
Denominator				
Average common shares outstanding – basic	159,932	160,000	159,966	160,000
Effect of dilutive securities:				
Restricted stock	33	—	—	—
Restricted stock units	11	—	—	—
Average common shares outstanding – diluted	159,976	160,000	159,966	160,000

Options to purchase 608 shares of the Company's common stock were excluded from the calculation of diluted common shares outstanding because the calculated proceeds from the exercise of the options were greater than the average market price of the Company's common stock during the three month period ended June 30, 2008. There were also 190 restricted stock units and 1,470 stock options which were excluded from the calculation of diluted common shares outstanding because certain performance conditions were not satisfied as of June 30, 2008. All of the potentially dilutive securities have been excluded for the six months ended June 30, 2008 because they are anti-dilutive. The Company had no potentially dilutive shares for the three and six month periods ending June 30, 2007.

Note 14: 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.

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The following table includes the Company's summarized segment information:

	As of or for the Three Months Ended June 30, 2008			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 526,248	$ 67,038	$ (3,917)	$ 589,369
Depreciation and amortization	63,656	1,861	1,790	67,307
Impairment charge	—	—	—	—
Total operating expenses, net	392,038	62,924	(8,251)	446,711
Adjusted EBIT (1)	134,213	4,681		
Total assets	10,472,290	250,337	1,804,055	12,526,682
Capital expenditures	235,279	2,244	—	237,523

	As of or for the Three Months Ended June 30, 2007			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 508,634	$ 55,480	$ (5,381)	$ 558,733
Depreciation and amortization	65,635	2,594	(92)	68,137
Impairment charge	—	—	—	—
Total operating expenses, net	368,289	46,969	(8,015)	407,243
Adjusted EBIT (1)	140,938	10,330		
Total assets	9,725,776	310,026	3,035,783	13,071,585
Capital expenditures	136,295	2,147	—	138,442

	As of or for the Six Months Ended June 30, 2008			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 975,782	$128,210	$ (7,808)	$ 1,096,184
Depreciation and amortization	123,948	3,269	4,006	131,223
Impairment charge	—	—	750,000	750,000
Total operating expenses, net	770,253	120,449	733,182	1,623,884
Adjusted EBIT (1)	206,113	9,263		
Total assets	10,472,290	250,337	1,804,055	12,526,682
Capital expenditures	422,934	3,026	—	425,960

	As of or for the Six Months Ended June 30, 2007			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 927,910	$108,781	$ (9,414)	$ 1,027,277
Depreciation and amortization	127,206	5,247	311	132,764
Impairment charge	—	—	—	—
Total operating expenses, net	719,480	97,740	(14,751)	802,469
Adjusted EBIT (1)	210,052	14,031		
Total assets	9,725,776	310,026	3,035,783	13,071,585
Capital expenditures	301,441	3,116	—	304,557

(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.

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

	For the Three Months Ended June 30, 2008		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 134,213	$ 4,681	$ 138,894
Add:			
Allowance for other funds used during construction	3,387	—	3,387
Allowance for borrowed funds used during construction	1,725	—	1,725
Less:			
Interest, net	(55,085)	750	(54,335)
Preferred dividends of subsidiaries	(56)	—	(56)
Amortization of debt expense	(1,441)	—	(1,441)
Segments' income from continuing operations before income taxes	$ 82,743	$ 5,431	88,174
Interest, net			(15,731)
Other			3,221
Income from continuing operations before income taxes			$ 75,664

	For the Three Months Ended June 30, 2007		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 140,938	$10,330	$ 151,268
Add:			
Allowance for other funds used during construction	1,511	—	1,511
Allowance for borrowed funds used during construction	419	—	419
Less:			
Interest, net	(54,811)	(2,571)	(57,382)
Preferred dividends of subsidiaries	(56)	—	(56)
Amortization of debt expense	(1,368)	—	(1,368)
Segments' income from continuing operations before income taxes	$ 86,633	$ 7,759	94,392
Interest, net			(13,381)
Other			1,622
Income from continuing operations before income taxes			$ 82,633

	For the Six Months Ended June 30, 2008		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 206,113	$ 9,263	$ 215,376
Add:			
Allowance for other funds used during construction	5,928	—	5,928
Allowance for borrowed funds used during construction	3,093	—	3,093
Less:			
Interest, net	(111,821)	1,386	(110,435)
Preferred dividends of subsidiaries	(113)	—	(113)
Amortization of debt expense	(2,759)	—	(2,759)
Segments' income from continuing operations before income taxes	$ 100,441	$10,649	111,090
Impairment charges			(750,000)
Interest, net			(29,599)
Other			7,587
Loss from continuing operations before income taxes			$(660,922)

	For the Six Months Ended June 30, 2007		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 210,052	$14,031	$ 224,083
Add:			
Allowance for other funds used during construction	3,169	—	3,169
Allowance for borrowed funds used during construction	1,512	—	1,512
Less:			

Interest, net	(109,201)	(5,667)	(114,868)
Preferred dividends of subsidiaries	(113)	—	(113)
Amortization of debt expense	(2,587)	—	(2,587)
Segments' income from continuing operations before income taxes	$ 102,832	$ 8,364	111,196
Interest, net			(28,102)
Other			3,698
Income from continuing operations before income taxes			$ 86,792

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Note 15: Felton Water System Asset Sale

In May of 2008, the Company's California subsidiary reached an agreement with the San Lorenzo Valley Water District to sell ownership of its Felton operating assets for total proceeds of $13,400, including $10,500 in cash and the assumption of $2,900 in debt, pending regulatory approval. The Felton water system serves approximately 1,330 customers.

Note 16: Subsequent Events

On July 28, 2008, the Company's Board of Directors declared a quarterly cash dividend payment of $0.20 per share payable on September 2, 2008 to all shareholders of record as of August 15, 2008.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain matters within this Quarterly Report on Form 10-Q include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as "may," "should," "will," "could," "estimates," "predicts," "potential," "continue," "anticipates," "believes," "plans," "expects," "future" and "intends" and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the "Risk Factors" section or other sections in the Company's Form 424(b)(4) prospectus filed April 24, 2008 with the Securities and Exchange Commission, as well as in Item IA of Part II of this Quarterly Report. All forward-looking statements are expressly qualified in their entirety by such risk factors. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

GENERAL

American Water Works Company, Inc. (herein referred to as "American Water" or the "Company") is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. The businesses that provide these services are generally subject to economic regulation by state regulatory agencies in the states in which they operate. We report these results in our Regulated Businesses segment. We also provide services that are not subject to regulation by the state commissions. We report these results in our Non-regulated Businesses segment. For further description of our businesses see the "Business" section found in our Form 424(b)(4) prospectus filed on April 24, 2008 with the Securities and Exchange Commission.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Prospectus filed with the SEC on April 24, 2008, with the information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Form 424(b)(4) prospectus filed with the Securities and Exchange Commission on April 24, 2008.

OVERVIEW

Financial Results American Water's net income was $45.5 million for the three months ended June 30, 2008 as compared to $49.2 million for the three months ended June 30, 2007. Income from continuing operations was $45.5 million for the three months ended June 30, 2008, compared to $50.0 million for the three months ended June 30, 2007. Diluted earnings per average common share were $0.28 for the three months ended June 30, 2008 as compared to $0.31 for the three months ended June 30, 2007.

American Water's net loss, which includes an impairment charge, net of tax of $738.5 million, was $687.0 million, for the six months ended June 30, 2008 as compared to net income of $51.9 million for the six months ended June 30, 2007. Loss from continuing operations was $687.0 million for the six months ended June 30, 2008, compared to income from continuing operations of $52.4 million for the six months ended June 30, 2007. Diluted earnings (loss) per average common share were ($4.29) for the six months ended June 30, 2008 as compared to $0.32 for the six months ended June 30, 2007.

Revenues for the three months ended June 30, 2008 increased by $30.6 million compared to the same period in the prior year primarily due to increased revenues in our Regulated Businesses of $17.6 million which is largely attributable to rate increases and revenues in our Non-regulated Businesses which increased by $11.6 million due to increased Contract Operations Group and Homeowner Services Group revenues, partially offset by decreased revenues in our Applied Water Group. Offsetting the increased revenues were $39.5 million higher operating expenses for the three months ended June 30, 2008. The increase in operating expenses primarily resulted from increased operating expenses in our Regulated Businesses of $23.7 million for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. This increase was

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mainly driven by higher employee related costs of $9.5 million due to $3.3 million of wages related to job reclassification of certain hourly employees for services performed, stock based compensation expense of $2.1 million primarily attributable to the issuance of awards granted in connection with the IPO, an increase in the number of employees and wage rate increases and higher pension expense in 2008. In addition, the Regulated Businesses' maintenance costs increased by $6.3 million primarily due to higher removal costs, increased tank painting expenses as well as higher costs of $0.9 million associated with a project in our Illinois subsidiary to maintain valves. Operating expenses in our Non-regulated Businesses also increased by $16.0 million for the three months ended June 30, 2008 compared to three months ended June 30, 2007 as a result of higher operating and maintenance expenses of $10.6 million which corresponds with their increased revenues as well as a gain on sale of assets of $6.3 million recognized in 2007.

Other items affecting income from continuing operations for the three months ended June 30, 2008 as compared to the same period in the prior year include increased allowance for funds used during construction ("AFUDC") of $3.2 million attributable to the increase in the construction work in progress primarily in New Jersey and Missouri and lower income tax expense of $2.5 million.

Revenues for the six months ended June 30, 2008 increased by $68.9 million compared to the same period in the prior year primarily due to increased revenues in our Regulated Businesses of $47.9 million which is largely attributable to rate increases and revenues in our Non-regulated Businesses increased by $19.4 million due to increased Contract Operations and Homeowner Services Group revenues, partially offset by decreased revenues in our Applied Water Group. Offsetting the increased revenues were $821.4 million higher operating expenses for the six months ended June 30, 2008. These expenses primarily resulted from the impairment charge of $750.0 million which is discussed below, and increased expenses in our Regulated Businesses of $50.8 million in the six months ended June 30, 2008 compared to six months ended June 30, 2007. This increase was mainly driven by higher employee related costs of $25.1 million due to $3.3 million of wages related to job reclassification of certain hourly employees for services performed, stock based compensation expense of $2.3 million primarily attributable to the issuance of awards granted in connection with the IPO, an increase in the number of employees and wage rate increases in 2008 and higher pension expense in 2008. In addition, the Regulated Businesses' maintenance costs increased by $10.8 million primarily due to higher removal costs, increased expenses of $3.6 million associated with a project in Illinois to maintain valves as well as increased tank painting expenses. Operating expenses in our Non-regulated Businesses also increased by $22.7 million for the six months ended June 30, 2008 compared to six months ended June 30, 2007 as a result of higher operating and maintenance expenses of $18.7 million which corresponds with their increased revenues as well as a gain on sale of assets of $6.1 million recognized in the six months ended June 30, 2007.

Other items affecting income from continuing operations for the six months ended June 30, 2008 as compared to the same period in the prior year include lower interest expense of $2.9 million, as a result of the repayment of outstanding debt, increased AFUDC of $4.3 million attributable to the increase in the construction work in progress primarily in New Jersey and Missouri and lower income tax expense of $8.3 million.

Regulatory Developments During the three months ended June 30, 2008, we received authorizations for additional annualized revenues from general rate cases in California and Arizona amounting to $19.2 million. California's rates were retroactive to January 1, 2008, while Arizona's rates were effective in the second quarter of 2008. In the first six months of 2008 we received authorizations for additional annualized revenues from general rate cases of $47.2 million. As of June 30, 2008, we were awaiting final orders for three general cases that were filed in 2007, requesting $39.6 million in total additional annual revenues. In July 2008, the Illinois rate case filed in 2007 for $32. 8 million was approved and received authorization to increase rates which will provide additional annualized revenues of $24.9 million. In the first six months of 2008, we filed general rate cases in ten additional states that would provide $271.0 million of additional revenues, if approved as filed. Of the rate cases filed in 2008, one state's rates were effective in 2008 with an annualized increase of $0.2 million and is included in the $47.2 million of annualized revenue outlined above. The remaining amount of $270.8 million remains under consideration by state public utility commissions at this time. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted.

Financing Activities During the six months ended June 30, 2008, we met our capital resource requirements with internally generated cash as well as funds from external sources primarily through commercial paper and the issuance of $200.0 million of private placement debt. In addition, as a result of the impairment charge, RWE made a capital contribution in the second quarter of 2008 of $245.0 million. The cash was used to reduce short-term borrowings.

Initial Public Offering Our common stock began trading on the New York Stock Exchange on April 23, 2008. On April 28, 2008, the Company completed its initial public offering ("IPO"). RWE Aqua Holdings GmbH, the Company's selling stockholder, sold 58.0 million shares of the Company's common stock at a price of $21.50 per share. The selling stockholder granted the underwriters a 30 day option to purchase up to an additional 8.7 million shares of the Company's

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stock at a price of $21.50. On May 27, 2008, the Company announced the underwriters' partial exercise of their option to purchase 5.2 million shares to cover over allotments. The Company did not receive any proceeds from the sale of shares. Prior to the IPO, the Company was a wholly-owned subsidiary of RWE. After the IPO, and the exercise of the underwriters' over-allotment option, RWE owns approximately 60% of the Company's common shares.

On April 22, 2008, RWE contributed approximately 89.9 thousand shares of the Company's common stock to the Company and the Company granted approximately 89.9 thousand restricted stock awards, 269.3 thousand restricted stock units and 2.1 million stock options. The awards were issued to the Company's employees and certain non-employee directors under our 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 6.0 million. The restricted stock units and the stock options were granted in two grants with "Grant 1" vesting on January 1, 2010 and "Grant 2" vesting on January 1, 2011.

Effective the first quarter of 2008, the Company's Board of Directors' authorized 50.0 million shares of par value $0.01 per share preferred stock. As of June 30, 2008 there are no shares outstanding.

Impairment Charge As previously disclosed in our free writing and final prospectuses, filed April 22, 2008 and April 24, 2008, respectively, the Company determined that it was reasonably likely based in large part on an initial public offering price of our common stock of $21.50, that the current carrying value of our goodwill which the Company recorded as a result of the 2003 acquisition of American Water by RWE and acquisition of E'Town Corporation in 2001, was impaired. At the time the Company's initial public offering price of $21.50 was established, we were unable to determine if there was any goodwill impairment or to provide a reliable estimate of the amount of any goodwill impairment, if any.

In light of the initial public offering price and trading levels in our stock since the date of IPO, we performed an interim impairment test and on May 9, 2008, concluded that the current carrying value of our goodwill was impaired as a result of the current market price at that time and trading levels of our common stock. Based on that assessment, we recorded an impairment charge to goodwill related to our Regulated Businesses of $750.0 million in our financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less than what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of our debt (due to increased market interest rates).

In developing our estimated fair value of the Company's reporting units, significant judgment was required. We determined the estimated fair value of the reporting units utilizing a methodology consistent with its 2007 annual test. Whenever possible, market information including the initial public offering price of the Company's common stock and subsequent trading price was used to update our modeling assumptions. Our methodology utilized a combination of the trading price of the Company's common stock, an estimated control premium, trading price market multiples of peer companies (regulated water utilities) and the Company's discounted cash flow analysis based on our five-year business plan were used, each of which has differing weights. The majority of the weighting is applied to the traded price as this represents the market objective evidence of fair value with minimal weight applied to the discounted cash flow analysis.

We may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in valuation multiples of comparable water utilities, a decline over a period of time of the Company's stock price or the lack of appreciation of the Company's stock price to a level consistent with peer companies or increases in equity value. 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, may also result in an incremental impairment charge.

As a result of the impairment and in accordance with certain regulatory commitments, RWE transferred $245.0 million to us on May 13, 2008. RWE is not obligated to make any additional capital contributions.

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Other Matters In May 2008, our California subsidiary reached an agreement with the San Lorenzo Valley Water District to sell ownership of our Felton operating assets for consideration of $13.4 million. The district's payment will consist of $10.5 million in cash and the acquirer's assumption of $2.9 million in debt, pending regulatory approval. The Felton water system serves approximately 1,330 customers.

On July 28, 2008, our Board of Directors declared a quarterly cash dividend payment of $0.20 per share payable on September 2, 2008 to all shareholders of record as of August 15, 2008.

Results of Operations

Three Months Ended June 30, 2008 Compared To Three Months Ended June 30, 2007

	For the three months ended June 30,		Favorable (Unfavorable)
(Dollars in thousands)	**2008**	**2007**	**Change**
Operating revenues	$ 589,369	$ 558,733	$ 30,636
Operating expenses			
Operation and maintenance	330,575	299,385	(31,190)
Depreciation and amortization	67,307	68,137	830
General taxes	49,629	45,940	(3,689)
Gain on sale of assets	(800)	(6,219)	(5,419)
Impairment charge	—	—	—
Total operating expenses, net	446,711	407,243	(39,468)
Operating income (loss)	142,658	151,490	(8,832)
Other income (deductions)			
Interest, net	(70,066)	(70,763)	697
Allowance for other funds used during construction	3,387	1,511	1,876
Allowance for borrowed funds used during construction	1,725	419	1,306
Amortization of debt expense	(1,441)	(1,178)	(263)
Preferred dividends of subsidiaries	(56)	(56)	—
Other, net	(543)	1,210	(1,753)
Total other income (deductions)	(66,994)	(68,857)	1,863
Income (loss) from continuing operations before income taxes	75,664	82,633	(6,969)
Provision for income taxes	30,166	32,648	2,482
Income (loss) from continuing operations	45,498	49,985	(4,487)
Income (loss) from discontinued operations, net of tax	—	(807)	807
Net income (loss)	$ 45,498	$ 49,178	$ (3,680)

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The following table summarizes certain financial information for our Regulated and Non-regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

	For the three months ended June 30,			
	2008		2007	
	Regulated Businesses	Non-regulated Businesses	Regulated Businesses	Non-regulated Businesses
	(In thousands)			
Operating revenues	$526,248	$ 67,038	$508,634	$ 55,480
Adjusted EBIT [1]	$134,213	$ 4,681	$140,938	$ 10,330

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. 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 the 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.

Operating revenues Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues resulting from rate authorizations, including infrastructure charges, which were granted and became effective in the second quarter of 2008.

	Annualized Rate Increases Granted (In millions)
State	
General rate case:	
California	$ 13.0
Arizona	6.2
Infrastructure Charges:	
Pennsylvania	4.6
Indiana	3.9
Missouri	2.7
Total	$ 30.4

Operating revenues increased by $30.6 million, or 5.5% for the three months ended June 30, 2008 compared to the three months ended June 30, 2007. Regulated Businesses' revenues increased by $17.6 million, or 3.5% for the three months ended June 30, 2008 compared to the same period in the prior year. The Non-regulated Businesses' revenues for the three months ended June 30, 2008 increased by $11.6 million, or 20.8% compared to the three months ended June 30, 2007.

The increase in revenues from the Regulated Businesses for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 was primarily due to rate increases obtained through general rate cases in Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $25.0 million and a $1.4 million retroactive rate adjustment in California. These increases were offset by a $12.6 million decrease in revenues related to reduced customer consumption, mainly in our Midwestern and Mid-Atlantic state subsidiaries for the three months ended June 30, 2008 compared to the same period in the prior year.

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The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

	For the three months ended June 30,			
	Operating Revenues		Water Sales Volume	
Customer Class	2008	2007	2008	2007
Water service:				
Residential	57.5%	58.0%	53.1%	52.8%
Commercial	19.5%	19.1%	22.0%	21.8%
Industrial	5.0%	4.7%	10.7%	10.7%
Public and other	12.0%	12.2%	14.2%	14.7%
Other water revenues	2.3%	2.3%	—	—
Total water revenues	96.3%	96.3%	100.0%	100.0%
Wastewater service	3.7%	3.7%		
	100.0%	100.0%		

The following discussion related to water services indicates the increase or decrease in the Regulated Businesses' revenues and associated water sales volumes in gallons by customer class.

Water Services —Water service operating revenues from residential customers for the three months ended June 30, 2008 totaled $302.6 million, a $7.9 million increase, or 2.7%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 2.1% for the three months ended June 30, 2008 to 51.6 billion gallons, from 52.7 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California and our Midwestern states.

Water service operating revenues from commercial water customers for the three months ended June 30, 2008 increased by $5.3 million, or 5.4%, to $102.7 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2007. The volume of water sold to commercial customers decreased by 1.4% for the three months ended June 30, 2008, to 21.4 billion gallons, from 21.7 billion gallons for the three months ended June 30, 2007.

Water service operating revenues from industrial customers totaled $26.5 million for the three months ended June 30, 2008, an increase of $2.7 million, or 11.3%, over those recorded for the same period of 2007 mainly due to rate increases offset by decreased sales volume. The volume of water sold to industrial customers totaled 10.4 billion gallons for the three months ended June 30, 2008, a decrease of 2.8% from the 10.7 billion gallons for the three months ended June 30, 2007.

Water service operating revenues from public and other customers increased $0.9 million, or 1.5%, for the three months ended June 30, 2008 to $62.9 million from $62.0 million for the three months ended June 30, 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $26.2 million for the three months ended June 30, 2008, an increase of $1.6 million over the same period of 2007. Revenues generated by sales to governmental entities and resale customers for the three months ended June 30, 2008 totaled $36.7 million, a decrease of $0.6 million from the three months ended June 30, 2007.

Wastewater services —Our subsidiaries provide wastewater services in 11 states. Revenues from these services increased by $0.8 million, or 4.2%, to $19.7 million for the three months ended June 30, 2008, from $18.9 million for the same period of 2007. The increase was attributable to increases in rates charged to customers principally in Arizona, Hawaii, and New Jersey.

Non-regulated Businesses' operating revenues increased by $11.6 million, or 20.8% for the three months ended June 30, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $12.1 million in our Contract Operations Group and $1.9 million in our Homeowner Services Group, partially offset by decreased revenues of $2.5 million in our Applied Water Group. The increase in Contract Operations Group revenues was primarily due to incremental revenues associated with design and build contracts, as well as increased military project revenues. The increase from our Homeowner Service Group represented expansion into new geographic markets. Applied Water Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

Operation and maintenance Operation and maintenance expense increased $31.2 million, or 10.4%, for the three months ended June 30, 2008 compared to the same period in the prior year.

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Operation and maintenance expenses for the three months ended June 30, 2008 and 2007, by major expense category, were as follows:

	For the three months ended June 30,	
	2008	2007*
	(In thousands)	
Production costs	$ 72,582	$ 69,794
Employee-related costs	131,422	119,237
Operating supplies and services	66,747	63,914
Maintenance materials and services	37,221	26,318
Customer billing and accounting	11,941	9,134
Other	10,662	10,988
Total	$ 330,575	$ 299,385

* Certain 2007 amounts have been reclassified within operating expenses to conform to the 2008 presentation.

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by $2.8 million, or 4.0%, for the three months ended June 30, 2008 compared to the same period in 2007. The increase was primarily the result of increased costs in our Regulated Businesses of $2.5 million. Fuel and power costs were higher by $0.7 million which can be attributed to increases in electricity prices. Chemical costs also increased by $1.7 million primarily due to rising chemical costs and waste disposal costs were also higher by $0.5 million. These increases were partially offset by lower purchased water costs of $0.4 million attributable to the decrease in customer usage.

Employee-related costs including wage and salary, group insurance, and pension expense increased $12.2 million or 10.2%, for the three months ended June 30, 2008 compared to the same period in the prior year. These employee related costs represented 39.8% of operation and maintenance expenses for both the three months ended June 30, 2008 and 2007. The employee related cost increase of $9.5 million and $1.3 million in our Regulated and Non-regulated Businesses, respectively, was primarily the result of $3.3 million of wages related to job reclassification of certain hourly employees for services performed, stock based compensation expense of $2.1 million mainly attributable to awards granted in connection with the IPO, as well as an increase in the number of employees and wage rate increases. In addition, our Regulated Businesses' pension expense increased $3.0 million or 34.4% for the three months ended June 30, 2008 compared to the same period in the prior year. Pension expense in excess of the amount contributed to the pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense in accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions" ("SFAS 87") remained relatively unchanged, pension expense increased for the three months ended June 30, 2008 due to increased contributions in certain of our regulated operating companies whose costs are recovered based on the Company's funding policy which is the minimum amount required by the Employee Retirement Income Security Act of 1974 ("ERISA"), rather than the SFAS 87 expense. The increase in the contributions is attributable to lower than expected returns on plan assets.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the three months ended June 30, 2008, these costs increased by $2.8 million or 4.4%, compared to the same period in 2007. Factors contributing to this increase include an overall increase in general office and travel costs of $1.8 million mainly due to inflation, and higher fuel and other transportation costs of $2.4 million. Partially offsetting these increases was a decrease in remediation costs, mainly consulting fees, in connection with the Sarbanes-Oxley Act of $6.2 million or 68.1%, to $2.9 million for the three months ended June 30, 2008 compared to $9.1 million for the three months ended June 30, 2007. Included in the three months ended June 30, 2008 are divestiture and IPO related costs amounting to $3.1 million compared to divestiture related costs of $2.3 million for the three months ended June 30, 2007. Corresponding with the increase in revenues, the Non-regulated Businesses' operating supplies and service expenses increased by $5.5 million for the three months ended June 30, 2008 compared to the same period in the prior year. The increase is mainly attributable to additional expense in the Contract Operations Group associated with several operating contracts (including a design, build and operate project in Fillmore, California), partially offset by lower contracted services costs in the Applied Water Management Group due to the downturn in new home construction and profits of $1.5 million as a result of the finalization and acceptance by the third party of a construction project.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased $10.9 million or by 41.4%, for the three months ended June 30, 2008 compared to the same period in the prior year. Regulated Businesses' maintenance materials and service costs increased by $6.3 million for the three months ended June 30, 2008 compared to the same period in the prior year due to costs of $0.8 million associated with a project in Illinois to maintain valves, higher cost of removal expenses amounting to $3.9 million in certain of our operating

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companies and increased tank painting costs of $1.3 million in our New Jersey and Missouri operating companies. Our Non-regulated Businesses' maintenance expense increased by $1.8 million for the three months ended June 30, 2008 compared to the same period in the prior year primarily due to higher frequency service line protection contract usage by Homeowner Services Group customers as well as increased costs in the Contract Operations Group mainly attributable to costs associated with new military operations and maintenance projects.

Customer billing and accounting expenses increased by $2.8 million, or 30.7%, for the three months ended June 30, 2008 compared to the same period in the prior year. The increase was the result of higher uncollectible accounts expense in our Regulated Businesses of $1.4 million and in our Non-Regulated Businesses of $1.4 million.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by $0.3 million, or 3.0%, in 2008 primarily due to decreased insurance costs of $0.9 million for the three months ended June 30, 2008 due to more favorable claims experience compared to the three months ended June 30, 2007, partially offset by increased regulatory expenses of $0.6 million.

Depreciation and amortization Depreciation and amortization expense decreased by $0.8 million, or 1.2%, for the three months ended June 30, 2008 compared to the same period in the prior year. This decrease was primarily due to depreciation rate adjustments resulting from rate orders, particularly in our Pennsylvania subsidiary offset by increased expense due to additional utility plant placed in service.

General taxes General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by $3.7 million, or 8.0%, in the three months ended June 30, 2008 compared to the three months ended June 30, 2007. This increase is primarily due to increased gross receipts taxes of $2.0 million in New Jersey and increased property tax expense in Missouri of $0.7 million.

Gain on sale of assets Gain on sale of assets was $0.8 million for the three months ended June 30, 2008 as compared to a gain of $6.2 million for the three months ended June 30, 2007 due to non-recurring sales of assets no longer used in our utility operations.

Other income (deductions) Interest, the primary component of our other income (deductions), decreased by $0.7 million, or 1.0%, for the three months ended June 30, 2008 compared to the same period in the prior year. The decline is primarily due to the repayment of outstanding debt with the 2007 equity contributions from RWE that were made to meet the capital structure expectations of various state regulatory commissions. Also, AFUDC increased by $3.2 million for the three months ended June 30, 2008 compared to the same period in 2007 as a result of increased construction work in progress. Other items contributing to the change include lower miscellaneous income for the three months ended June 30, 2008 compared to the three months ended June 30, 2007 primarily as a result of a decrease in jobbing work of $1.0 million and an increase in the amortization of debt expense of $0.3 million for the three months ended June 30, 2008 compared to same period in 2007 as a result of the debt restructuring.

Provision for income taxes Our consolidated provision for income taxes decreased $2.5 million or 7.6%, to $30.2 million for the three months ended June 30, 2008. The effective tax rate was 39.9% for the three months ended June 30, 2008 compared to 39.5% for the three months ended June 30, 2007.

Net income (loss). Net income decreased $3.7 million, to $45.5 million for the three months ended June 30, 2008 from $49.2 million for the three months ended June 30, 2007. The decrease is the result of the aforementioned changes.

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Six Months Ended June 30, 2008 Compared To Six Months Ended June 30, 2007

(Dollars in thousands)	For the six months ended June 30, 2008	2007	Favorable (Unfavorable) Change
Operating revenues	$1,096,184	$1,027,277	$ 68,907
Operating expenses			
Operation and maintenance	641,837	581,999	(59,838)
Depreciation and amortization	131,223	132,764	1,541
General taxes	101,694	93,819	(7,875)
Gain on sale of assets	(870)	(6,113)	(5,243)
Impairment charge	750,000	—	(750,000)
Total operating expenses, net	1,623,884	802,469	(821,415)
Operating income (loss)	(527,700)	224,808	(752,508)
Other income (deductions)			
Interest, net	(140,034)	(142,970)	2,936
Allowance for other funds used during construction	5,928	3,169	2,759
Allowance for borrowed funds used during construction	3,093	1,512	1,581
Amortization of debt expense	(2,759)	(2,397)	(362)
Preferred dividends of subsidiaries	(113)	(113)	—
Other, net	663	2,783	(2,120)
Total other income (deductions)	(133,222)	(138,016)	4,794
Income (loss) from continuing operations before income taxes	(660,922)	86,792	(747,714)
Provision for income taxes	26,064	34,378	8,314
Income (loss) from continuing operations	(686,986)	52,414	(739,400)
Income (loss) from discontinued operations, net of tax	—	(551)	551
Net income (loss)	$ (686,986)	$ 51,863	$ (738,849)

The following table summarizes certain financial information for our Regulated and Non-regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

	For the six months ended June 30, 2008		2007	
	Regulated Businesses	Non-regulated Businesses	Regulated Businesses	Non-regulated Businesses
	(In thousands)			
Operating revenues	$975,782	$128,210	$927,910	$108,781
Adjusted EBIT [1]	$206,113	$ 9,263	$210,052	$ 14,031

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. 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 the 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.

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Operating revenues Our primary business involves the ownership of water and wastewater utilities that services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues resulting from rate authorizations, including infrastructure charges, which were granted and became effective in 2008.

State	Annualized Rate Increases Granted (In millions)
General rate case:	
California	$ 13.0
New York	6.6
Iowa	4.3
Arizona	8.6
West Virginia	14.5
Other	0.2
Infrastructure Charges:	
Pennsylvania	4.6
Indiana	3.9
Missouri	2.7
Illinois	1.1
Total	$ 59.5

Operating revenues increased by $68.9 million, or 6.7% for the six months ended June 30, 2008 compared to the six months ended June 30, 2007. Regulated Businesses' revenues increased by $47.9 million, or 5.2% for the six months ended June 30, 2008 compared to the same period in the prior year. The Non-regulated Businesses' revenues for the six months ended June 30, 2008 increased by $19.4 million, or 17.9% compared to the six months ended June 30, 2007.

The increase in the Regulated Businesses' revenues for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 was primarily due to rate increases obtained through general rate cases in New Jersey, Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $58.1 million and a $1.4 million retroactive rate adjustment in California made in June 2008. This increase was offset by a $20.4 million decrease in revenues related to customer consumption, mainly in our states in the Western region of the United States, for the six months ended June 30, 2008 compared to the same period in the prior year.

The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

	For the six months ended June 30,			
	Operating Revenues		Water Sales Volume	
Customer Class	2008	2007	2008	2007
Water service:				
Residential	57.4%	57.7%	52.6%	52.3%
Commercial	19.0%	19.0%	21.9%	21.8%
Industrial	5.2%	5.0%	11.0%	10.8%
Public and other	12.4%	12.5%	14.5%	15.1%
Other water revenues	2.1%	1.8%	—	—
Total water revenues	96.1%	96.0%	100.0%	100.0%
Wastewater service	3.9%	4.0%		
	100.0%	100.0%		

The following discussion related to water services indicates the increase or decrease in the Regulated Businesses' revenues and water associated sales volumes in gallons by customer class.

Water Services —Water service operating revenues from residential customers for the six months ended June 30, 2008 totaled $559.9 million, a $24.5 million increase, or 4.6%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 2.2% for the six months ended June 30, 2008 to 96.9 billion gallons, from 99.1 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California and the Midwestern region in the United States.

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Water service operating revenues from commercial water customers for the six months ended June 30, 2008 increased by $9.5 million, or 5.4%, to $185.5 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2007. The volume of water sold to commercial customers decreased by 2.4% for the six months ended June 30, 2008, to 40.3 billion gallons, from 41.3 billion gallons for the six months ended June 30, 2007.

Water service operating revenues from industrial customers totaled $50.3 million for the six months ended June 30, 2008, an increase of $4.2 million, or 9.1%, over those recorded for the same period of 2007 mainly due to rate increases offset by decreased sales volume. The volume of water sold to industrial customers totaled 20.3 billion gallons in the six months ended June 30, 2008, a decrease of 1.0% from the 20.5 billion gallons for the six months ended June 30, 2007.

Water service operating revenues from public and other customers increased $4.7 million, or 4.1%, for the six months ended June 30, 2008 to $120.7 million from $116.0 million for the six months ended June 30, 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $51.9 million for the six months ended June 30, 2008, an increase of $2.7 million over the same period of 2007. Revenues generated by sales to governmental entities and resale customers for the six months ended June 30, 2008 totaled $68.9 million, an increase of $2.1 million from the six months ended June 30, 2007.

Wastewater services —Our subsidiaries provide wastewater services in 11 states. Revenues from these services increased by $0.9 million, or 2.4%, to $38.4 million for the six months ended June 30, 2008, from $37.5 million for the same period of 2007. The increase was attributable to increases in rates charged to customers principally in Arizona, Hawaii, and New Jersey.

Non-regulated Businesses' operating revenues increased by $19.4 million, or 17.9% for the six months ended June 30, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $20.9 million in our Contract Operations Group and $3.9 million in our Homeowner Services Group, partially offset by decreased revenues of $5.5 million in our Applied Water Group. The increase in Contract Operations Group revenues was primarily attributable to incremental revenues associated with design and build contracts, as well as increased military construction and operations & maintenance project revenues. The increase from our Homeowner Service Group represented expansion into new geographic markets. Applied Water Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

Operation and maintenance Operation and maintenance expense increased $59.8 million, or 10.3%, for the six months ended June 30, 2008 compared to the same period in the prior year.

Operation and maintenance expenses for the six months ended June 30, 2008 and 2007, by major expense category, were as follows:

	For the six months ended June 30,	
	2008	**2007***
	(In thousands)	
Production costs	$ 136,810	$ 130,938
Employee-related costs	258,255	228,356
Operating supplies and services	136,243	127,669
Maintenance materials and services	72,168	57,171
Customer billing and accounting	19,351	17,402
Other	19,010	20,463
Total	$ 641,837	$ 581,999

* Certain 2007 amounts have been reclassified within operating expenses to conform to the 2008 presentation.

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by $5.9 million, or 4.5%, for the six months ended June 30, 2008 compared to the same period in 2007. The increase was primarily the result of increased costs in our Regulated Businesses of $5.2 million. Fuel and power costs were higher by $2.3 million which can be attributed to increases in electricity prices. Chemical costs also increased by $2.3 million primarily due to rising chemical costs and waste disposal costs were also higher by $1.1 million. Offsetting these increases was lower purchased water costs of $0.5 million.

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Employee-related costs including wage and salary, group insurance, and pension expense increased $29.9 million or 13.1%, for the six months ended June 30, 2008 compared to the same period in the prior year. These employee related costs represented 40.2% and 39.2% of operation and maintenance expenses for the six months ended June 30, 2008 and 2007, respectively. The increase was due to higher wage and salary expenses of $13.9 million and $3.4 million in our Regulated and Non-regulated Businesses, respectively, primarily resulting from $3.3 million of wages related to job reclassification of certain hourly employees for services performed, stock based compensation expense of $2.3 million mainly attributable to the issuance of awards granted in connection with the IPO and an increase in the number of employees and wage rate increases. In addition, our Regulated Businesses' pension expense increased by $6.3 million or 34.1% for the six months ended June 30, 2008 compared to the same period in the prior year. Pension expense in excess of the amount contributed to the pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense in accordance with SFAS 87 remained relatively unchanged, pension expense increased for the six months ended June 30, 2008 due to increased contributions in certain of our regulated operating companies, which costs are recovered based on the Company's funding policy which is the minimum amount required by ERISA, rather than the SFAS 87 expense. The increase in the contributions is attributable to lower than expected returns on plan assets.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the six months ended June 30, 2008, these costs increased by $8.6 million or 6.7%, compared to the same period in 2007. Factors contributing to this increase include an overall increase in general office costs and travel costs of $4.1 million mainly due to inflation, higher costs of $0.9 million in our Illinois operating company due to legal proceedings associated with the Illinois valve and hydrant project, and higher fuel and other transportation costs of $2.9 million. Partially offsetting these increases was a decrease in remediation costs, mainly consulting fees in connection with the Sarbanes-Oxley Act of $8.0 million or 47.3%, to $8.9 million for the six months ended June 30, 2008 compared to $16.9 million for the six months ended June 30, 2007. Included in the six months ended June 30, 2008 are divestiture and IPO related costs amounting to $5.7 million compared to divestiture related costs of $4.9 million for the six months ended June 30, 2007. Corresponding with the increase in revenues, the Non-regulated Businesses operating supplies and service expenses increased by $7.9 million for the six months ended June 30, 2008 compared to the same period in the prior year. The increase is mainly attributable to additional expense in the Contract Operations group associated with several operating contracts (including a design, build and operate project in Fillmore, California), partially offset by lower contracted services costs in the Applied Water Management Group due to the downturn in new home construction and profits of $1.5 million as a result of the finalization and acceptance by a third party of a construction project.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased $15.0 million or by 26.2%, for the six months ended June 30, 2008 compared to the same period in the prior year. The Regulated Businesses' maintenance materials and service costs increased by $10.8 million in the first half of 2008 mainly due to costs of $2.8 million associated with a project in Illinois to maintain valves, higher cost of removal expenses of $5.4 million in certain of our operating companies and increased tank painting costs of $1.5 million in our New Jersey and Missouri operating companies. These increases were offset by lower main break costs in 2008 due to winter weather conditions in the first half of 2007 primarily in our companies in the Midwest region of the United States. The Non-Regulated Businesses' maintenance expenses increased by $1.9 million as a result of higher frequency service line protection contract usage by Homeowner Services Group customers as well as increased cost associated with the Contract Operations Group mainly attributable to costs associated with new military operations and maintenance projects.

Customer billing and accounting expenses increased by $1.9 million or 11.2%, for the six months ended June 30, 2008 compared to the same period in the prior year. The increase was the result of higher expense in our Non-Regulated Businesses of $2.2 million mainly due to increased uncollectible expense on a number of contracts in our Applied Group as well as a credit adjustment recorded to the uncollectible expense account in 2007 partially offset by lower uncollectible accounts expense of $0.2 million in our regulated subsidiaries as a result of an increased focus on collection of past due accounts.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by $1.5 million or 7.1%, in 2008 primarily due to decreased insurance costs of $1.7 million for the six months ended June 30, 2008 due to more favorable claims experience compared to the six months ended June 30, 2007, partially offset by increased regulatory expenses of $0.2 million.

Depreciation and amortization Depreciation and amortization expense decreased by $1.5 million, or 1.2%, for the six months ended June 30, 2008 compared to the same period in the prior year. This decrease was primarily due to depreciation rate adjustments resulting from rate orders, particularly in our Pennsylvania subsidiary partially offset by increased expense due to additional utility plant placed in service.

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General taxes General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by $7.9 million, or 8.4%, in the six months ended June 30, 2008 compared to the first six months of 2007. This increase is primarily due to increased gross receipts taxes of $3.9 million in New Jersey and higher property taxes expense in Ohio of $1.6 million and Missouri of $0.7 million.

Gain on sale of assets Gain on sale of assets was $0.9 million for the six months ended June 30, 2008 compared to a gain of $6.1 million for the six months ended June 30, 2007 due to non-recurring sales of assets no longer used in our utility operations.

Impairment charge The impairment charge was $750.0 million for the six months ended June 30, 2008. The 2008 impairment charge was primarily due 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 what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased interest rates). There was no impairment charge for the six months ended June 30, 2007.

Other income (deductions) Interest, the primary component of our other income (deductions), decreased by $2.9 million, or 2.1% for the six months ended June 30, 2008 compared to the same period in the prior year. The decline is primarily due to the repayment of outstanding debt with the 2007 equity contributions from RWE which were made to meet the capital structure expectations of various state regulatory commissions. Also, AFUDC increased by $4.3 million for the six months ended June 30, 2008 compared to the same period in 2007 as a result of increased construction work in progress. Other items contributing to the change include lower miscellaneous income for the six months ended June 30, 2008 compared to the six months ended June 30, 2007 primarily as a result of a decrease in jobbing work of $1.4 million and an increase in the amortization of debt expense of $0.4 million for the six months ended June 30, 2008 compared to the same period in 2007as a result of the debt restructuring.

Provision for income taxes Our consolidated provision for income taxes decreased $8.3 million or 24.1%, to $26.1 million for the six months ended June 30, 2008 from $34.4 million for the six months ended June 30, 2007. The Company recorded an effective tax rate for the first quarter 2008 of (0.6%) which reflects the tax effect of the goodwill impairment as a discrete item as we consider this charge an infrequently occurring or unusual event.

Net income (loss) Net income decreased $738.9 million, to a net loss of $687.0 million for the six months ended June 30, 2008 from net income of $51.9 million for the six months ended June 30, 2007. The decrease is the result of the aforementioned changes.

Liquidity and Capital Resources

Our business is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary we obtain funds from external sources in the capital markets and through bank borrowings. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to support our commercial paper programs and to issue letters of credit. See the "Credit Facilities and Short-Term Debt" section below for further discussion.

In addition, our regulated utility subsidiaries 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, which vary according to state regulations, as new customers begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from rate base. Generally, we depreciate contributed property and amortize contributions at the composite rate of the related property. Some of our subsidiaries do not depreciate contributed property, based on regulatory guidelines.

We use capital resources, including cash, to fund capital requirements, including construction expenditures, pay off maturing debt, pay dividends, fund pension and postretirement welfare obligations and invest in new and existing businesses. We spend a significant amount of cash on construction projects that have a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. As a result of these factors, our working capital, defined as current assets less current liabilities, was in a net deficit position at June 30, 2008.

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We expect to fund future maturities of long-term debt through a combination of external debt and cash flow from operations. We have no plans to reduce debt significantly.

Cash Flows from Operating Activities

Cash flows from operating activities primarily result from the sale of water and wastewater services and due to the seasonality of operations are weighted toward the third quarter of each fiscal year. Our future cash flows from operating activities will be affected by changes in the rate regulatory environments; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; declining per customer usage of water; and weather and seasonality. Cash flows from operating activities for the six months ended June 30, 2008 were $141.3 million compared to $136.2 million for the six months ended June 30, 2007.

The following table provides a summary of the major items affecting our cash flows from operating activities for the six months ended June 30, 2008 and 2007:

	For the six months ended June 30,	
	2008	2007
	(In thousands)	
Net income (loss)	$(686,986)	$ 51,863
Add (subtract):		
Non-cash operating activities (1)	923,994	175,329
Changes in working capital (2)	(36,057)	(59,304)
Pension and postretirement healthcare contributions	(59,676)	(31,707)
Net cash flows provided by operations	$ 141,275	$136,181

(1) Includes depreciation and amortization, impairment charges, removal costs net of salvage, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, gain on sale of assets, and other non-cash items, net, less pension and postretirement healthcare contributions.

(2) Changes in working capital include changes to accounts receivable and unbilled utility revenue, taxes receivable (including federal income), other current assets, accounts payable, taxes accrued (including federal income), interest accrued and other current liabilities.

Cash Flows from Investing Activities

Cash flows used in investing activities for the six months ended June 30, 2008 and 2007 were $427.6 million and $279.4 million, respectively. Construction expenditures increased $121.4 million to $426.0 million for the six months ended June 30, 2008 from $304.6 million for the six months ended June 30, 2007 as a result of increased investment in regulated utility plant projects. We anticipate spending approximately $950 million on capital investment in 2008.

Our construction program consists of both infrastructure renewal programs, where we replace infrastructure, as needed, and construction of facilities to meet new customer growth. Also, an integral aspect of our strategy is to seek growth through tuck-ins and other acquisitions which are complementary to our existing business and support the continued geographical diversification and growth of our operations. Generally, acquisitions will be funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

Included in the 2008 planned construction expenditures is approximately $26 million to construct a new water treatment plant on the Kentucky River. On April 25, 2008, the Kentucky Public Service Commission approved Kentucky American Water’s application for a certificate of convenience and necessity to construct a 20.0 million gallon per day treatment plant on the Kentucky River and a 30.6 mile pipeline to meet Central Kentucky’s water supply deficit. The Kentucky project is expected to be completed by 2010 with an estimated cost of between $162 million and $168 million.

On December 21, 2007, New Jersey-American Water, our subsidiary, signed an agreement with the City of Trenton, New Jersey to purchase the assets of the city’s water system located in Ewing, Hamilton, Hopewell and Lawrence townships for $100.0 million. The agreement was approved by the Trenton City Council but requires approval by various regulatory agencies, including the New Jersey Board of Public Utilities. We can provide no assurances that the agreement will be approved.

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Cash Flows from Financing Activities

Our financing activities include the issuance of long-term and short-term debt, primarily through our wholly-owned financing subsidiary, American Water Capital Corp. ("AWCC"). In addition, we have received capital contributions from RWE and intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in our registration rights agreement with RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of $2.2 million and $15.7 million for the six months ended June 30, 2008 and 2007, respectively. In connection with the RWE divestiture, we have made and will continue to make significant changes to our capital structure through debt refinancing and equity offerings.

The following long-term debt was issued in the first six months of 2008:

Company	Type	Interest Rate	Maturity	Amount (In Thousands)
American Water Capital Corp.	Senior notes	6.25%	2018	$ 110,000
American Water Capital Corp.	Senior notes	6.55%	2023	$ 90,000
Other subsidiaries.	State financing authority loans and other	1.00%	2024	1,546
Total issuances				$ 201,546

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

Company	Type	Interest Rate	Maturity	Amount (In Thousands)
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	State financing authority loans and other	0.00%-9.87%	2008-2034	18,721
Preferred stock with mandatory redemption requirements:				
Other subsidiaries		4.75%-5.75%	2017-2019	6
Total retirements & redemptions				$ 191,452

In the second quarter of 2008, the Company completed an offer to exchange $750,000 principal amount of its 6.085% Senior Notes due in 2017 and $750,000 principal amount of its 6.593% Senior Notes due in 2037 which are both registered under the Securities Act of 1933 (the "Exchange Notes") for all $750,000 of its currently outstanding 6.085% Senior Notes due in 2017 and all $750,000 of its currently outstanding 6.593% Senior Notes due in 2037, which have not been registered under the Securities Act of 1933 (the "Original Notes"). The Company did not receive any proceeds from the exchange offer, nor did the Company's debt level change as a result of the exchange offer. The terms of the Exchange Notes and the Original Notes are substantially identical in all material respects.

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 sheet.

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Dividends There were no dividend payments made for the six months ended June 30, 2008 or 2007. Our board of directors has adopted a dividend policy, effective upon the consummation of the IPO, to distribute to our stockholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Our policy will be to distribute 50% to 70% of our annual net income, adjusted for certain non-cash items.

On July 28, 2008, our Board of Directors declared a quarterly cash dividend payment of $0.20 per share payable on September 2, 2008 to all shareholders of record as of August 15, 2008.

Contributions from RWE As a result of the impairment charges recorded for the six months ended June 30, 2008, RWE transferred $245.0 million on May 13, 2008. This cash was used to reduce short-term debt. Contributions from RWE were $651.1 million for the six months ended June 30, 2007.

Credit Facilities and Short Term Debt

The components of short-term debt were as follows:

	June 30,2008 (In Thousands)
Commercial paper, net	$ 205,835
Book overdraft	28,329
Other short-term debt	9,254
Total short-term debt	$ 243,418

Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to support our commercial paper programs and to issue letters of credit.

AWCC has entered into a one-year $10.0 million committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2008 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 25 basis points. As of June 30, 2008, $9.3 million was outstanding under this revolving line of credit.

On September 15, 2006, AWCC entered into an $800.0 million unsecured revolving credit facility syndicated among a group of ten banks. This revolving credit facility, which terminates on September 15, 2012 unless extended, is principally used to support the $700 million commercial paper program at AWCC and to provide up to $150.0 million in letters of credit. AWCC had no loans outstanding under the net $800.0 million unsecured revolving credit facility as of June 30, 2008.

At June 30, 2008, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper.

Letter of Credit Sublimit (In thousands)	Available Capacity (In thousands)	Outstanding Commercial Paper (In thousands)
$ 150,000	$ 106,060	$ 205,835

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. As of June 30, 2008, our ratio was 0.55 and therefore we were in compliance with the ratio.

The average interest rate on commercial paper for the six months ended June 30, 2008 was approximately 4.2%.

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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 reporting covenants as of June 30, 2008.

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 June 30, 2008:

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

On June 19, 2008, Standard & Poor's Ratings Services (S&P) downgraded to "BBB+"(stable outlook) from "A-" (negative outlook) the senior unsecured issuer rating of AWCC. In addition, S&P assigned a "BBB+" corporate credit rating to American Water and affirmed AWCC's "A-2" short-term rating.

Moody's 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.

None of our 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 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 our 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.

Current Credit Market Position

The liquidity crisis that began in 2007 as a result of the collapse of the subprime mortgage market has adversely impacted global credit markets and, if it continues, could increase our cost of capital or impair our ability to access the capital markets.

At this time, the Company does not believe recent market developments significantly impact its ability to obtain financing and expects to have access to liquidity in the capital markets on favorable terms. In addition, the Company has access to unsecured revolving credit facilities, which are not as dependent upon general market conditions, with aggregate bank commitments of $810 million, of which a portion is currently committed primarily to backstop the Company's commercial paper program and letters of credit.

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 June 30, 2008 a hypothetical 10% increase in interest rates associated with variable rate debt would result in a $1.2 million decrease in our pre-tax earnings. Our risks associated with price increase for chemicals, electricity and other commodities are reduced through contracts and the ability to recover price increases through rates. Non-performance by these commodity suppliers could have a material 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.

Application of Critical Accounting Policies and Estimates

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates," in our Form 424(b)(4) prospectus filed on April 24, 2008 with the Securities and Exchange Commission for a discussion of the critical accounting policies.

Recent Accounting Pronouncements

See Part I, Item 1 *Financial Statements (Unaudited)- Note 2- New Accounting Pronouncements* in this Quarterly Report on Form 10-Q for a discussion of new accounting standards recently adopted or pending adoption.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. For further discussion of market risks see "Market Risk" in Part I, Item 2 – Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934, as amended ("Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the Commission's rules and forms and that such information is accumulated and communicated to the Company's management including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company's management evaluated the effectiveness of the design and operation of disclosure controls and procedures pursuant to Rule 13a-15(b) of the Exchange Act. This evaluation was done under the supervision and with the participation of management, including our President and Chief Executive Officer and our Chief Financial Officer.

Based on this evaluation and because of the material weaknesses described below, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of June 30, 2008. Notwithstanding these material weaknesses, management concluded that the financial statements included in this Form 10-Q for the three and six-months ended June 30, 2008 fairly present in all material respects their financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America.

Material Weaknesses in Internal Control over Financial Reporting

A material weakness is a control deficiency or a combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 to April 28, 2008, we were an indirect wholly-owned subsidiary of RWE and, as a privately owned company, were not required to maintain a system of internal control consistent with the requirements of the SEC and the Sarbanes-Oxley Act, or to prepare our own financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal

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control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting.

In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants identified the following material weaknesses in our internal control over financial reporting:

- Inadequate internal staffing and skills;
- Inadequate controls over financial reporting processes;
- Inadequate controls over month-end closing processes, including account reconciliations;
- Inadequate controls over maintenance of contracts and agreements;
- Inadequate controls over segregation of duties and restriction of access to key accounting applications; and
- Inadequate controls over tax accounting and accruals.

Remediation of Material Weaknesses

Since joining the Company in 2006, Donald L. Correll, our Chief Executive Officer, and Ellen C. Wolf, our Chief Financial Officer, have assigned a high priority to the evaluation and remediation of our internal controls, and have taken numerous steps to remediate these material weaknesses and to evaluate and strengthen our other internal controls over financial reporting. Some of the actions taken include:

- Increasing our internal financial staff numbers and skill levels, and using external resources to supplement our internal staff when necessary;
- Implementing detailed processes and procedures related to our period end financial closing processes, key accounting applications and our financial reporting processes;
- Implementing or enhancing systems used in the financial reporting processes and month-end close processes;
- Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;
- Enhancing our internal audit staff;
- Hiring a director of internal control and a director of taxes;
- Implementing a tracking mechanism and new policy and procedure for approval of all contracts and agreements; and
- Retaining a nationally recognized accounting and auditing firm to assist management in developing policies and procedures surrounding internal controls over financial reporting, to evaluate and test these internal controls and to assist in the remediation of internal control deficiencies.

With respect to the material weaknesses described above, we have initiated a process to clearly delineate our control weaknesses and formulated a remediation plan. We believe that we have substantially completed remediating most of the identified material weaknesses; however, as our testing procedures have not yet been completed, we can make no assurances as to the success of our remediation efforts. As of June 30, 2008, the Company had incurred $57.8 million to remediate these material weaknesses and to document and test key financial reporting controls. We will need to allocate additional resources to enhance the quality of our staff and to carry out the remediation of these material weaknesses. Based upon our current assessment, we expect to complete the remediation of these material weaknesses during 2008 with an estimated additional cost of approximately $2.8 million. The Company cannot indicate with certainty that the material weaknesses will be remediated or what additional costs may be incurred. The Company needs to finalize its remediation efforts of the controls and complete the testing of the effectiveness of controls prior to concluding controls are effective. As a condition to state Public Utility Commissions' approval of the RWE divestiture, we agreed that costs incurred in connection with our initial internal control and remediation initiatives would not be recoverable in rates charged to our customers. Elements of our remediation activities can only be accomplished over time, and our initiatives provide no assurances that they will result in an effective internal control environment. Our board of directors, in coordination with our audit committee, will continually assess the progress and sufficiency of these initiatives and make adjustments, as necessary.

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The Company believes the additional control procedures as designed, when implemented, will fully remediate the above material weaknesses.

Changes in Internal Control Over Financial Reporting

Except as described above, there were no changes in internal control over financial reporting for the three or six-months ended June 30, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Previously reported under "Business – Legal Proceedings" in the Company's Form 424(b)(4) prospectus filed April 24, 2008.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the "Risk Factors" in the Company's Form 424(b)(4) prospectus filed April 24, 2008, and our Form 10-Q for the quarterly period ended March 31, 2008 filed on May14, 2008, which could materially affect our business, financial condition or future results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

In April 2008, in connection with the IPO, RWE Aqua Holdings GmbH, the Company's sole stockholder at this time, approved the adoption of the Company's Restated Certificate of Incorporation by written consent.

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
10.1	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 15, 2008)
*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.

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Signatures

Pursuant to the requirements 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.

	American Water Works Company, Inc. (Registrant)
August 12, 2008 (Date)	/s/ Donald L. Correll Donald L. Correll President and Chief Executive Officer (Principal Executive Officer)
August 12, 2008 (Date)	/s/ Ellen C. Wolf Ellen C. Wolf Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

Exhibit Number	Exhibit Description
10.1	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 15, 2008)
*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.

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

(Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Donald L. Correll, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Water Works Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2008

By: /s/ Donald L. Correll
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER AND CHIEF ACCOUNTING OFFICER

(Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Ellen C. Wolf, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Water Works Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2008

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

Exhibit 32.1

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of American Water Works Company, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Donald L. Correll , President and Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Donald L. Correll
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer)

August 12, 2008

Exhibit 32.2

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of American Water Works Company, Inc. (the “Company”) on Form 10-Q for the period ended June 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Ellen C. Wolf, Senior Vice President and Chief Financial Officer, of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

August 12, 2008

AMERICAN WATER WORKS COMPANY, INC.

FORM 10-Q
(Quarterly Report)

Filed 11/06/08 for the Period Ending 09/30/08

Address	1025 LAUREL OAK ROAD VOORHEES, NJ 08043
Telephone	856-346-8200
CIK	0001410636
Symbol	AWK
SIC Code	4941 - Water Supply
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2008

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _______to _______

Commission file: number 001-34028

AMERICAN WATER WORKS COMPANY, INC.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**51-0063696** **(I.R.S. Employer Identification No.)**
1025 Laurel Oak Road, Voorhees, NJ **(Address of principal executive offices)**	**08043** **(Zip Code)**

(856) 346-8200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☒	Smaller reporting company	☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.). ☐ Yes ☒ No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at November 5, 2008
Common Stock, $0.01 par value per share	159,983,844 shares

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FOR THE QUARTER ENDED SEPTEMBER 30, 2008
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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

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

	(Unaudited) September 30, 2008	December 31, 2007
ASSETS		
Property, plant and equipment		
Utility plant—at original cost, net of accumulated depreciation of $2,932,051 at September 30 and $2,776,950 at December 31	$ 9,742,671	$ 9,199,909
Nonutility property, net of accumulated depreciation of $81,561 at September 30 and $67,538 at December 31	128,920	118,052
Total property, plant and equipment	9,871,591	9,317,961
Current assets		
Cash and cash equivalents	6,689	13,481
Restricted funds	902	3,258
Utility customer accounts receivable	172,421	147,640
Allowance for uncollectible accounts	(19,669)	(20,923)
Unbilled utility revenues	150,912	134,326
Non-Regulated trade and other receivables, net	75,222	66,540
Federal income taxes receivable	32,530	23,111
Materials and supplies	32,949	27,458
Other	45,268	35,463
Total current assets	497,224	430,354
Regulatory and other long-term assets		
Regulatory assets	628,050	628,039
Restricted funds	8,471	10,252
Goodwill	1,704,310	2,456,952
Other	71,086	90,514
Total regulatory and other long-term assets	2,411,917	3,185,757
TOTAL ASSETS	$12,780,732	$12,934,072

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
(In thousands, except per share data)

	(Unaudited) September 30, 2008	December 31, 2007
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stockholders' equity	$ 4,162,357	$ 4,542,046
Preferred stock without mandatory redemption requirements	4,557	4,568
Long-term debt		
Long-term debt	4,669,502	4,674,837
Redeemable preferred stock at redemption value	24,217	24,296
Total capitalization	8,860,633	9,245,747
Current liabilities		
Short-term debt	327,185	220,514
Current portion of long-term debt	95,836	96,455
Accounts payable	160,518	168,886
Taxes accrued, including income taxes of $6,819 at September 30 and $8,086 at December 31	65,928	56,002
Interest accrued	91,271	50,867
Other	196,752	181,765
Total current liabilities	937,490	774,489
Regulatory and other long-term liabilities		
Advances for construction	629,058	655,375
Deferred income taxes	720,569	638,918
Deferred investment tax credits	34,148	35,361
Regulatory liability-cost of removal	197,910	192,650
Accrued pension expense	253,244	290,722
Accrued postretirement benefit expense	151,899	158,552
Other	117,483	123,871
Total regulatory and other long-term liabilities	2,104,311	2,095,449
Contributions in aid of construction	878,298	818,387
Commitments and contingencies	—	—
TOTAL CAPITALIZATION AND LIABILITIES	$12,780,732	$12,934,072

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 (Unaudited)
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Operating revenues	$672,193	$ 633,117	$1,768,377	$1,660,394
Operating expenses				
Operation and maintenance	342,226	328,305	984,063	910,304
Depreciation and amortization	68,376	69,699	199,599	202,463
General taxes	49,380	47,091	151,074	140,910
(Gain) loss on sale of assets	457	(708)	(413)	(6,821)
Impairment charge	—	243,345	750,000	243,345
Total operating expenses, net	460,439	687,732	2,084,323	1,490,201
Operating income (loss)	211,754	(54,615)	(315,946)	170,193
Other income (deductions)				
Interest, net	(72,684)	(68,739)	(212,718)	(211,709)
Allowance for other funds used during construction	4,442	2,028	10,370	5,197
Allowance for borrowed funds used during construction	2,970	846	6,063	2,358
Amortization of debt expense	(1,601)	(1,227)	(4,360)	(3,624)
Preferred dividends of subsidiaries	(55)	(55)	(169)	(169)
Other, net	881	1,362	1,544	4,146
Total other income (deductions)	(66,047)	(65,785)	(199,270)	(203,801)
Income (loss) from continuing operations before income taxes	145,707	(120,400)	(515,216)	(33,608)
Provision for income taxes	57,549	39,717	83,612	74,095
Income (loss) from continuing operations	88,158	(160,117)	(598,828)	(107,703)
Income (loss) from discontinued operations, net of tax	—	—	—	(551)
Net income (loss)	$ 88,158	$(160,117)	$ (598,828)	$ (108,254)
Basic earnings per common share (1) :				
Income (loss) from continuing operations	$ 0.55	$ (1.00)	$ (3.74)	$ (0.67)
Income (loss) from discontinued operations, net of tax	$ —	$ —	$ —	$ 0.00
Net income (loss)	$ 0.55	$ (1.00)	$ (3.74)	$ (0.68)
Diluted earnings per common share (1) :				
Income (loss) from continuing operations	$ 0.55	$ (1.00)	$ (3.74)	$ (0.67)
Income (loss) from discontinued operations, net of tax	$ —	$ —	$ —	$ 0.00
Net income (loss)	$ 0.55	$ (1.00)	$ (3.74)	$ (0.68)
Average common shares outstanding during the period:				
Basic	159,949	160,000	159,960	160,000
Diluted	160,000	160,000	159,960	160,000

(1) Amounts may not sum due to rounding.

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 (Unaudited)
(In thousands, except per share data)

	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$(598,828)	$ (108,254)
Adjustments		
Depreciation and amortization	199,599	202,463
Impairment charge	750,000	243,345
Amortization of removal costs net of salvage	31,797	22,576
Provision for deferred income taxes	76,742	(1,649)
Amortization of deferred investment tax credits	(1,213)	(1,261)
Provision for losses on utility accounts receivable	13,350	11,073
Allowance for other funds used during construction	(10,370)	(5,197)
Gain on sale of assets	(413)	(6,821)
Other, net	(46,199)	(35,298)
Changes in assets and liabilities		
Receivables and unbilled utility revenues	(64,653)	(85,971)
Other current assets	(24,734)	(18,416)
Accounts payable	6,364	(16,520)
Taxes accrued, including income taxes	12,544	79,510
Interest accrued	40,404	22,930
Other current liabilities	8,523	27,403
Net cash provided by operating activities	392,913	329,913
CASH FLOWS FROM INVESTING ACTIVITIES		
Construction expenditures	(714,559)	(507,237)
Acquisitions	(8,021)	(944)
Proceeds from sale of assets and securities	12,159	15,588
Proceeds from sale of discontinued operations	—	9,660
Removal costs from property, plant and equipment retirements, net	(17,290)	(5,026)
Net restricted funds released	4,137	5,009
Net cash used in investing activities	(723,574)	(482,950)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	201,829	2,367,562
Repayment of long-term debt	(199,655)	(492,191)
Net borrowings (repayments) under short-term debt agreements	124,578	(573,745)
Advances and contributions for construction, net of refunds of $48,111 and $28,401 at September 30, 2008 and 2007	3,204	25,645
Change in cash overdraft position	(17,907)	—
Capital contributions	245,000	701,092
Debt issuance costs	(1,037)	(3,511)
Redemption of preferred stock	(151)	(1,750,310)
Dividends paid	(31,992)	—
Net cash provided by financing activities	323,869	274,542
Net increase (decrease) in cash and cash equivalents	(6,792)	121,505
Cash and cash equivalents at beginning of period	13,481	29,754
Cash and cash equivalents at end of period	$ 6,689	$ 151,259
Non-cash investing activity:		
Capital expenditures acquired on account but unpaid at quarter-end	$ 79,994	$ 72,096
Non-cash financing activity:		
Advances and contributions	$ 40,906	$ 60,337
Capital contribution	$ —	$ 100,000

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 Statement of Changes in Common Stockholders' Equity
(Unaudited)
(In thousands, except per share data)

	Common Stock, $.01 Par Value: 500,000 Shares Authorized				Accumulated Other	Treasury Stock		Common Stockholders'
	Shares	Par Value	Paid-in Capital	(Accumulated Deficit)	Comprehensive Income (Loss)	Shares	At Cost	Equity
Balance at December 31, 2007	160,000	$ 1,600	$5,637,947	$(1,079,118)	$ (18,383)	—	$ —	$4,542,046
Net loss	—	—	—	(598,828)	—	—	—	(598,828)
Equity investment by RWE	—	—	245,000	—	—	—	—	245,000
Contribution of common stock by RWE	—	—	1,933	—	—	(90)	(1,933)	—
Stock-based compensation activity	—	—	2,476	—	—	74	1,586	4,062
Pension plan amortized to periodic benefit cost:								
Prior service cost	—	—	—	—	20	—	—	20
Foreign currency translation	—	—	—	—	2,049	—	—	2,049
Dividends on common stock	—	—	—	(31,992)	—	—	—	(31,992)
Balance at September 30, 2008	160,000	$ 1,600	$5,887,356	$(1,709,938)	$ (16,314)	(16)	$ (347)	$4,162,357

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

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

Note 1: Basis of Presentation

The accompanying consolidated balance sheet of American Water Works Company, Inc. and Subsidiary Companies (the "Company") at September 30, 2008, the consolidated statements of operations for the three months and nine months ended September 30, 2008 and 2007, the consolidated statements of cash flows for the nine months ended September 30, 2008 and 2007, and the consolidated statement of changes in common stockholders' equity for the nine months ended September 30, 2008, are unaudited, but reflect all adjustments, which are, in the opinion of management, necessary to present fairly the consolidated financial position, the consolidated changes in common stockholders' equity, the consolidated results of operations, and the consolidated cash flows for the periods presented. All adjustments are of a normal, recurring nature, except as otherwise disclosed. Because they cover interim periods, the unaudited consolidated financial statements and related notes to the consolidated financial statements do not include all disclosures and notes normally provided in annual financial statements and, therefore, should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's annual consolidated financial statements for the year ended December 31, 2007. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

Note 2: New Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("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 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. 157, "Fair Value Measurements" ("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. In February 2008, the FASB issued FASB Staff Position 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 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 will be required to measure the assets of its defined benefit pension and other post retirement welfare plans pursuant to SFAS 157 at the next measurement date, which will be December 31, 2008. The Company is evaluating the effect, if any, that the adoption of SFAS 157 for the Company's nonfinancial assets and liabilities will have on its results of operations, financial position and cash flows.

On October 10, 2008, the FASB issued 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 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.

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Note 3: Goodwill

At September 30, 2008, the Company's goodwill totaled $1,704,310. The Company's annual goodwill impairment test is conducted at November 30 of each calendar year and interim reviews are performed 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 market price of the Company's common stock at September 30, 2008 was below its consolidated carrying value. Subsequent to September 30, 2008, the Company's market price has experienced a high degree of volatility. As a result, management considered whether the Company's market capitalization being below the consolidated carrying value of its reporting units represented an interim triggering event.

Having considered both qualitative and quantitative factors, management concluded that no interim triggering event has occurred. As such, an interim impairment test was not performed, as management believes there were no significant adverse changes in its business. Further, the Company's methodology is not based purely on stock price but adjusts for other valuation techniques and relevant market information, as described in the testing methodology below, including the expected impact to the share price once RWE divests a substantial portion of its ownership.

The Company may be required to recognize an impairment as a result of this year's annual test or at other times in the future. This depends on other factors identified below in the description of the Company's test approach. These include market price declines such as levels experienced during October 2008, 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 and the lack of an increase in the Company's market price consistent with increases in the carrying value or to a level consistent with its peer companies. 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, may also result in an incremental impairment charge. Further 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 secure financing on attractive terms and maintain compliance with debt covenants.

The following table summarizes the nine-month changes in the Company's goodwill by reporting unit:

	Regulated Unit	Non-Regulated Units	Consolidated
Balance at December 31, 2007	$2,327,270	$129,682	$2,456,952
Impairment charge	(750,000)	—	(750,000)
Felton water system asset sale	(2,373)	—	(2,373)
Other activity	(269)	—	(269)
Balance at September 30, 2008	$1,574,628	$129,682	$1,704,310

The Company recognized goodwill impairment charges of $0 and $243,345 for the three months ended September 30, 2008 and 2007, respectively and $750,000 and $243,345 for the nine months ended September 30, 2008 and 2007, respectively.

In light of the initial public offering price and trading levels in our common stock since the date of the initial public offering ("IPO"), the Company performed an interim impairment test and, on May 9, 2008, concluded that the current carrying value of the Company's goodwill was impaired as a result of the current market price at that time and trading levels of the Company's common stock. The Company believes 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 goodwill related to its Regulated Businesses in the amount of $750,000 in the financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due 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 that implied by the trading value of peer companies 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 ("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.

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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 IPO, 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 Businesses in the amount of $243,345. 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 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 Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). The step 1 calculation used to identify potential impairment compares the 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 shall be performed to measure the amount of the impairment loss (if any) for such reporting units.

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 net fair value of each reporting unit's assets and liabilities above the carrying value of such reporting unit's assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss shall be recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

If step 2 is required, the determination of the fair value of each reporting unit and the fair value of each reporting unit's assets and liabilities will be 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). The step 2 fair value determination will use a combination of the following valuation techniques:

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

Each of the Company's reporting unit's fair value is determined by weighting, according to relevance, the results of three valuation techniques. The first, and primary, valuation is based upon the observable market price of the Company's common equity as adjusted for control premiums and other relevant market conditions.

The second model-based valuation technique applies an average peer multiple to the Company's historic and forecasted cash flows. The cash flow multiple is calculated using the quoted market equity prices of comparable publicly-traded water utilities, and their published cash flows. This market multiple is then applied to the applicable reporting unit's internal historic and forecasted cash flows as adjusted to remove non-recurring items and forecast acquisitions.

The third model-based valuation technique discounts the five-year business plan forecast cash flows, as adjusted to remove non-recurring items and forecast acquisitions, at the Company's weighted average cost of capital.

If step 2 of the impairment test is required, the Company will determine 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 at the measurement date. For the step 2 calculations of the fair value of debts, the Company will use observable prices of instruments and indices which share similar risk to those instruments being valued, adjusted to compensate for different credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit's debts.

Note 4: 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.

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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 September 30, 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.

On October 17, 2008, the Company's Board of Directors declared a quarterly cash dividend payment of $0.20 per share payable on December 1, 2008 to all shareholders of record as of November 18, 2008.

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 three and nine months ended September 30, 2008 and 2007:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Stock Options	$ 571	$ —	$ 1,041	$ —
Restricted stock units	231	170	667	510
Restricted stock	393	—	1,799	—
Stock-based compensation in operation and maintenance expense	1,195	170	3,507	510
Income tax benefit	(466)	(66)	(1,368)	(199)
After-tax stock-based compensation expense	$ 729	$ 104	$ 2,139	$ 311

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 September 30, 2008, 684 stock option and 88 restricted stock awards are not considered probable to meet performance conditions.

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

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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 September 30, 2008 ranged from 1.25 years to 2.25 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 September 30, 2008.

	Outstanding Shares	Weighted Average Exercise Price (per share)
Nonvested at December 31, 2007	—	—
Granted	2,083	$ 21.50
Vested	—	—
Forfeited	(14)	21.50
Nonvested at September 30, 2008	2,069	$ 21.50

There are zero option awards vested and no option awards have been exercised as of September 30, 2008.

As of September 30, 2008, $4,238 of total unrecognized compensation costs related to the nonvested stock options is expected to be recognized over the remaining weighted-average period of 1.9 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.

The following table presents information with respect to restricted stock unit activity as of September 30, 2008.

	Outstanding Shares	Weighted Average Grant Date Fair Value (per share)
Nonvested at December 31, 2007	—	—
Granted	270	$ 21.50
Vested	—	—
Forfeited	(2)	21.50
Nonvested at September 30, 2008	268	$ 21.50

As these restricted stock units would have paid-out in cash if the IPO was not 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 September 30, 2008, $2,280 of total unrecognized compensation costs related to the nonvested restricted stock units is expected to be recognized over the remaining weighted-average period of 2.0 years.

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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 September 30, 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 September 30, 2008	—	$ —

As of September 30, 2008, the restricted stock was fully vested and there were no unrecognized compensation costs related to the nonvested restricted stock units. 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 a discount. The Company's ESPP is considered compensatory under SFAS 123(R). Compensation costs of $77 were recognized for the three and nine months ended September 30, 2008. At September 30, 2008, 23 shares were issued from treasury stock under the ESPP.

Note 5: Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2008	2007	2008	2007
Net income (loss) to common stock	$88,158	$(160,117)	$(598,828)	$(108,254)
Pension plan amortized to periodic benefit cost:				
Prior service cost	7	9	20	27
Actuarial loss	—	18	—	54
Foreign currency translation adjustment	2,212	509	2,049	252
Total comprehensive income (loss)	$90,377	$(159,581)	$(596,759)	$(107,921)

Significant changes in facts and circumstances of the Company's Canadian subsidiaries indicated that their functional currency changed from the U.S. dollar to the Canadian dollar. In accordance with Statement of Financial Accounting Standards No. 52 "Foreign Currency Translation", the Company accounted for the change in functional currency of its Canadian subsidiaries to the Canadian dollar in August of 2008.

Note 6: Long-Term Debt

The Company primarily issues long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term debt are as follows:

	Rate	Maturity Date	September 30, 2008	December 31, 2007
Long-term debt of American Water Capital Corp. ("AWCC")				
Private activity bonds and government funded debt				
Floating rate (a)	1.80%-3.60%	2018-2032	$ 86,860	$ 86,860
Senior notes				
Fixed rate	5.39%-6.87%	2011-2037	2,884,000	2,712,000
Long-term debt of other subsidiaries				
Private activity bonds and government funded debt				
Fixed rate	0.00%-6.88%	2009-2038	935,766	942,941
Floating rate (b)	1.70%-10.00%	2015-2032	33,420	178,145
Mortgage bonds				

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	Rate	Maturity Date	September 30, 2008	December 31, 2007
Fixed rate	6.31%-9.71%	2008-2034	715,800	731,340
Senior debt				
Fixed rate	5.60%-9.10%	2009-2025	40,705	45,473
Mandatory redeemable preferred stock	4.60%-9.75%	2013-2036	24,503	24,644
Notes payable and other (c)	5.76%-11.91%	2012-2026	2,993	3,442
Long-term debt			4,724,047	4,724,845
Unamortized debt discount, net (d)			65,508	70,743
Total long-term debt			$4,789,555	$4,795,588

(a) Variable rate tax-exempt bonds which are 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. However, the Company expects investors to purchase the bonds and thus the bonds are classified as long-term.

(b) $24,860 of the total represents variable rate tax-exempt bonds which are remarketed every 7 to 35 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. The remaining $8,560 represents variable rate tax-exempt bonds remarketed for periods up to 270 days. See (a) above.

(c) Includes capital lease obligations of $1,870 and $1,982 at September 30, 2008 and December 31, 2007, respectively.

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

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
Other subsidiaries	State financing authority loans and other	1.00%	2024	1,829
Total Issuances				$201,829

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	20,374
Other subsidiaries	State financing authority loans and other	0.00%-9.87%	2008-2034	9,276
Preferred stock with mandatory redemption requirements				
Other subsidiaries		4.60%-6.00%	2013-2019	140
Total retirements & redemptions				$202,515

Other subsidiaries fixed rate bonds and notes redemptions includes $2,832 of debt assumed by the purchaser in the Felton water system asset sale. (See Note 15).

Gains from early extinguishment of debt included in interest, net amounted to $0 for the three and nine months ended September 30, 2008 and $4,949 and $13,113 for the three and nine months ended September 30, 2007, respectively.

Interest, net includes interest income of approximately $786 and $5,404 for the three and nine months ended September 30, 2008, respectively and $2,364 and $7,457 for the three and nine months ended September 30, 2007, respectively.

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Note 7: Short-Term Debt

The components of short-term debt are as follows:

	September 30, 2008	December 31, 2007
Commercial paper, net of $90 and $680 discount	$ 131,910	$ 169,267
Book overdraft	24,291	42,198
Lines of credit	170,984	9,049
Total short-term debt	$ 327,185	$ 220,514

Note 8: Income Taxes

The Company's estimated annual effective tax rate for 2008 is 40.3% compared to 38.6% for 2007, excluding various discrete items including goodwill impairment. The Company's actual effective tax rates for the three months ended September 30, 2008 and 2007 were 39.5% and (33.0%), respectively. The Company's actual effective rates for the nine months ended September 30, 2008 and 2007 of (16.2%) and (220.5%), respectively, reflect the tax effects of the goodwill impairments as discrete items as the Company considers this charge an infrequently occurring or unusual event.

During 2006, the Company filed with the Internal Revenue Service ("IRS") federal refund claims. 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"). In August 2008, the Company received notification from the IRS outlining their final findings from the audit to which the Company and IRS have agreed. Subsequently, the Company received notification that the JCT approved the full agreed refund claim in the amount of $28,763 excluding interest. The Company received $26,796 in October 2008 and expects to receive the remaining portion of the fully agreed refund claim plus interest before December 31, 2008.

Note 9: Pension and Other Postretirement Benefits

The following table provides the components of net periodic benefit costs:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Components of net periodic pension benefit cost				
Service cost	$ 6,551	$ 6,403	$ 19,653	$ 19,209
Interest cost	14,549	13,322	43,647	39,966
Expected return on plan assets	(12,925)	(11,763)	(38,775)	(35,289)
Amortization of:				
Prior service cost	45	32	135	96
Actuarial loss	1	66	3	198
Periodic pension benefit cost	8,221	8,060	24,663	24,180
Special termination pension benefit charge	—	—	—	93
Net periodic pension benefit cost	$ 8,221	$ 8,060	$ 24,663	$ 24,273

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
Components of net periodic other postretirement benefit cost				
Service cost	$ 3,106	$ 3,171	$ 9,318	$ 9,513
Interest cost	7,049	6,346	21,147	19,038
Expected return on plan assets	(5,751)	(5,266)	(17,253)	(15,798)
Amortization of:				
Transition obligation	43	43	129	129
Prior service credit	203	(295)	609	(885)
Actuarial loss	(295)	—	(885)	—
Net periodic other postretirement benefit cost	$ 4,355	$ 3,999	$ 13,065	$ 11,997

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The Company contributed $61,000 to its defined benefit pension plan in the first nine months of 2008 and expects to contribute $15,000 during the balance of 2008. In addition, the Company contributed $20,514 for the funding of its other postretirement plans in the first nine months of 2008 and expects to contribute $6,838 during the balance of 2008.

Note 10: 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 has agreed to provide a limited twelve month warranty relating to certain components of the facilities that OMI/TW constructed (the “WW39 Plant”), 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 final settlement with OMI, the Company has a loss reserve of approximately $3,000 and $4,000 at September 30, 2008 and December 31, 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 September 30, 2008, no claims have been made related to this warranty.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At September 30, 2008, the Company had accrued approximately $4,800 as probable costs and it is reasonably possible that additional losses could range up to $33,000 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 non-regulated 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 remaining contract revenue of $1,337,103 and $480,742 at September 30, 2008 and December 31, 2007, respectively. The Company’s Operations and Maintenance agreements with municipalities and other customers expire between 2009 and 2028 and have remaining performance commitments as measured by remaining contract revenue of $343,136 and $403,829 at September 30, 2008 and December 31, 2007, respectively.

Included in the military services performance commitment at September 30, 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.

Note 11: Guarantees

The Company guarantees performance on its non-regulated agreements. The Company, through AW-Acciona has contracted with Tampa Bay Water (“Tampa Bay”), an interlocal governmental agency of the State of Florida, to remedy and operate the Tampa Bay Seawater Desalination Plant. The Company entered into a guarantee with Tampa Bay in November 2004 for the full and prompt performance of certain contractual obligations limited to a total aggregate liability of $35,000. Contractual obligations call for certain construction activities and management services to be completed satisfactorily. AW-Acciona took over operation of the plant in January 2005. At December 31, 2007, the plant was fully operational and successful performance testing of the construction activities had been completed. At September 30, 2008 and December 31, 2007, no accruals have been made related to this guarantee.

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Note 12: Environmental Matters

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. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to approximately $11,000 at September 30, 2008 and December 31, 2007. At September 30, 2008, $10,100 of the reserve relates 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.

Note 13: Net Income (Loss) per Common Share

Basic net income (loss) per common share, income (loss) from discontinued operations, net of tax, per common share and income (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 income (loss) per common share, income (loss) from discontinued operations, net of tax, per common share and income (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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Numerator				
Income (loss) from continuing operations	$ 88,158	$(160,117)	$(598,828)	$(107,703)
Income (loss) from discontinued operations, net of tax	—		—	(551)
Net income (loss)	$ 88,158	$(160,117)	$(598,828)	$(108,254)
Denominator				
Average common shares outstanding – basic	159,949	160,000	159,960	160,000
Effect of dilutive securities:				
Restricted stock units	32	—	—	—
Restricted stock	19	—	—	—
Average common shares outstanding – diluted	160,000	160,000	159,960	160,000

Options to purchase 777 shares of the Company's common stock were excluded from the calculation of diluted common shares outstanding because the calculated proceeds from the exercise of the options were greater than the average market price of the Company's common stock during the three month period ended September 30, 2008. There were also 169 restricted stock units and 1,306 stock options which were excluded from the calculation of diluted common shares outstanding because certain performance conditions were not satisfied as of September 30, 2008. All of the potentially dilutive securities have been excluded for the nine months ended September 30, 2008 because they are anti-dilutive. The Company had no potentially dilutive shares for the three and nine month periods ending September 30, 2007.

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Note 14: 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 following table includes the Company's summarized segment information:

	As of or for the Three Months Ended September 30, 2008			
	Regulated	Non-Regulated	Other	Consolidated
Net operating revenues	$ 603,432	$ 73,870	$ (5,109)	$ 672,193
Depreciation and amortization	64,046	1,089	3,241	68,376
Impairment charge	—	—	—	—
Total operating expenses, net	399,721	67,044	(6,326)	460,439
Adjusted EBIT (1)	204,963	7,095		
Total assets	10,675,905	254,123	1,850,704	12,780,732
Capital expenditures	286,831	1,768	—	288,599

	As of or for the Three Months Ended September 30, 2007			
	Regulated	Non-Regulated	Other	Consolidated
Net operating revenues	$ 571,853	$ 66,391	$ (5,127)	$ 633,117
Depreciation and amortization	66,996	2,236	467	69,699
Impairment charge	—	—	243,345	243,345
Total operating expenses, net	388,543	63,541	235,648	687,732
Adjusted EBIT (1)	184,549	3,575		
Total assets	9,904,688	307,246	2,877,903	13,089,837
Capital expenditures	185,648	17,032	—	202,680

	As of or for the Nine Months Ended September 30, 2008			
	Regulated	Non-Regulated	Other	Consolidated
Net operating revenues	$ 1,579,214	$ 202,080	$ (12,917)	$ 1,768,377
Depreciation and amortization	187,994	4,358	7,247	199,599
Impairment charge	—	—	750,000	750,000
Total operating expenses, net	1,169,974	187,493	726,856	2,084,323
Adjusted EBIT (1)	411,076	16,358		
Total assets	10,675,905	254,123	1,850,704	12,780,732
Capital expenditures	709,765	4,794	—	714,559

	As of or for the Nine Months Ended September 30, 2007			
	Regulated	Non-Regulated	Other	Consolidated
Net operating revenues	$1,499,763	$ 175,172	$ (14,541)	$ 1,660,394
Depreciation and amortization	194,202	7,483	778	202,463
Impairment charge	—	—	243,345	243,345
Total operating expenses, net	1,108,023	161,281	220,897	1,490,201
Adjusted EBIT (1)	394,601	17,606		
Total assets	9,904,688	307,246	2,877,903	13,089,837
Capital expenditures	487,089	20,148	—	507,237

(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.

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

	For the Three Months Ended September 30, 2008		
	Regulated	Non-Regulated	Total Segments
Adjusted EBIT	$204,963	$ 7,095	$ 212,058
Add:			
Allowance for other funds used during construction	4,442	—	4,442
Allowance for borrowed funds used during construction	2,970	—	2,970
Less:			
Interest, net	(57,906)	904	(57,002)
Preferred dividends of subsidiaries	(55)	—	(55)
Amortization of debt expense	(1,601)	—	(1,601)
Segments’ income from continuing operations before income taxes	$152,813	$ 7,999	160,812
Interest, net			(15,682)
Other			577
Income from continuing operations before income taxes			$ 145,707

	For the Three Months Ended September 30, 2007		
	Regulated	Non-Regulated	Total Segments
Adjusted EBIT	$184,549	$ 3,575	$ 188,124
Add:			
Allowance for other funds used during construction	2,028	—	2,028
Allowance for borrowed funds used during construction	846	—	846
Less:			
Interest, net	(55,054)	(2,364)	(57,418)
Preferred dividends of subsidiaries	(55)	—	(55)
Amortization of debt expense	(1,037)	—	(1,037)
Segments’ income from continuing operations before income taxes	$131,277	$ 1,211	132,488
Impairment charges			(243,345)
Interest, net			(11,321)
Other			1,778
Income from continuing operations before income taxes			$(120,400)

	For the Nine Months Ended September 30, 2008		
	Regulated	Non-Regulated	Total Segments
Adjusted EBIT	$ 411,076	$ 16,358	$ 427,434
Add:			
Allowance for other funds used during construction	10,370	—	10,370
Allowance for borrowed funds used during construction	6,063	—	6,063
Less:			
Interest, net	(169,727)	2,290	(167,437)
Preferred dividends of subsidiaries	(169)	—	(169)
Amortization of debt expense	(4,360)	—	(4,360)
Segments’ income from continuing operations before income taxes	$ 253,253	$ 18,648	271,901
Impairment charges			(750,000)
Interest, net			(45,281)
Other			8,164
Loss from continuing operations before income taxes			$(515,216)

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	For the Nine Months Ended September 30, 2007		
	Regulated	Non-Regulated	Total Segments
Adjusted EBIT	$ 394,601	$ 17,606	$ 412,207
Add:			
Allowance for other funds used during construction	5,197	—	5,197
Allowance for borrowed funds used during construction	2,358	—	2,358
Less:			
Interest, net	(164,255)	(8,031)	(172,286)
Preferred dividends of subsidiaries	(169)	—	(169)
Amortization of debt expense	(3,624)	—	(3,624)
Segments' income from continuing operations before income taxes	$ 234,108	$ 9,575	243,683
			(243,345)
Interest, net			(39,423)
Other			5,477
Income from continuing operations before income taxes			$ (33,608)

Note 15: 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 includes 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 for the three and nine month periods ended September 30, 2008 (See Note 3).

Note 16: Subsequent Event

In November of 2008, the Company received $15,387 of settlement proceeds from lawsuits seeking to recover cleanup and treatment costs and seeking to protect certain groundwater supplies related to contamination by methyl tertiary butyl ether ("MTBE") and other gasoline additives. The Company has deferred the receipt of cash and is evaluating its regulatory accounting treatment.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain matters within this Quarterly Report on Form 10-Q include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements included in this Form 10-Q, other than statements of historical fact, may constitute forward-looking statements. Forward-looking statements can be identified by the use of words such as "may," "should," "will," "could," "estimates," "predicts," "potential," "continue," "anticipates," "believes," "plans," "expects," "future" and "intends" and similar expressions. Forward-looking statements may involve known and unknown risks, uncertainties and other factors that may cause the actual results or performance to differ from those projected in the forward-looking statements. These statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond our control and difficult to predict and could cause actual results to differ materially from those expressed or forecasted in the forward-looking statements. Factors that could cause or contribute to differences in results and outcomes from those in our forward-looking statements include, without limitation, those items discussed in the "Risk Factors" section or other sections in the Company's Rule 424(b)(4) prospectus filed April 24, 2008 with the Securities and Exchange Commission, as well as in Item IA of Part II of this Quarterly Report. All forward-looking statements are expressly qualified in their entirety by such risk factors. We undertake no obligation, other than as required by law, to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

GENERAL

American Water Works Company, Inc. (herein referred to as "American Water" or the "Company") is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state regulatory agencies in the states in which they operate. We report the results of these businesses in our Regulated Businesses segment. We also provide services that are not subject to economic regulation by state regulatory agencies. We report the results of these businesses in our Non-Regulated Businesses segment. For further description of our businesses see the "Business" section found in our Rule 424(b)(4) prospectus filed on April 24, 2008 with the Securities and Exchange Commission.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Quarterly Report on Form 10-Q and in our Prospectus filed with the SEC on April 24, 2008, with the information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Rule 424(b)(4) prospectus filed with the Securities and Exchange Commission on April 24, 2008.

OVERVIEW

Financial Results American Water's net income was $88.2 million for the three months ended September 30, 2008 compared to a net loss of $160.1 million, which included an impairment charge net of tax of $239.6 million, for the three months ended September 30, 2007. Diluted earnings per average common share were $0.55 for the three months ended September 30, 2008 as compared to ($1.00) for the three months ended September 30, 2007.

American Water's net loss, which includes an impairment charge net of tax of $738.5 million, was $598.8 million, for the nine months ended September 30, 2008 as compared to net loss of $108.3 million, which also includes an impairment charge net of tax of $239.6 million for the nine months ended September 30, 2007. Diluted loss per average common share was ($3.74) for the nine months ended September 30, 2008 as compared to ($0.68) for the nine months ended September 30, 2007.

The increase in net income for the three months ended September 30, 2008 compared to the same period in the prior year is primarily the result of higher revenues and decreased operating expenses. Revenues for the three months ended September 30, 2008 increased by $39.1 million compared to the same period in the prior year. This was primarily due to increased revenues in our Regulated Businesses of $31.6 million, which was largely attributable to rate increases, as well as higher revenues of $7.5 million in our Non-Regulated Businesses due to increased Contract Operations Group and Homeowner Services Group revenues. These were partially offset by decreased revenues in our Applied Water Management Group and Canadian Fixed Residuals. Operating expenses for the three months ended September 30, 2008 were $460.4 million compared to $687.7 million, for the three months ended September 30, 2007. Included in the 2007 expenses was an impairment charge of $243.3 million which is discussed in more detail below. Partially offsetting the impairment charge is an increase in our other operating expenses of $16.0 million. This increase was primarily driven by increased operating expenses in our Regulated Businesses of $11.2 million and in our Non-Regulated Businesses of $3.5 million for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. The Regulated Businesses' increase was mainly driven by higher employee related costs of $13.0 million primarily as a result of

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enhancing customer service, increased customer billing and accounting expense of $3.7 million and higher maintenance costs of $3.0 million due to increased removal costs partially offset by lower Sarbanes-Oxley remediation and divestiture related costs. The increase in the Regulated Businesses' employee related costs was mainly due to an increase in the number of employees and wage rate increases, higher stock based compensation expense and higher pension expense in 2008. The increase in the Non-Regulated Businesses' operating expenses was primarily the result of higher operating and maintenance expenses of $3.9 million which corresponds with their increased revenues, partially offset by lower depreciation expense of $1.1 million. In addition, included in the three months ended September 30, 2007 Non-Regulated Businesses' results was a gain on sale of assets of $0.8 million.

Other items affecting income from continuing operations for the three months ended September 30, 2008 as compared to the same period in the prior year include increased allowance for funds used during construction ("AFUDC") of $4.5 million attributable to the increase in construction work in progress primarily in New Jersey and Missouri and higher income tax expense of $17.8 million mainly the result of higher taxable income for the three months ended September 30, 3008 and the inclusion of a $3.7 million tax benefit associated with the impairment charge recorded in the quarter ended September 30, 2007.

For the nine months ended September 30, 2008, revenues increased by $108.0 million compared to the same period in the prior year primarily due to increased revenues in our Regulated Businesses of $79.5 million, which is largely attributable to rate increases, while revenues in our Non-Regulated Businesses increased by $26.9 million due to increased Contract Operations and Homeowner Services Group revenues, partially offset by decreased revenues in our Applied Water Management Group. Operating expenses for the nine months ended September 30, 2008 were $2,084.3 million compared to $1,490.2 million for the nine months ended September 30, 2007. Impairment charges were included in both periods' operating expenses. The impairment charge for the nine months ended September 30, 2008 was $750.0 million compared to $243.3 million for the nine months ended September 30, 2007. These impairment charges are discussed in more detail below. The remaining increase in operating expenses for the nine months ended September 30, 2008 compared to the same period in the prior year was primarily the result of increased operating expenses in our Regulated Businesses of $62.0 million and in our Non-Regulated Businesses of $26.2 million. The increase in our Regulated Businesses' operating expenses was mainly driven by higher employee related costs of $38.1 million due to $3.3 million of wages related to job reclassification of certain hourly employees for services performed, stock based compensation expense of $3.5 million including $1.8 million attributable to the issuance of awards granted in connection with the IPO, an increase in the number of employees primarily as a result of enhancing customer service and wage rate increases in 2008 as well as higher pension expense in 2008. The Regulated Businesses' maintenance costs increased by $13.8 million primarily due to higher removal costs, increased expenses of $2.2 million associated with a project in Illinois to perform valve and hydrant maintenance as well as increased tank painting expenses. Also contributing to the Regulated Businesses variance was higher production costs of $5.2 million, primarily fuel and power, as well as chemical costs and higher general taxes of $9.4 million mainly due to increased gross receipts and property taxes. Partially offsetting these increases was lower depreciation expense as a result of depreciation rate adjustments resulting from rate orders, particularly in our Pennsylvania subsidiary. The increase in our Non-Regulated Businesses' operating expenses was mainly due to higher operation and maintenance expenses of $22.6 million in 2008 which corresponds with their increased revenues partially offset by lower depreciation expense. In addition, included in the nine months ended September 30, 2007 was a gain on sale of assets of $6.9 million.

Other items affecting income from continuing operations for the nine months ended September 30, 2008 as compared to the same period in the prior year include increased AFUDC of $8.9 million attributable to the increase in construction work in progress primarily in New Jersey and Missouri.

Regulatory Developments During the three months ended September 30, 2008, we received authorizations for additional annualized revenues from general rate cases in Illinois and Tennessee amounting to $23.3 million. Illinois's rates were effective in the third quarter of 2008 while the Tennessee rates are effective October 1, 2008. In the first nine months of 2008 we received authorizations for additional annualized revenues from general rate cases of $73.9 million. As of September 30, 2008, we were awaiting final orders for Ohio and Hawaii's general cases that were filed in 2007, requesting $5.5 million and $1.3 million, respectively, in total additional annual revenues. In October 2008, The Hawaii Public Utility Commission approved on an interim basis an increase in additional annualized revenues of $0.7 million. The interim rates will be effective for the fourth quarter of 2008. In the first nine months of 2008, we filed general rate cases in ten additional states that would provide $272.9 million of additional revenues, if approved as filed. Of the rate cases filed in 2008, two states' rates were effective through the nine months ended September 30, 2008 with an additional annualized increase of $1.9 million and are included in the $73.9 million of annualized revenues referred to above. In addition, new rates which would provide for additional $4.3 million of annualized revenues were put into effect under bond for our Virginia subsidiary. In October 2008, the Virginia commission issued a final order which would provide $3.4 million in additional annual revenue. The residual amount of $260.8 million for the other eight states remains under consideration by state public utility commissions at this time. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted. On October 1, 2008, additional annualized revenues of $4.1 million resulting from infrastructure charges for our Pennsylvania subsidiary became effective.

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Financing Activities During the nine months ended September 30, 2008, we met our capital resource requirements with internally generated cash as well as funds from external sources primarily through commercial paper, borrowings under our credit facilities and the issuance of $200.0 million of private placement debt. In addition, as a result of the impairment charge, RWE made a capital contribution in the second quarter of 2008 of $245.0 million. The cash was used to reduce short-term debt.

Felton Sale In September 2008, our California subsidiary completed its sale of the Felton water system to SLVWD. Under the terms of the agreement, SLVWD paid $13.4 million for the operating assets of the water system, which serves approximately 1,330 customers in Felton. The payment included a $10.6 million cash payment to California American Water and the assumption by SLVWD of $2.8 million in debt. The sale of the Felton system resulted in a loss on sale of $0.4 million.

Initial Public Offering Our common stock began trading on the New York Stock Exchange on April 23, 2008. On April 28, 2008, the Company completed its initial public offering ("IPO"). RWE Aqua Holdings GmbH, the Company's selling stockholder, sold 58.0 million shares of the Company's common stock at a price of $21.50 per share. The selling stockholder granted the underwriters a 30-day option to purchase up to an additional 8.7 million 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 option to purchase 5.2 million 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 the exercise of the underwriters' over-allotment option, RWE owns approximately 60% of the Company's common shares.

On April 22, 2008, a subsidiary of RWE contributed approximately 89,900 shares of the Company's common stock to the Company and the Company granted approximately 89,900 restricted stock awards, 269,300 restricted stock units and 2.1 million stock options. The awards were issued to the Company's employees and certain non-employee directors under our 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 6.0 million. 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 on January 1, 2011. Shares issued under the 2007 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 4,759 stock options and 602 restricted stock units to newly appointed non-employee directors in two grants vesting on January 1, 2011.

Effective the first quarter of 2008, the Company's Board of Directors authorized 50.0 million shares of par value $0.01 per share preferred stock. As of September 30, 2008 there are no shares outstanding.

Impairment Charge: At September 30, 2008, the Company's goodwill totaled $1,704.3 million. The Company's annual goodwill impairment test is conducted at November 30 of each calendar year and interim reviews are performed 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 market price of the Company's common stock at September 30, 2008 was below its consolidated carrying value. Subsequent to September 30, 2008, the Company's market price has experienced a high degree of volatility. As a result, management considered whether the Company's market capitalization being below the consolidated carrying value of its reporting units represented an interim triggering event.

Having considered both qualitative and quantitative factors, management concluded that no interim triggering event has occurred. As such, an interim impairment test was not performed, as management believes there were no significant adverse changes in its business. Further, the Company's methodology is not based purely on stock price but adjusts for other valuation techniques and relevant market information, as described in the testing methodology below, including the expected impact to the share price once RWE divests a substantial portion of its ownership.

The Company may be required to recognize an impairment as a result of this year's annual test or at other times in the future. This depends on other factors identified below in the description of the Company's test approach. These include market price declines such as levels experienced during October 2008, 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 and the lack of an increase in the Company's market price consistent with increases in the carrying value or to a level consistent with its peer companies. 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, may also result in an incremental impairment charge. Further 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 secure financing on attractive terms and maintain compliance with debt covenants.

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In light of the initial public offering price and trading levels in our common stock since the date of the IPO, the Company performed an interim impairment test and, on May 9, 2008, concluded that the current carrying value of the Company's goodwill was impaired as a result of the current market price at that time and trading levels of the Company's common stock. The Company believes 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 goodwill related to its Regulated Businesses in the amount of $750.0 million in the financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due 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 that implied by the trading value of peer companies 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 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 IPO, 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 Businesses in the amount of $243.3 million. 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 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 Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). The step 1 calculation used to identify potential impairment compares the 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 shall be performed to measure the amount of the impairment loss (if any) for such reporting units.

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 net fair value of each reporting unit's assets and liabilities above the carrying value of such reporting unit's assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss shall be recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

If step 2 is required, the determination of the fair value of each reporting unit and the fair value of each reporting unit's assets and liabilities will be 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). The step 2 fair value determination will use a combination of the following valuation techniques:

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

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Each of the Company's reporting unit's fair value is determined by weighting, according to relevance, the results of three valuation techniques. The first, and primary, valuation is based upon the observable market price of the Company's common equity as adjusted for control premiums and other relevant market conditions.

The second model-based valuation technique applies an average peer multiple to the Company's historic and forecasted cash flows. The cash flow multiple is calculated using the quoted market equity prices of comparable publicly-traded water utilities, and their published cash flows. This market multiple is then applied to the applicable reporting unit's internal historic and forecasted cash flows as adjusted to remove non-recurring items and forecast acquisitions.

The third model-based valuation technique discounts the five-year business plan forecast cash flows, as adjusted to remove non-recurring items and forecast acquisitions, at the Company's weighted average cost of capital.

If step 2 of the impairment test is required, the Company will determine 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 at the measurement date. For the step 2 calculations of the fair value of debts, the Company will use observable prices of instruments and indices which share similar risk to those instruments being valued, adjusted to compensate for different credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit's debts.

Other Matters

Acquisitions During the third quarter of 2008 our Regulated Businesses completed a number of water and wastewater acquisitions amounting to approximately $7.8 million. The larger acquisitions included our West Virginia subsidiary acquiring the water and wastewater systems in Fayetteville, West Virginia which will add 1,861 water customers and 1,082 sewer customers and our Pennsylvania subsidiary acquiring the water and wastewater assets of the Claysville-Donegal Joint Municipal Authority which provide drinking water to approximately 550 customers, as well as wastewater treatment services to nearly 500 customers and Three Lane Utilities, Inc which will add nearly 200 water customers.

On October 30, 2008, our Pennsylvania subsidiary acquired the wastewater assets of Clarion Area Authority ("CAA") for approximately $4.0 million. CAA provided wastewater service to approximately 2,200 customer connections, completely within our water footprint.

Newly Awarded Contract for our Non-Regulated Business In September 2008, our Contracts Operation Group was awarded two United States military contracts for operation and maintenance of the water and wastewater systems at Fort Polk and Fort Hood Army Installations. The estimated gross revenues we will receive from these 50-year fixed price contracts which are subject to modification as described below will be approximately $348 million and $329 million for Fort Polk and Fort Hood, respectively. All of the contracts with the U.S. government may be terminated, in whole or in part, prior to the end of the 50-year term for convenience of the U.S. government or as a result of default or non-performance by the subsidiary performing the contract. In either event, we are entitled to recover the remaining amount of our capital investment pursuant to the terms of a termination settlement with the U.S. government at the time of termination as provided in each of the contracts. The contract price for each of these contracts is subject to redetermination two years after commencement of operations and every three years thereafter. Price redetermination is a contract mechanism to periodically adjust the service fee in the next period to reflect changes in contract obligations and anticipated market conditions.

Dividend There were no dividend payments made for 2007 or the six months ended June 30, 2008. We paid a dividend of $0.20 per share on September 2, 2008. On October 17, 2008 we declared a dividend of $0.20 per share payable to holders of record on November 18, 2008, which will be paid on December 1, 2008.

Business Transformation As part of our strategy to improve operational efficiencies, we are evaluating our processes to optimize workflow throughout our field operations as well as streamlining our back-office operations, as we believe are necessary and appropriate. When we make adjustments to our operations, we may incur incremental expenses prior to realizing the benefit of a more efficient workforce and operating structure, but we believe that increasing our operating efficiency and reducing the costs associated with the operation of our business are important to our long-term competitiveness. We are currently developing a timeline for the implementation of this strategy and currently expect to complete our planning in early 2009.

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Results of Operations

Three Months Ended September 30, 2008 Compared To Three Months Ended September 30, 2007

(In thousands)	For the three months ended September 30, 2008	2007	Favorable (Unfavorable) Change
Operating revenues	$ 672,193	$ 633,117	$ 39,076
Operating expenses			
Operation and maintenance	342,226	328,305	(13,921)
Depreciation and amortization	68,376	69,699	1,323
General taxes	49,380	47,091	(2,289)
(Gain) loss on sale of assets	457	(708)	(1,165)
Impairment charge	—	243,345	243,345
Total operating expenses, net	460,439	687,732	227,293
Operating income (loss)	211,754	(54,615)	266,369
Other income (deductions)			
Interest, net	(72,684)	(68,739)	(3,945)
Allowance for other funds used during construction	4,442	2,028	2,414
Allowance for borrowed funds used during construction	2,970	846	2,124
Amortization of debt expense	(1,601)	(1,227)	(374)
Preferred dividends of subsidiaries	(55)	(55)	—
Other, net	881	1,362	(481)
Total other income (deductions)	(66,047)	(65,785)	(262)
Income (loss) from continuing operations before income taxes	145,707	(120,400)	266,107
Provision for income taxes	57,549	39,717	(17,832)
Income (loss) from continuing operations	88,158	(160,117)	248,275
Income (loss) from discontinued operations, net of tax	—	—	—
Net income (loss)	$ 88,158	$ (160,117)	$ 248,275

The following table summarizes certain financial information for our Regulated and Non-Regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

	For the three months ended September 30, 2008		2007	
	Regulated Businesses	Non-Regulated Businesses	Regulated Businesses	Non-Regulated Businesses
	(In thousands)			
Operating revenues	$603,432	$ 73,870	$571,853	$ 66,391
Adjusted EBIT [1]	$204,963	$ 7,095	$184,549	$ 3,575

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. 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 the 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.

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Operating revenues Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues, including step increases, resulting from rate authorizations, including infrastructure charges, which were granted and became effective in the third quarter of 2008.

State	Annualized Rate Increases Granted (In millions)
General rate case:	
Illinois	$ 21.6
Virginia*	3.4
Tennessee	1.7
Total	$ 26.7

* New rates were put into effect in July 2008 under bond and a final order was received in October 2008 which will provide for additional annualized revenue of $3.4 million for jurisdictional customers and a $0.3 million increase for non-jurisdictional customers which is not subject to commission filing.

Operating revenues increased by $39.1 million, or 6.2% for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. Regulated Businesses' revenues increased by $31.6 million, or 5.5% for the three months ended September 30, 2008 compared to the same period in the prior year. The Non-Regulated Businesses' revenues for the three months ended September 30, 2008 increased by $7.5 million, or 11.3% compared to the three months ended September 30, 2007.

The increase in revenues from the Regulated Businesses for the three months ended September 30, 2008 compared to the three months ended September 30, 2007 was primarily due to rate increases obtained through general rate cases in Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $43.0 million. These increases were offset by a $11.4 million decrease in revenues related to reduced customer consumption, mainly in our Midwestern and Mid-Atlantic state subsidiaries for the three months ended September 30, 2008 compared to the same period in the prior year.

Non-Regulated Businesses' operating revenues increased by $7.5 million, or 11.3% for the three months ended September 30, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $7.6 million in our Contract Operations Group and $1.7 million in our Homeowner Services Group, partially offset by decreased revenues of $1.2 million and $0.6 million in our Applied Water Management Group and Canadian Fixed Residual, respectively. The increase in Contract Operations Group revenues was primarily due to additional revenues associated with design and build contracts, as well as increased military project revenues. The increase from our Homeowner Service Group represented increased product penetration within its existing customer base. Applied Water Management Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

	For the three months ended September 30,			
	Operating Revenues		Water Sales Volume	
Customer Class	2008	2007	2008	2007
Water service:				
Residential	58.5%	58.4%	53.5%	53.8%
Commercial	19.9%	20.1%	22.5%	22.2%
Industrial	4.7%	4.6%	9.7%	10.1%
Public and other	11.7%	11.9%	14.3%	13.9%
Other water revenues	1.8%	1.7%	—	—
Total water revenues	96.6%	96.7%	100.0%	100.0%
Wastewater service	3.4%	3.3%		
	100.0%	100.0%		

The following discussion related to water services indicates the increase or decrease in the Regulated Businesses' revenues and associated water sales volumes in gallons by customer class.

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Water Services —Water service operating revenues from residential customers for the three months ended September 30, 2008 totaled $353.3 million, a $19.9 million increase, or 6.0%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 5.3% for the three months ended September 30, 2008 to 65.5 billion gallons, from 69.2 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California and our Midwestern states.

Water service operating revenues from commercial water customers for the three months ended September 30, 2008 increased by $4.7 million, or 4.1%, to $119.9 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2007. The volume of water sold to commercial customers decreased by 3.5% for the three months ended September 30, 2008, to 27.5 billion gallons, from 28.5 billion gallons for the three months ended September 30, 2007.

Water service operating revenues from industrial customers totaled $28.1 million for the three months ended September 30, 2008, an increase of $1.7 million, or 6.4%, over those recorded for the same period of 2007 mainly due to rate increases offset by decreased sales volume. The volume of water sold to industrial customers totaled 11.9 billion gallons for the three months ended September 30, 2008, a decrease of 8.5% from the 13.0 billion gallons for the three months ended September 30, 2007.

Water service operating revenues from public and other customers increased $2.4 million, or 3.5%, for the three months ended September 30, 2008 to $70.6 million from $68.2 million for the three months ended September 30, 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $25.9 million for the three months ended September 30, 2008, an increase of $1.2 million over the same period of 2007. Revenues generated by sales to governmental entities and resale customers for the three months ended September 30, 2008 totaled $44.7 million, an increase of $1.2 million from the three months ended September 30, 2007.

Wastewater services —Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by $1.6 million, or 8.4%, to $20.7 million for the three months ended September 30, 2008, from $19.1 million for the same period of 2007. The increase was attributable to increases in rates charged to customers principally in Arizona, Hawaii, and New Jersey.

Operation and maintenance Operation and maintenance expense increased $13.9 million, or 4.2%, for the three months ended September 30, 2008 compared to the same period in the prior year.

Operation and maintenance expenses for the three months ended September 30, 2008 and 2007, by major expense category, were as follows:

	For the three months ended September 30,	
	2008	2007*
	(In thousands)	
Production costs	$ 84,093	$ 83,496
Employee-related costs	127,384	112,815
Operating supplies and services	72,152	83,937
Maintenance materials and services	32,049	27,646
Customer billing and accounting	13,445	8,623
Other	13,103	11,788
Total	$ 342,226	$ 328,305

* Certain 2007 amounts have been reclassified within operating expenses to conform to the 2008 presentation.

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by $0.6 million, or 0.7%, for the three months ended September 30, 2008 compared to the same period in 2007. The increase was primarily due to increased fuel and power costs of $0.7 million which can be attributed to increases in electricity prices.

Employee-related costs including wage and salary, group insurance, and pension expense increased $14.6 million or 12.9%, for the three months ended September 30, 2008 compared to the same period in the prior year. These employee related costs represented 37.2% and 34.4% of operation and maintenance expenses for the three months ended September 30, 2008 and 2007, respectively. The employee related cost increase of $13.0 million and $0.7 million in our Regulated and Non-Regulated Businesses, respectively, was primarily the result of stock based compensation expense of $1.0 million including $0.4 million attributable to awards granted in connection with the IPO, as well as an increase in the number of employees primarily as a result of enhancing customer service and wage rate increases. In addition, our Regulated Businesses' pension expense increased $1.8 million or 19.2% for the three months ended September 30, 2008 compared to the same period in the prior year. Pension expense in excess of the amount contributed to the

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pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense in accordance with Statement of Financial Accounting Standards No. 87, “Employers’ Accounting for Pensions” (“SFAS 87”) remained relatively unchanged, pension expense increased for the three months ended September 30, 2008 due to increased contributions in certain of our regulated operating companies whose costs are recovered based on the Company’s funding policy which is the minimum amount required by the Employee Retirement Income Security Act of 1974 (“ERISA”), rather than the SFAS 87 expense. The increase in the contributions is attributable to lower than expected returns on plan assets.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the three months ended September 30, 2008, these costs decreased by $11.8 million or 14.0%, compared to the same period in 2007. Factors contributing to this decrease include a decrease of $8.5 million in Sarbanes-Oxley remediation costs, mainly consulting fees, decreased legal expenses, and a 2007 loss reserve adjustment in our West Virginia subsidiary for the three months ended September 30, 2008 compared to the three months ended September 30, 2007. Also, contributing to the decrease are lower divestiture costs of $2.6 million for the three months ended September 30, 2008 including costs associated with regulatory approval, condemnation and retention/completion bonuses. Partially offsetting these decreases was an overall increase in general office and travel costs of $0.9 million mainly due to inflation, and higher fuel and other transportation costs of $0.9 million.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased $4.4 million or by 15.9%, for the three months ended September 30, 2008 compared to the same period in the prior year. Regulated Businesses’ maintenance materials and service costs increased by $3.0 million for the three months ended September 30, 2008 compared to the same period in the prior year due to higher cost of removal expenses amounting to $3.8 million in certain of our operating companies offset by $0.7 million of lower paving expenses for our Illinois and Missouri subsidiaries. Our Non-Regulated Businesses’ maintenance expense increased by $1.4 million for the three months ended September 30, 2008 compared to the same period in the prior year primarily due to higher frequency service line protection contract usage by Homeowner Services Group customers as well as increased costs in the Contract Operations Group mainly attributable to costs associated with new military operations and maintenance projects.

Customer billing and accounting expenses increased by $4.8 million, or 55.9%, for the three months ended September 30, 2008 compared to the same period in the prior year. The increase was the result of higher uncollectible accounts expense in our Regulated Businesses of $2.5 million including increases in specific provisions for certain receivables due to the uncertainty of collectibility and stricter shut-off practices for delinquent accounts by certain subsidiaries. In addition, the 2008 expense is higher as the 2007 expense included recoveries of amounts previously written off. Our Non-Regulated Businesses uncollectible expense also increased by $1.6 million primarily due to our Applied Water Group as a result of the downturn in the construction market.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by $1.3 million, or 11.2%, in 2008 primarily due to increased regulatory expenses of $3.3 million related to write-offs of deferred rate case expenses, primarily in Tennessee and Ohio of $1.7 million and $0.5 million, respectively. Partially offsetting these increases, insurance costs decreased $2.0 million for the three months ended September 30, 2008 due to more favorable claims experience compared to the three months ended September 30, 2007.

Depreciation and amortization Depreciation and amortization expense decreased by $1.3 million, or 1.9%, for the three months ended September 30, 2008 compared to the same period in the prior year. This decrease was primarily due to depreciation rate adjustments resulting from rate orders, particularly in our Pennsylvania subsidiary offset by increased expense due to additional utility plant placed in service.

General taxes General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by $2.3 million, or 4.9%, in the three months ended September 30, 2008 compared to the three months ended September 30, 2007. This increase is primarily due to increased gross receipts taxes in New Jersey of $1.9 million and in Missouri of $0.9 million offset by lower property taxes of $0.6 million in Pennsylvania.

Gain on sale of assets Loss on sale of assets was $0.5 million for the three months ended September 30, 2008 primarily due to the Felton Sale as compared to a gain of $0.7 million for the three months ended September 30, 2007 due to non-recurring sales of assets no longer used in our operations.

Impairment charge There was no impairment charge for the three months ended September 30, 2008. For the three months ended September 30, 2007, we recorded an impairment charge to goodwill of our Regulated Businesses in the amount of $243.3 million. The 2007 impairment charge was primarily due to slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

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Other income (deductions) Interest expense, net of interest income, is the primary component of our other income (deductions), increased by $3.9 million, or 5.7%, for the three months ended September 30, 2008 compared to the same period in the prior year. The increase is primarily due to the increased borrowings associated with capital expenditures. Offsetting the change in interest expense is an increase in AFUDC of $4.5 million for the three months ended September 30, 2008 compared to the same period in 2007 as a result of increased construction work in progress. Other items contributing to the change include lower miscellaneous income for the three months ended September 30, 2008 compared to the three months ended September 30, 2007 primarily as a result an increase in the amortization of debt expense of $0.4 million for the three months ended September 30, 2008 compared to same period in 2007 as a result of the debt restructuring.

Provision for income taxes Our consolidated provision for income taxes increased $17.8 million or 44.8%, to $57.5 million for the three months ended September 30, 2008. The effective tax rate for the three months ended September 30, 2008 was 39.5%. Our effective tax rate for the third quarter 2007 of (33.0%) reflects the tax effect of the goodwill impairment as a discrete item as we considered this charge an infrequently occurring or unusual event.

Net income (loss). Net income increased $248.3 million, to $88.2 million for the three months ended September 30, 2008 from a net loss of $160.1 million for the three months ended September 30, 2007. The increase is the result of the aforementioned changes.

Nine months Ended September 30, 2008 Compared To Nine months Ended September 30, 2007

	For the nine months ended September 30,		Favorable (Unfavorable)
(In thousands)	**2008**	**2007**	**Change**
Operating revenues	$1,768,377	$1,660,394	$ 107,983
Operating expenses			
Operation and maintenance	984,063	910,304	(73,759)
Depreciation and amortization	199,599	202,463	2,864
General taxes	151,074	140,910	(10,164)
Gain on sale of assets	(413)	(6,821)	(6,408)
Impairment charge	750,000	243,345	(506,655)
Total operating expenses, net	2,084,323	1,490,201	(594,122)
Operating income (loss)	(315,946)	170,193	(486,139)
Other income (deductions)			
Interest, net	(212,718)	(211,709)	(1,009)
Allowance for other funds used during construction	10,370	5,197	5,173
Allowance for borrowed funds used during construction	6,063	2,358	3,705
Amortization of debt expense	(4,360)	(3,624)	(736)
Preferred dividends of subsidiaries	(169)	(169)	—
Other, net	1,544	4,146	(2,602)
Total other income (deductions)	(199,270)	(203,801)	4,531
Income (loss) from continuing operations before income taxes	(515,216)	(33,608)	(481,608)
Provision for income taxes	83,612	74,095	(9,517)
Income (loss) from continuing operations	(598,828)	(107,703)	(491,125)
Income (loss) from discontinued operations, net of tax	—	(551)	551
Net income (loss)	$ (598,828)	$ (108,254)	$ (490,574)

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The following table summarizes certain financial information for our Regulated and Non-Regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

	For the nine months ended September 30,			
	2008		2007	
	Regulated Businesses	Non-regulated Businesses	Regulated Businesses	Non-regulated Businesses
	(In thousands)			
Operating revenues	$1,579,214	$202,080	$1,499,763	$175,172
Adjusted EBIT [1]	$ 411,076	$ 16,358	$ 394,601	$ 17,606

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. 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 the 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.

Operating revenues Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues, including step increases, resulting from rate authorizations, including infrastructure charges, which were granted and became effective in the nine months ended September 30, 2008.

	Annualized Rate Increases Granted (In millions)
State	
General rate case:	
Illinois	$ 21.6
California	13.0
New York	6.6
Iowa	4.3
Arizona	8.6
West Virginia	14.5
Virginia*	3.4
Tennessee	1.7
Other	0.2
Infrastructure Charges:	
Pennsylvania**	4.6
Indiana	3.9
Missouri	2.7
Illinois	1.1
Total	$ 86.2

* New rates were put into effect in July 2008, under bond and a final order was received in October 2008 which will provide for additional annualized revenues of $3.4 million for jurisdictional customers and a $0.3 million increase for non-jurisdictional customers which is not subject to commission filing.

** Does not include annualized increases for infrastructure charge which were granted in the third quarter of 2008 of $5.7 million in our Pennsylvania subsidiary, effective October 1, 2008.

Operating revenues increased by $108.0 million, or 6.5% for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. Regulated Businesses' revenues increased by $79.5 million, or 5.3% for the nine months ended September 30, 2008 compared to the same period in the prior year. The Non-Regulated Businesses' revenues for the nine months ended September 30, 2008 increased by $26.9 million, or 15.4% compared to the nine months ended September 30, 2007.

The increase in the Regulated Businesses' revenues for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 was primarily due to rate increases obtained through general rate cases in New Jersey, Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $95.1 million and a $1.4 million retroactive rate adjustment in California made in June 2008. This increase was offset by a $25.0 million decrease in

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revenues related to lower customer consumption, mainly in our states in the Midwestern region of the United States, for the nine months ended September 30, 2008 compared to the same period in the prior year.

Non-Regulated Businesses' operating revenues increased by $26.9 million, or 15.4% for the nine months ended September 30, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $28.6 million in our Contract Operations Group and $5.6 million in our Homeowner Services Group, partially offset by decreased revenues of $6.8 million and $0.7 million in our Applied Water Management Group and Canadian Fixed Residuals, respectively. The increase in Contract Operations Group revenues was primarily attributable to incremental revenues associated with design and build contracts, as well as increased military construction and operations & maintenance project revenues. The increase from our Homeowner Service Group represented increased product penetration within its existing customer base. Applied Water Management Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

The following table sets forth the percentage of Regulated Businesses' revenues and water sales volume by customer class:

	For the nine months ended September 30,			
	Operating Revenues		Water Sales Volume	
Customer Class	2008	2007	2008	2007
Water service:				
Residential	57.9%	57.9%	53.0%	53.0%
Commercial	19.3%	19.4%	22.1%	21.9%
Industrial	5.0%	4.8%	10.5%	10.5%
Public and other	12.1%	12.3%	14.4%	14.6%
Other water revenues	2.0%	1.8%	—	—
Total water revenues	96.3%	96.2%	100.0%	100.0%
Wastewater service	3.7%	3.8%		
	100.0%	100.0%		

The following discussion related to water services indicates the increase or decrease in the Regulated Businesses' revenues and water associated sales volumes in gallons by customer class.

Water Services —Water service operating revenues from residential customers for the nine months ended September 30, 2008 totaled $913.1 million, a $44.3 million increase, or 5.1%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 3.5% for the nine months ended September 30, 2008 to 162.3 billion gallons, from 168.2 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California and the Midwestern region in the United States.

Water service operating revenues from commercial water customers for the nine months ended September 30, 2008 increased by $14.3 million, or 4.9%, to $305.4 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2007. The volume of water sold to commercial customers decreased by 2.9% for the nine months ended September 30, 2008, to 67.8 billion gallons, from 69.8 billion gallons for the nine months ended September 30, 2007.

Water service operating revenues from industrial customers totaled $78.4 million for the nine months ended September 30, 2008, an increase of $5.9 million, or 8.1%, over those recorded for the same period of 2007 mainly due to rate increases offset by decreased sales volume. The volume of water sold to industrial customers totaled 32.2 billion gallons in the nine months ended September 30, 2008, a decrease of 3.6% from the 33.4 billion gallons for the nine months ended September 30, 2007.

Water service operating revenues from public and other customers increased $7.1 million, or 3.9%, for the nine months ended September 30, 2008 to $191.4 million from $184.3 million for the nine months ended September 30, 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $77.8 million for the nine months ended September 30, 2008, an increase of $3.8 million over the same period of 2007. Revenues generated by sales to governmental entities and resale customers for the nine months ended September 30, 2008 totaled $113.6 million, an increase of $3.3 million from the nine months ended September 30, 2007.

Wastewater services —Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by $2.5 million, or 4.4%, to $59.1 million for the nine months ended September 30, 2008, from $56.6 million for the same period of 2007. The increase was attributable to increases in rates charged to customers principally in Arizona, Hawaii, and New Jersey.

Operation and maintenance Operation and maintenance expense increased $73.8 million, or 8.1%, for the nine months ended September 30, 2008 compared to the same period in the prior year.

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Operation and maintenance expenses for the nine months ended September 30, 2008 and 2007, by major expense category, were as follows:

	For the nine months ended September 30,	
	2008	2007*
	(In thousands)	
Production costs	$ 220,902	$ 212,612
Employee-related costs	385,639	341,154
Operating supplies and services	208,394	211,012
Maintenance materials and services	104,218	87,250
Customer billing and accounting	32,796	26,025
Other	32,114	32,251
Total	$ 984,063	$ 910,304

* Certain 2007 amounts have been reclassified within operating expenses to conform to the 2008 presentation.

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by $8.3 million, or 3.9%, for the nine months ended September 30, 2008 compared to the same period in 2007. The increase was primarily the result of increased costs in our Regulated Businesses of $5.2 million. Fuel and power costs were higher by $2.8 million due to increases in electricity prices. Chemical costs also increased by $2.1 million primarily due to rising chemical costs and waste disposal costs were also higher by $0.7 million. Partially offsetting these increases was lower purchased water costs of $0.4 million.

Employee-related costs including wage and salary, group insurance, and pension expense increased $44.5 million or 13.0%, for the nine months ended September 30, 2008 compared to the same period in the prior year. These employee related costs represented 39.2% and 37.5% of operation and maintenance expenses for the nine months ended September 30, 2008 and 2007, respectively. The increase was due to higher wage and salary expenses of $23.2 million and $3.7 million in our Regulated and Non-Regulated Businesses, respectively, primarily resulting from stock based compensation expense of $3.5 million mainly attributable to the issuance of awards granted in connection with the IPO and an increase in the number of employees primarily as a result of enhancing customer service and wage rate increases. In addition, our Regulated Businesses' pension expense increased by $8.0 million or 29.1% for the nine months ended September 30, 2008 compared to the same period in the prior year. Pension expense in excess of the amount contributed to the pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense in accordance with SFAS 87 remained relatively unchanged, pension expense increased for the nine months ended September 30, 2008 due to increased contributions in certain of our regulated operating companies, which costs are recovered based on the Company's funding policy which is the minimum amount required by ERISA, rather than the SFAS 87 expense. The increase in the contributions is attributable to lower than expected returns on plan assets.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment rental charges. For the nine months ended September 30, 2008, these costs decreased by $2.6 million or 1.2%, compared to the same period in 2007. Factors contributing to this decrease include lower remediation costs, mainly consulting fees in connection with the Sarbanes-Oxley Act, of $16.6 million, or 65.1%, to $8.9 million for the nine months ended September 30, 2008 compared to $25.5 million for the nine months ended September 30, 2007. Also contributing to the decrease are lower divestiture and IPO related costs of $1.7 million for the nine months ended September 30, 2008 including costs associated with regulatory approval, condemnation and retention/competition bonuses. Partially offsetting these decreases was an overall increase in general office costs and travel costs of $3.3 million, mainly due to inflation, and higher fuel and other transportation costs of $4.2 million. Corresponding with the increase in revenues, the Non-Regulated Businesses operating supplies and service expenses increased by $8.2 million for the nine months ended September 30, 2008 compared to the same period in the prior year. The Non-Regulated Businesses' increase is mainly attributable to additional expense in the Contract Operations group of $13.7 million associated with several operating contracts (including a design, build and operate project in Fillmore, California), partially offset by lower contracted services costs in the Applied Water Management Group due to the downturn in new home construction of $4.9 million and profits of $1.5 million as a result of the acceptance by a third party of a construction contract.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased $17.0 million or by 19.4%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The Regulated Businesses' maintenance materials and service costs increased by $13.8 million in the first nine months of 2008 mainly due to increased costs of $2.2 million associated with a program in Illinois to maintain valves, higher cost of removal expenses of $9.2 million in certain of our operating companies and increased tank painting costs of $1.8 million in our New Jersey and Missouri operating companies. Partially offsetting these increases were lower main break costs in 2008, as we experienced higher than average

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main break costs in the first half of 2007 due to winter weather conditions in the Midwest region of the United States. The Non-Regulated Businesses' maintenance and services expenses increased by $3.3 million as a result of higher frequency service line protection contract usage by Homeowner Services Group customers as well as increased cost associated with the Contract Operations Group mainly attributable to costs associated with new military operations and maintenance projects.

Customer billing and accounting expenses increased by $6.8 million, or 26.0%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The increase was primarily the result of higher uncollectible accounts expense in our Regulated Businesses of $2.3 million, including increases in specific provisions for certain receivables due to the uncertainty of collectibility and stricter shut-off practices for delinquent accounts by certain subsidiaries. In addition, the 2008 expense is higher as the 2007 expense included recoveries of amounts previously written off. Our Non-Regulated Businesses uncollectible expense increased by $3.1 million primarily due to increases in the Applied Group of $1.9 million as the result of the downturn in the construction market and our Contract Operation Group. In addition, postage expense increased in our Regulated subsidiaries $0.7 million compared to the same period in the prior year.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by $0.1 million, or 0.4%, in 2008 primarily due to decreased insurance costs of $3.6 million for the nine months ended September 30, 2008 due to more favorable claims experience compared to the nine months ended September 30, 2007, partially offset by increased regulatory expenses of $3.4 million related to write-offs of deferred rate case expenses, primarily in Tennessee, Illinois, and Ohio of $1.7 million, $0.9 million, and $0.5 million, respectively.

Depreciation and amortization Depreciation and amortization expense decreased by $2.9 million, or 1.4%, for the nine months ended September 30, 2008 compared to the same period in the prior year. This decrease was primarily due to depreciation rate adjustments resulting from rate orders, particularly in our Pennsylvania subsidiary partially offset by increased expense due to additional utility plant placed in service.

General taxes General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by $10.2 million, or 7.2%, in the nine months ended September 30, 2008 compared to the first nine months of 2007. This increase is primarily due to increased gross receipts taxes of $5.7 million in New Jersey and $0.7 million in Missouri and higher property tax expense of $1.7 million and $1.0 million in Ohio and Missouri, respectively.

Gain on sale of assets The gain on sale of assets was $0.4 million for the nine months ended September 30, 2008 compared to a gain of $6.8 million for the nine months ended September 30, 2007. The gain in 2008 and 2007 is primarily attributable to non-recurring sales of assets no longer used in our operations. Partially offsetting the 2008 gain was the loss attributable to the sale of the Felton water system to SLVWD.

Impairment charge The impairment charge was $750.0 million for the nine months ended September 30, 2008 compared to $243.3 million for the nine months ended September 30, 2007. The 2008 impairment charge was primarily due 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 what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company's debt (due to increased interest rates). The 2007 impairment charge to goodwill to our Regulated Businesses was primarily due to slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

Other income (deductions) Interest, the primary component of our other income (deductions), increased by $1.0 million, or 0.5% for the nine months ended September 30, 2008 compared to the same period in the prior year. The increase is primarily due to increased borrowings associated with capital expenditures. Offsetting the change in interest expense is an increase in AFUDC of $8.9 million for the nine months ended September 30, 2008 compared to the same period in 2007 as a result of increased construction work in progress. Other items contributing to the change include higher miscellaneous income for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily as a result of losses recorded for a contract in our Non-Regulated business in 2007 of $2.1 million, and an increase in the amortization of debt expense of $0.7 million for the nine months ended September 30, 2008 compared to the same period in 2007 as a result of the debt restructuring.

Provision for income taxes Our consolidated provision for income taxes increased $9.5 million, or 12.8%, to $83.6 million for the nine months ended September 30, 2008 from $74.1 million for the nine months ended September 30, 2007.

Net income (loss) The net loss for the nine months ended September 30, 2008 was $598.8 million compared to a net loss of $108.3 million for the nine months ended September 30, 2007. The variation between the periods is the result of the aforementioned changes.

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Liquidity and Capital Resources

Our business is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary we obtain funds from external sources in the capital markets and through bank borrowings. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to fulfill our short-term liquidity needs and to issue letters of credit. See the "Credit Facilities and Short-Term Debt" section below for further discussion.

In addition, our regulated utility subsidiaries 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, which vary according to state regulations, as new customers begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from the rate base. Generally, we depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property. Some of our subsidiaries do not depreciate contributed property, based on regulatory guidelines.

We use our capital resources, including cash, to (i) fund capital requirements, including construction expenditures, (ii) pay off maturing debt, (iii) pay dividends, (iv) fund pension and postretirement welfare obligations and (v) invest in new and existing ventures. We spend a significant amount of cash on construction projects that have a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. As a result of these factors, our working capital, defined as current assets less current liabilities, was in a net deficit position as of September 30, 2008.

We expect to fund future maturities of long-term debt through a combination of external debt and cash flow from operations. We have no plans to reduce debt significantly.

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. On September 15, 2008, we sought to issue commercial paper but were unable to consummate the issuance due to adverse market conditions. In order to meet our short-term liquidity needs we are borrowing under our existing $800.0 million revolving credit facility, which was scheduled to expire on September 15, 2012. On September 15, 2008, a majority of our lenders agreed to extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. AWCC had $147.2 million of outstanding borrowings and $42.9 million of outstanding letters of credit under this credit facility as of November 4, 2008. AWCC had $148.1 million of outstanding overnight commercial paper as of November 4, 2008. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

Cash Flows from Operating Activities

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of operations, are weighted toward the third quarter of each fiscal year. Our future cash flows from operating activities will be affected by economic utility regulation; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; declining per customer usage of water; and weather and seasonality. Cash flows from operating activities have been a reliable, steady source of cash flow, sufficient to meet operating requirements and a portion of our capital expenditures requirements. We will seek access to debt and equity capital markets to meet the balance of our capital expenditure requirements. There can be no assurance that we will be able to successfully access such markets on favorable terms or at all. Operating cash flows can be negatively affected by changes in our rate regulatory environments or changes in our customer economic outlook and ability to pay for service in a timely manner. We can provide no assurance that our customers' historical payment pattern will continue in the future. Cash flows from operating activities for the nine months ended September 30, 2008 were $392.9 million compared to $329.9 million for the nine months ended September 30, 2007.

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The following table provides a summary of the major items affecting our cash flows from operating activities for the nine months ended September 30, 2008 and 2007:

	For the nine months ended September 30, 2008	2007
	(In thousands)	
Net (loss)	$ (598,828)	$(108,254)
Add (subtract):		
Non-cash operating activities (1)	1,094,807	482,392
Changes in working capital (2)	(21,552)	8,936
Pension and postretirement healthcare contributions	(81,514)	(53,161)
Net cash flows provided by operations	$ 392,913	$ 329,913

(1) Includes depreciation and amortization, impairment charges, removal costs net of salvage, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, gain on sale of assets, and other non-cash items, net, less pension and postretirement healthcare contributions.

(2) Changes in working capital include changes to receivables and unbilled utility revenue, other current assets, accounts payable, taxes accrued (including income taxes), interest accrued and other current liabilities.

Cash Flows from Investing Activities

Cash flows used in investing activities for the nine months ended September 30, 2008 and 2007 were $723.6 million and $483.0 million, respectively. Construction expenditures increased $207.4 million to $714.6 million for the nine months ended September 30, 2008 from $507.2 million for the nine months ended September 30, 2007 as a result of increased investment in regulated utility plant projects. We anticipate spending approximately $950 million on capital investment in 2008.

Our construction program consists of both infrastructure renewal programs, where we replace infrastructure as needed, and construction of new water and wastewater treatment and delivery facilities to meet new customer growth. An integral aspect of our strategy is to seek growth through tuck-ins and other acquisitions which are complementary to our existing business and support the continued geographical diversification and growth of our operations. Generally, acquisitions are funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

Included in 2008 are planned construction expenditures of approximately $32 million to construct a new water treatment plant on the Kentucky River. On April 25, 2008, the Kentucky Public Service Commission approved Kentucky American Water's application for a certificate of convenience and necessity to construct a 20.0 million gallon per day treatment plant on the Kentucky River and a 30.6 mile pipeline to meet Central Kentucky's water supply deficit. The Kentucky project is expected to be completed by 2010 with an estimated cost of $162 million.

Other significant investing activities for the nine months ended September 30, 2008 and 2007 include:

- We paid approximately $8.0 million for the acquisition of water and waste water systems including Fayetteville, West Virginia, Claysville-Donegal Joint Municipal Authority in Pennsylvania and the Three Lane Utilities, Inc. also in Pennsylvania
- Proceeds from the sale of the Felton Water System which included a $10.6 million cash payment to California American Water and the assumption by the SLVWD of $2.8 million in debt.
- In 2007, we paid approximately $0.9 million for the acquisition of a number of water and wastewater systems.
- We received approximately $15.6 million in cash proceeds from the sale of other assets including $13.0 million in proceeds on a property in Mansfield, New Jersey owned by a Non-Regulated Subsidiary.
- In 2007, we received approximately $9.7 million in cash proceeds from the sale of our discontinued operations, primarily in our United States-based Residual Group.

Our investing activities require considerable capital resources which we have generated in operations and attained through financing activates. We can provide no assurance that the resources will be sufficient to meet our expected investment needs and may be required to delay or reevaluate our investment plans.

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On December 21, 2007, New Jersey-American Water, our subsidiary, signed an agreement with the City of Trenton, New Jersey to purchase the assets of the city's water system located in Ewing, Hamilton, Hopewell and Lawrence townships for a purchase price of $100.0 million. The agreement was approved by the Trenton City Council but requires approval by various regulatory agencies, including the New Jersey Board of Public Utilities. We can provide no assurances that the agreement will be approved.

Cash Flows from Financing Activities

Our financing activities include the issuance of long-term and short-term debt, primarily through our wholly-owned financing subsidiary, American Water Capital Corp. ("AWCC"). We intend to access the capital markets on a regular basis, subject to market conditions. In addition, we have received capital contributions from RWE and intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in our registration rights agreement with RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of $3.2 million and $25.6 million for the nine months ended September 30, 2008 and 2007, respectively.

The following long-term debt was issued in the first nine months of 2008:

Company	Type	Interest Rate	Maturity	Amount (In Thousands)
American Water Capital Corp.	Senior notes	6.25%	2018	$ 110,000
American Water Capital Corp.	Senior notes	6.55%	2023	90,000
Other subsidiaries.	State financing authority loans and other	1.00%	2024	1,829
Total issuances				$ 201,829

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

Company	Type	Interest Rate	Maturity	Amount (In Thousands)
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	Subsidiary fixed rate bonds & notes	5.05%-9.35%	2008-2029	20,374
Other subsidiaries	State financing authority loans and other	0.00%-9.87%	2008-2034	9,276
Preferred stock with mandatory redemption requirements:				
Other subsidiaries		4.60%-6.00%	2013-2019	140
Total retirements & redemptions				$ 202,515

In the second quarter of 2008, the Company completed an offer to exchange $750.0 million principal amount of its 6.085% Senior Notes due in 2017 and $750.0 million principal amount of its 6.593% Senior Notes due in 2037 which are both registered under the Securities Act of 1933 (the "Exchange Notes") for all $750.0 million of its currently outstanding 6.085% Senior Notes due in 2017 and all $750.0 million of its currently outstanding 6.593% Senior Notes due in 2037, which have not been registered under the Securities Act of 1933 (the "Original Notes"). The Company did not receive any proceeds from the exchange offer, nor did the Company's debt level change as a result of the exchange offer. The other terms of the Exchange Notes and the Original Notes are substantially identical in all material respects.

During the first nine months of 2007, the Company issued senior notes through private placement offerings totaling $617.0 million. We used the proceeds from this senior notes offering and the $801.1 million of equity contributions from RWE, described below, to offset loans payable to RWE, to repay outstanding commercial paper and for other corporate purposes. Additionally, during September 2007, AWCC borrowed $1,750.0 million of RWE redemption notes from RWE. The Company used the proceeds from the RWE redemption notes to redeem $1,750.0 million of its 5.9% mandatory redeemable preferred stock held by RWE. The $1,750.0 million of RWE redemptions notes was retired in the fourth quarter of 2007 in connection with AWCC's issuance of additional senior notes.

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 sheet.

Dividends Our board of directors has adopted a dividend policy to distribute a portion of our net cash provided by operating activities to our stockholders as regular quarterly dividends, rather than retaining that cash for other purposes. We expect to distribute 50% to 70% of our annual net income, adjusted for certain non-cash items.

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On September 2, 2008, we paid a cash dividend of $32.0 million or $0.20 per share to all shareholders of record as of August 15, 2008. There were no dividend payments made for the nine months ended September 30, 2007.

On October 17, 2008, our Board of Directors declared a quarterly cash dividend payment of $0.20 per share payable on December 1, 2008 to all shareholders of record as of November 18, 2008.

Contributions from RWE As a result of the impairment charges recorded for the nine months ended September 30, 2008, RWE transferred $245.0 million on May 13, 2008. This cash was used to repay $243.4 million of short-term debt. Contributions from RWE were $801.1 million for the nine months ended September 30, 2007. RWE is not obligated to make any additional capital contributions.

Credit Facilities and Short-Term Debt

The components of short-term debt were as follows:

	September 30,2008 (In thousands)
Commercial paper, net	$ 131,910
Book overdraft	24,291
Lines of credit	170,984
Total short-term debt	$ 327,185

AWCC has entered into a one-year $10.0 million committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2008 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 25 basis points. As of September 30, 2008, $4.5 million was outstanding under this revolving line of credit. If this line of credit were not extended beyond its current maturity date of December 31, 2008, AWCC would continue to have access to its $800.0 million unsecured revolving credit facility described below.

On September 15, 2006, AWCC, our finance subsidiary, entered into an $800 million senior unsecured credit facility syndicated among the following group of 10 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 Stanly Bank	80,000	80,000
UBS Loan Finance LLC	80,000	80,000
National City Corporation	50,000	50,000
PNC Bank, National Association	40,000	40,000
	$ 800,000	$ 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. 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 $166.5 million of outstanding borrowings and $43.5 million of outstanding letters of credit under this credit facility as of September 30, 2008.

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At September 30, 2008, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper.

Credit Facility Commitment (In thousands)	Available Credit Facility Capacity (In thousands)	Letter of Credit Sublimit (In thousands)	Available Letter of Credit Capacity (In thousands)	Outstanding Commercial Paper (net of Discount) (In thousands)
$ 810,000	$ 595,500	$ 150,000	$ 106,484	$ 131,910

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. As of September 30, 2008, our ratio was 0.55 and therefore we were in compliance with the ratio.

The average interest rate on short-term borrowings for the nine months ended September 30, 2008 was approximately 3.3%.

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 September 30, 2008.

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 September 30, 2008:

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

On June 19, 2008, Standard & Poor’s Ratings Services (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.

Moody’s 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 assurance 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 a downgrading of securities 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 our 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.

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Current Credit Market Position

Due to recent market developments, including a series of rating agency downgrades of subprime U.S. mortgage-related assets, a decline in the fair value of subprime-related investments, increased volatility in the capital markets and severe liquidity crises at major financial institutions, the Company performed an assessment to determine the impact, if any, of current market conditions on the Company's financial position. As of September 30, 2008 there were no direct investments in subprime mortgage-related assets within the Company's short-term investment balances.

The Company also performed an assessment of its investments held in trusts, which will be used by the Company to satisfy future obligations under the Company's pension and postretirement benefit plans. Based upon this assessment, it determined that a *de minimis* portion of the holdings within the trusts are directly invested in subprime mortgage-related assets, auction rate debt securities or securities of weakened financial institutions. The Company does not believe that any decline in the fair value of these and other assets will have a material impact on its results of operations or its future cash funding requirements.

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.

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. The current adverse market conditions have also temporarily delayed the Company's plans to issue long-term debt, and the Company expects future long-term debt issuances to be at higher interest rates than incurred on its most recently issued long-term debt.

As of September 30, 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. On March 28, 2008, the Company, through its subsidiary, entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A. (successor to Bank One, N.A.), which agreed to purchase the bonds issued by Illinois American Water if remarketing funds are unavailable. As of November 4, 2008, $24.2 million of bonds were held by JPMorgan Chase Bank, N.A. These bonds bear interest at a rate of up to the prime rate plus 1.0%. The standby bond purchase agreement with JPMorgan Chase Bank, NA. expires on March 28, 2009, and we can provide no assurances that this agreement will be extended. The variable rate demand debt is classified as long-term since the Company expects the debt to remarket successfully and the Company expects to extend the maturity of the standby purchase agreement. The Company can provide no assurances that it will continue to remarket the bonds successfully or extend the standby bond purchase agreement. If the Company cannot remarket the bonds or extend the maturity of the standby bond purchase agreement, the bonds will be classified as short-term debt.

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.

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 September 30, 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 increase for chemicals, electricity and other commodities are reduced through contracts and the ability to recover price increases through rates. Non-performance by these commodity suppliers could have a material 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 as well as 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 nonpayment 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.

Application of Critical Accounting Policies and Estimates

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates,” in our Rule 424(b)(4) prospectus filed on April 24, 2008 with the Securities and Exchange Commission for a discussion of the critical accounting policies.

Recent Accounting Pronouncements

See Part I, Item 1 – Financial Statements (Unaudited)—Note 2—New Accounting Pronouncements in this Quarterly Report on Form 10-Q for a discussion of new accounting standards recently adopted or pending adoption.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are subject to market risks in the normal course of business, including changes in interest rates and equity prices. For further discussion of market risks see “Market Risk” in Part I, Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports filed or submitted under the Securities Exchange Act of 1934, as amended (“Exchange Act”), is recorded, processed, summarized, and reported within the time periods specified in the Commission’s rules and forms and that such information is accumulated and communicated to the Company’s management including its principal executive and financial officers, as appropriate to allow timely decisions regarding required disclosure.

As of the end of the period covered by this report, the Company’s management evaluated the effectiveness of the design and operation of disclosure controls and procedures pursuant to Rule 13a-15(b) of the Exchange Act. This evaluation was done under the supervision and with the participation of management, including our President and Chief Executive Officer and our Chief Financial Officer.

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Based on this evaluation and because of the material weaknesses described below, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were not effective as of September 30, 2008. Notwithstanding these material weaknesses, management concluded that the financial statements included in this Form 10-Q for the three and nine-months ended September 30, 2008 fairly present in all material respects their financial position, results of operations and cash flows for the periods presented in conformity with accounting principles generally accepted in the United States of America.

Material Weaknesses in Internal Control over Financial Reporting

A material weakness is a control deficiency or a combination of control deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim consolidated financial statements will not be prevented or detected.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 to April 28, 2008, we were an indirect wholly-owned subsidiary of RWE and, as a privately owned company, were not required to maintain a system of effective internal control consistent with those reported upon by management in compliance with the requirements of the SEC and the Sarbanes-Oxley Act, or to prepare our own consolidated financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting.

In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants identified the following material weaknesses in our internal control over financial reporting:

- Inadequate internal staffing and skills;
- Inadequate controls over financial reporting processes;
- Inadequate controls over month-end closing processes, including account reconciliations;
- Inadequate controls over maintenance of contracts and agreements;
- Inadequate controls over segregation of duties and restriction of access to key accounting applications; and
- Inadequate controls over tax accounting and accruals.

Remediation of Material Weaknesses

Since joining the Company in 2006, Donald L. Correll, our Chief Executive Officer, and Ellen C. Wolf, our Chief Financial Officer, have assigned a high priority to the evaluation and remediation of our internal controls, and have taken numerous steps to remediate these material weaknesses and to evaluate and strengthen our other internal controls over financial reporting. Some of the actions taken include:

- Increasing our internal financial staff numbers and skill levels, and using external resources to supplement our internal staff when necessary;
- Implementing detailed processes and procedures related to our period end financial closing processes, key accounting applications and our financial reporting processes;
- Implementing or enhancing systems used in the financial reporting processes and month-end close processes;
- Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;
- Enhancing our internal audit staff;
- Hiring a director of internal control and a director of taxes during 2007;
- Implementing a tracking mechanism and new policy and procedure for approval of all contracts and agreements; and
- Retaining a nationally recognized accounting and auditing firm to assist management in developing policies and procedures surrounding internal controls over financial reporting, to evaluate and test these internal controls and to assist in the remediation of internal control deficiencies.

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With respect to the material weaknesses described above, we have formulated remediation plans which we believe address the areas of material weakness and tested the effectiveness of controls. Based on these actions and the length of time we believe that certain controls have been operating effectively, as of September 30, 2008, we no longer consider the following control deficiencies to be material weaknesses:

- Inadequate internal staffing and skills; and
- Inadequate controls over month-end closing processes, including account reconciliations.

While we believe that remediation procedures related to the identified material weaknesses are substantially complete, our testing procedures have not yet been fully completed. Therefore, we can make no assurances as to the success of our remediation efforts.

As of September 30, 2008, the Company had incurred $57.8 million to remediate these material weaknesses and to document and test key financial reporting controls. We will need to allocate additional resources to enhance the quality of our staff and to carry out the remediation of these deficiencies. Based upon our current assessment, we expect to complete our remediation procedures related to the identified material weaknesses during 2008 with an estimated additional cost of approximately $0.4 million. The Company cannot indicate with certainty that all deficiencies, including material weaknesses, will be remediated or what additional costs may be incurred. The Company needs to finalize its remediation efforts of the controls and complete the testing of the effectiveness of controls prior to concluding controls are effective. As a condition to state Public Utility Commissions' approval of the RWE divestiture, we agreed that costs incurred in connection with our initial internal control and remediation initiatives would not be recoverable in rates charged to our customers.

Elements of our remediation activities can only be accomplished over time, and our initiatives provide no assurances that they will result in an effective internal control environment. Our board of directors, in coordination with our audit committee, will continually assess the progress and sufficiency of these initiatives and make adjustments, as necessary.

The Company believes the additional control procedures as designed, when implemented, will fully remediate the material weaknesses described above.

Changes in Internal Control Over Financial Reporting

Except as described above, there were no changes in internal control over financial reporting for the three or nine-months ended September 30, 2008, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Legal Proceedings

There have been no material developments or reportable events from legal proceedings previously disclosed in "Legal Proceedings" in the Company's Rule 424(b)(4) prospectus filed April 24, 2008, other than as described below.

In 2001, our California American Water Company subsidiary, which we refer to as CAWC, entered into a conservation agreement with the National Oceanic and Atmospheric Administration, which we refer to as NOAA, requiring CAWC to implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed, study the removal of the San Clemente Dam and explore long-term water sources other than a new reservoir in the Carmel River. Since that time, CAWC has implemented a number of measures to reduce the impact of its operations on the steelhead trout and other species and has begun the environmental review and permitting process for our Coastal Water Project, which is intended to remedy some of the foregoing deficiencies. In early 2004, NOAA informed CAWC of its concern that CAWC's ongoing operations would cause the "take" of significant numbers of steelhead trout during the several remaining years required to implement the Coastal Water Project. In June 2006, CAWC and NOAA entered a settlement agreement whereby CAWC agreed to fund certain additional projects to improve habitat conditions for and aid in the recovery of steelhead trout in the Carmel River watershed. Under the settlement agreement, CAWC is required, among other things, to make an initial payment of $3.5 million plus six annual installments of $1.1 million. The settlement agreement requires that all payments made by CAWC to NOAA to be used for mitigation projects in the Carmel River watershed. NOAA is currently unable to ensure that settlement payments will be used for mitigation projects in the Carmel River watershed, and no payments have been made to date. CAWC is prepared to make the settlement payments once NOAA is able to confirm that settlement payments will be applied as required by the settlement agreement. We have established a reserve for the settlement agreement payments. NOAA has agreed not to assess any penalties or otherwise prosecute CAWC for any "take" of steelhead trout, so long as CAWC complies with the settlement agreement. On March 14, 2008, the Sierra Club and the Carmel River Steelhead Association notified CAWC of their intent to file a citizen suit, 60 days therefrom, for violations of the federal Endangered Species Act alleging the "take" of steelhead trout by CAWC along the Carmel River and seeking injunctive relief to reduce river water diversions and increase river flow and fish passage facilities. No such suit was filed, however, the Sierra Club and the Carmel River Steelhead Association recently filed an administrative complaint with the California State Water Resources Control Board claiming that certain fish passage facilities do not meet existing permit requirements. In addition, the State Water Resource Control Board recently has held administrative hearings to address claims that CAWC has exceeded its water diversion rights in the Carmel River and has not diligently pursued establishing an alternative water supply as required by an administrative order issued to CAWC by the State Water Resource Control Board in 1995. A decision on this matter is expected in December of 2008, at the earliest. Although CAWC believes it has continued to comply with its obligations under the State Water Resource Board's 1995 order, as well as the settlement agreement and CAWC's permit requirements, we can not assure you that any future requirements by the State Water Resources Control Board arising from the matters currently before it or other permit modifications would not result in material additional costs or obligations to us.

CAWC, NJAW and Long Island Water Corporation are each plaintiffs in lawsuits relating to contamination by methyl tertiary butyl ether (MTBE) and other gasoline additives, in which they seek to recover cleanup and treatment costs and to protect certain of their groundwater supplies. The defendants in both cases are oil and chemical companies that manufacture MTBE, refine gasoline containing MTBE, and/or supply gasoline containing MTBE to retail gasoline stations. The cases were consolidated with cases involving other plaintiffs in multidistrict litigation pending in the United States District Court for the Southern District of New York (*In Re: Methyl Tertiary Butyl Ether Products Liability Litigation* , Case No. MDL 1358 SAS). As a result of court-ordered mediation, CAWC, NJAW, Long Island Water Corporation and the other plaintiffs agreed to settle the lawsuits with some of the named defendants, who represent a significant portion of the total national refining capacity for MTBE. Under the settlement, which was approved by the court in August 2008, CAWC, NJAW and Long Island Water Corporation expect to receive payments, after deducting attorneys' fees and litigation expenses, totaling approximately $15.4 million in the aggregate to treat wells that were contaminated by MTBE at the time of the settlement. The settling defendants are obligated to pay a significant share of treatment costs for any wells that become contaminated by MTBE above certain concentration levels over the next 30 years. CAWC, NJAW and Long Island Water Corporation expect to continue to litigate their claims against the remaining non-settling defendants. Although we do not currently expect pending and future treatment costs for MTBE contamination to be material, there can be no guarantee that CAWC, NJAW or Long Island Water Corporation will be able to recover all of their respective costs relating to any past or future discovery of MTBE in their wells from any of the settling defendants by means of any pending or future litigation, or through their rate cases.

Our Terratec Environmental Ltd. subsidiary, which we refer to as Terratec, is subject to and has been complying with an Order by the Ontario Ministry of the Environment (MOE) issued on October 31, 2006 requiring it to take steps to thicken certain

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biosolids that had been more susceptible to spillage during transport. MOE has conducted an investigation of four such transport spillage incidents involving Terratec that occurred prior to the issuance of the Order and has laid charges against Terratec under applicable environmental legislation carrying minimum fines of Cdn $100,000 per incident. Terratec and the MOE are currently negotiating a resolution of these matters, which the Company does not expect to result in settlement or other costs that would be materially adverse to its operations or financial condition.

Periodically, we are involved in other proceedings or litigation arising in the ordinary course of business. We do not believe that the ultimate resolution of these matters will materially affect our financial position or results of operations.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in the "Risk Factors" in the Company's Rule 424(b)(4) prospectus filed April 24, 2008, and our other public filings, which could materially affect our business, financial condition or future results. There have been no material changes from risk factors previously disclosed in "Risk Factors" in the Company's Rule 424(b)(4) prospectus filed April 24, 2008 and our Form 10-Q for the quarterly period ended March 31, 2008 filed on May 14, 2008, other than as described below.

Market disruptions could affect our ability to meet our liquidity needs.

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. On September 15, 2008, we sought to issue commercial paper but were unable to consummate the issuance due to adverse market conditions. In order to meet our short-term liquidity needs we are borrowing under our existing $800.0 million revolving credit facility, which was scheduled to expire on September 15, 2012. On September 15, 2008, a majority of our lenders agreed to extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. AWCC had $147.2 million of outstanding borrowings and $42.9 million of outstanding letters of credit under this credit facility as of November 4, 2008. AWCC had $148.1 million of outstanding overnight commercial paper as of November 4, 2008. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

Our Non-Regulated Businesses, through American Water (excluding our regulated subsidiaries), provide performance guarantees and other forms of financial security to our public-sector clients that could be claimed by our clients or potential clients if we do not meet certain obligations.

Under the terms of some of our indebtedness and some of our agreements for the provision of services to water and wastewater facilities with the municipalities, other governmental entities and other customers, American Water (excluding its regulated subsidiaries) provides guarantees of the performance of our Non-Regulated Businesses, including financial guarantees or deposits, to ensure performance of certain obligations. At September 30, 2008, we had remaining performance commitments as measured by remaining contract revenue totaling approximately $1,680.2 million, and this amount is likely to increase if our Non-Regulated Businesses grow. The presence of these commitments may adversely affect our financial condition and make it more difficult for us to secure financing on attractive terms. In addition, if the obligor on the instrument fails to perform certain obligations to the satisfaction of the party that holds the performance commitments, that party may seek to enforce the performance commitments against us or proceed against the deposit. In that event, our financial condition, results of operations, cash flow and liquidity could be adversely affected.

We have recorded a significant amount of goodwill, and we may never realize the full value of our intangible assets, causing us to record impairments that may negatively affect our results of operations or require us to effect additional dilutive equity issuances.

Our total assets include substantial goodwill. At September 30, 2008, our goodwill totaled $1,704.3 million. The goodwill is primarily associated with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E'Town Corporation in 2001. Goodwill represents the excess of the purchase price the purchaser paid over the fair value of the net tangible and intangible assets acquired. Goodwill is recorded at fair value on the date of an acquisition and, in accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," or SFAS No. 142, is reviewed annually or more frequently if changes in circumstances indicate the carrying value may not be recoverable. Annual impairment reviews are performed at November 30 of each year and interim reviews are performed when management determines that a triggering event has occurred. We have been required to reflect, as required by SFAS No. 142 and other applicable accounting rules, a non-cash charge to operating

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results for goodwill impairment in the amounts of $396.3 million, $227.8 million, and $509.3 million for the years ended December 31, 2005, 2006 and 2007, respectively. These amounts include impairments relating to discontinued operations. Also, for the three months ended March 31, 2008 we recorded a goodwill impairment in the amount of $750.0 million.

While our annual goodwill impairment test is conducted at November 30, we have processes to monitor for interim triggering events. During the third quarter of 2007, management determined that it was appropriate to update its valuation analysis as a result of our debt being placed on review for a possible downgrade and the anticipated sale of a portion of the Company in our initial public offering. As a result of that update, we recorded an impairment charge to goodwill of our Regulated Businesses in the amount of $243.3 million in the third quarter of 2007. That decline in the value of our goodwill 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.

When we completed our annual goodwill impairment test for 2007 we determined that an impairment to goodwill had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, recorded an additional goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007.

In April of 2008, we determined that it was probable, based in large part on the initial public offering price of our common stock of $21.50 and subsequent trading levels, that the carrying value of our goodwill was impaired. At the time the Company's initial public offering price of $21.50 was established, we were unable to determine if there was any goodwill impairment or to provide a reliable estimate of the amount of goodwill impairment, if any. In light of the initial public offering price and trading levels of our common stock since the date of the initial public offering, we performed an interim impairment test, and on May 9, 2008, we concluded that the carrying value of our goodwill was impaired as a result of the market price and trading levels of our common stock. We believe 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 goodwill related to our Regulated Businesses in the amount of $750.0 million in our financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of our peer companies during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of our debt (due to increased market interest rates).

As a result of the impairment and in accordance with regulatory commitments, RWE transferred $245.0 million to us on May 13, 2008. The Equity Contribution was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Application of Critical Accounting Policies and Estimates."

The Company may be required to recognize an impairment as a result of this year's annual test or at other times in the future. This depends on, among other factors, sustained levels of market price declines such as levels experienced during October 2008, 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 and the lack of an increase in the Company's market price consistent with increases in the carrying value or to a level consistent with its peer companies. 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, may also result in an incremental impairment charge. Further 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 secure financing on attractive terms and maintain compliance with debt covenants. As a result, we may be required to issue and sell additional shares of common stock at market prices, which could be dilutive to existing holders of our common stock.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description
*3.1	Restated Certificate of Incorporation of American Water Works Company, Inc.
*3.2	Amended and Restated Bylaws of American Water Works Company, Inc.
*10.1	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
*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.

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Signatures

Pursuant to the requirements 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.

	American Water Works Company, Inc. (Registrant)
November 6, 2008 (Date)	/s/ Donald L. Correll Donald L. Correll President and Chief Executive Officer (Principal Executive Officer)
November 6, 2008 (Date)	/s/ Ellen C. Wolf Ellen C. Wolf Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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* filed herewith.

RESTATED

CERTIFICATE OF INCORPORATION

OF

AMERICAN WATER WORKS COMPANY, INC.

American Water Works Company, Inc., a corporation organized under the laws of the State of Delaware (the “Corporation”), hereby certifies as follows:

A. The name of the Corporation is “American Water Works Company, Inc.” The Corporation was originally incorporated under the name “American Communities Company,” and the original Certificate of Incorporation of the Corporation was filed with the Secretary of State of the State of Delaware on August 28, 1936.

B. This Restated Certificate of Incorporation, which amends the provisions of the Corporation’s Certificate of Incorporation as heretofore amended, restated and supplemented, was duly adopted by the Board of Directors of the Corporation and by the sole stockholder of the Corporation in accordance with the provisions of Sections 228, 242 and 245 of the General Corporation Law of the State of Delaware.

C. The text of the Certificate of Incorporation of the Corporation, as heretofore amended, restated and supplemented, is hereby amended and restated to read in its entirety as follows:

ARTICLE I

The name of the corporation (hereinafter called the “Corporation”) is American Water Works Company, Inc.

ARTICLE II

The address of the Corporation’s registered office in the State of Delaware is 1209 Orange Street, in the City of Wilmington, County of New Castle, Delaware 19801. The name of the Corporation’s registered agent at such address is The Corporation Trust Company.

ARTICLE III

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of the State of Delaware.

ARTICLE IV

A. Authorized Capital Stock . The total number of shares of all classes of stock that the Corporation shall have authority to issue is 550,000,000 shares, divided into two classes consisting of (i) 500,000,000 shares of common stock, par value $0.01 per share (the "Common Stock"), and (ii) 50,000,000 shares of preferred stock, par value $0.01 per share (the "Preferred Stock"). The following is a statement of the powers, preferences and rights, and the qualifications, limitations and restrictions thereof, in respect of each such class.

B. Preferred Stock . The Board of Directors is authorized to provide for the issuance from time to time of shares of Preferred Stock in one or more series and, by filing a certificate pursuant to the applicable provisions of the General Corporation Law of the State of Delaware (a "Preferred Stock Certificate of Designation"), to establish from time to time the number of shares to be included in each such series, with such powers, designations, preferences and relative, participating, optional or other rights, if any, and qualifications, limitations or restrictions thereof, if any, as are stated and expressed in the resolution or resolutions providing for the issuance thereof adopted by the Board of Directors (as such resolutions may be amended by a resolution or resolutions subsequently adopted by the Board of Directors), and as are not stated and expressed in this Restated Certificate of Incorporation, including, but not limited to, determination of any of the following:

(1) the distinctive designation of the series, whether by number, letter or title, and the number of shares which will constitute the series, which number may be increased or decreased (but not below the number of shares then outstanding and except to the extent otherwise provided in the applicable Preferred Stock Certificate of Designation) from time to time by action of the Board of Directors;

(2) the dividend rate, if any, and the times of payment of dividends, if any, on the shares of the series, whether such dividends will be cumulative and, if so, from what date or dates, and the relation which such dividends, if any, shall bear to the dividends payable on any other class or classes of stock;

(3) the price or prices at which, and the terms and conditions on which, the shares of the series may be redeemed at the option of the Corporation;

(4) whether or not the shares of the series will be entitled to the benefit of a retirement or sinking fund to be applied to the purchase or redemption of such shares and, if so entitled, the amount of such fund and the terms and provisions relative to the operation thereof;

(5) the amounts payable on, and the preferences, if any, of the shares of the series in the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Corporation;

(6) whether or not the shares of the series will be convertible into, or exchangeable for, any other shares of stock of the Corporation or other securities and, if so convertible or exchangeable, the conversion price or prices, or the rates of exchange, and any adjustments thereof, at which such conversion or exchange may be made, and any other terms and conditions of such conversion or exchange;

(7) whether or not the shares of the series will have priority over or be on a parity with or be junior to the shares of any other series or class of stock in any respect, or will be entitled to the benefit of limitations restricting the issuance of shares of any other series or class of stock, restricting the payment of dividends on or the making of other distributions in respect of shares of any other series or class of stock ranking junior to the shares of the series as to dividends or assets, or restricting the purchase or redemption of the shares of any such junior series or class, and the terms of any such restriction;

(8) whether or not the shares of the series will have voting rights in addition to any voting rights provided by law and, if so, the terms of such voting rights; and

(9) any other terms of the shares of the series.

C. Common Stock .

Except as otherwise required by applicable law, all shares of Common Stock shall be identical in all respects and shall entitle the holders thereof to the same rights, subject to the same qualifications, limitations and restrictions. The terms of the Common Stock set forth below shall be subject to the express terms of any series of Preferred Stock.

(1) Dividends . As, if and when dividends are declared or paid thereon, whether in cash, property or securities of the Corporation, the holders of Common Stock shall be entitled to participate in such dividends ratably on a per share basis.

(2) Voting Rights . Except as otherwise required by applicable law, the holders of Common Stock shall be entitled to one vote per share on all matters to be voted on by the Corporation's stockholders. No stockholder of the Corporation shall be entitled to exercise any right of cumulative voting.

(3) Liquidation Rights . The holders of Common Stock shall be entitled to participate ratably on a per share basis in all distributions to holders of Common Stock as a result of the liquidation, dissolution or winding up of the Corporation.

ARTICLE V

The number of directors of the Corporation shall be fixed from time to time in the manner provided in the Bylaws.

ARTICLE VI

In furtherance and not in limitation of the powers conferred upon it by law, the Board of Directors of the Corporation is expressly authorized to adopt, amend or repeal the Bylaws of the Corporation without the assent or vote of the stockholders of the Corporation. The stockholders may, at any annual or special meeting of the stockholders of the Corporation, duly called and upon proper notice thereof, make, alter, amend or repeal the Bylaws by the affirmative vote of the holders of not less than a majority of the then outstanding stock of the Corporation entitled to vote generally in the election of directors.

ARTICLE VII

Unless and except to the extent that the Bylaws of the Corporation so require, the election of directors of the Corporation need not be by written ballot.

ARTICLE VIII

No director of the Corporation shall be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director; provided , however , that the foregoing shall not eliminate or limit the liability of a director (A) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (B) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (C) under Section 174 of the General Corporation Law of the State of Delaware, or (D) for any transaction from which the director derived an improper personal benefit.

Any repeal or modification of this Article by the stockholders of the Corporation shall be prospective only, and shall not affect, to the detriment of any director, any limitation on the personal liability of a director of the Corporation existing at the time of such repeal or modification.

ARTICLE IX

Each person who is or was or had agreed to become a director or officer of the Corporation, and each such person who is or was serving or who had agreed to serve at the request of the Corporation as a director, officer, partner, member, trustee, employee or agent of another corporation, partnership, limited liability company, joint venture, trust or other enterprise (including the heirs, executor, administrators or estate of such person), shall be indemnified by the Corporation to the fullest extent permitted from time to time by applicable law.

ARTICLE X

Any action required or permitted to be taken by the stockholders of the Corporation must be effected at a duly called annual or special meeting of the stockholders of the Corporation, and the ability of the stockholders to consent in writing to the taking of any action is specifically denied.

IN WITNESS WHEREOF, this Restated Certificate of Incorporation of the Corporation has been executed by its duly authorized officer this 24th day of April, 2008.

AMERICAN WATER WORKS COMPANY, INC.

by /s/ George W. Patrick
Name: George W. Patrick
Title: Senior Vice President, General Counsel and Secretary

AMENDED AND RESTATED BYLAWS OF AMERICAN WATER WORKS COMPANY, INC.

a Delaware corporation

As adopted on March 31, 2008
with effect from April 22, 2008

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AMENDED AND RESTATED
BYLAWS OF

AMERICAN WATER WORKS COMPANY, INC.
a Delaware corporation

As adopted on March 31, 2008

with effect from April 22, 2008

ARTICLE I

Offices

SECTION 1. Registered Office . The registered office of American Water Works Company, Inc. (the “Corporation”) in the State of Delaware shall be located in the City of Wilmington.

SECTION 2. Other Offices . The Corporation may also have offices in such places, within or without the State of Delaware, as the Board of Directors of the Corporation (the “Board”) may from time to time determine or the business of the Corporation may require.

ARTICLE II

Meetings of Stockholders

SECTION 1. Annual Meetings . The annual meeting of the stockholders for the election of directors and for such other business as may properly come before the meeting shall be held at such place (within or without the State of Delaware), date and hour as shall be designated by the Board or as shall be designated in the notice or waiver of notice thereof.

SECTION 2. Special Meetings . Special meetings of the stockholders may be held only upon call by the Board or the Chairman of the Board or President or a stockholder or stockholders holding at least 15% of the shares of stock of the Corporation issued and outstanding and entitled to be voted at the meeting, at such place and at such time and date as may be fixed by the body or person or persons giving such call, and as may be stated in the notice setting forth such call. Only business within the purpose or purposes described in the notice or waiver of notice required by these Bylaws may be conducted at a special meeting of the stockholders.

SECTION 3. Notice of Meetings . (a) Each stockholder of record of each class of stock of the Corporation then outstanding and entitled to vote at any meeting of stockholders shall be given written notice of such meeting, which notice shall state the place, date and hour of the meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called. Each stockholder receiving such a notice shall be entitled to attend such meeting. Except as otherwise expressly required by law, notice of each meeting of stockholders shall be given not less than ten nor more than sixty days before the date of such meeting to each stockholder entitled to vote at such meeting.

(b) Attendance of a stockholder at a meeting shall constitute a waiver of notice of such meeting, except when the stockholder attends for the express purpose of objecting at the beginning of the meeting to the transaction of any business because the meeting is not lawfully called or convened

SECTION 4. Quorum. At each meeting of the stockholders, except as otherwise expressly required by law or the Corporation's Restated Certificate of Incorporation, stockholders holding a majority of the shares of stock of the Corporation issued and outstanding and entitled to be voted at the meeting shall be present in person or by proxy to constitute a quorum for the transaction of business. In the absence of a quorum at any such meeting or any adjournment or adjournments thereof, a majority in voting interest of those present in person or by proxy and entitled to vote thereat, or any officer entitled to preside at, or to act as secretary of, such meeting may adjourn such meeting until stockholders holding the amount of stock requisite for a quorum are present in person or by proxy. At any such adjourned meeting at which a quorum may be present, any business may be transacted which might have been transacted at the meeting as originally called.

SECTION 5. Organization. Meetings of stockholders shall be presided over by the Chairman of the Board, or in his or her absence by the President, or such other person as the Board may determine. The Secretary shall act as secretary of the meeting, and in his or her absence such other person as the person presiding over the meeting may appoint.

SECTION 6. Voting. When a quorum is present, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders, unless the question is one upon which by express provisions of an applicable law, the rules and regulations of any stock exchange or quotation system applicable to the Corporation, these Bylaws or the Corporation’s Restated Certificate of Incorporation, a different vote is required, in which case such express provision shall govern and control the decision of such question.

SECTION 7. Notice of Stockholder Business and Nominations. (a) Annual Meetings of Stockholders.

(i) Nominations of persons for election to the Board and the proposal of business to be considered by the stockholders may be made at an annual meeting of stockholders (A) by or at the direction of the Chairman of the Board or the Board generally, (B) pursuant to the Corporation’s notice of meeting (or any supplement thereto) or (C) by any stockholder of the Corporation who is entitled to vote at the meeting and who complies with the notice procedures set forth in clauses (ii) and (iii) of this paragraph and who was a stockholder of record at the time such notice is delivered to the Secretary.

(ii) For nominations or other business to be properly brought before an annual meeting by a stockholder, pursuant to clause (C) of paragraph (a)(i) of this Section 7 (or before a special meeting of stockholders pursuant to paragraph (b) of this Section 7), the stockholder must have given timely notice thereof in writing to the Secretary and any such proposed business other than the nominations of persons for election to the Board must constitute a proper matter for stockholder action. To be timely, a stockholder’s notice shall be delivered to the Secretary at the principal executive offices of the Corporation not less than ninety days prior to the first anniversary of the date of the preceding year’s annual meeting; provided , however , that if the Corporation did not hold an annual meeting the preceding year or if the date of the annual meeting is changed by more than thirty days from the date of the preceding year's annual meeting, to be timely, notice by the stockholder must be delivered not later than the ninetieth day prior to the date of the annual meeting (or, if later, the tenth day following the day on which public announcement is first made of the date of the annual meeting and of the nominees proposed by the Board to be elected at such meeting). In no event shall the adjournment of an annual meeting commence a new time period for the giving of a stockholder's notice as described above. Such stockholder's notice shall set forth (A) as to each person whom the stockholder proposes to nominate for election or reelection as a director, all information relating to such person that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, in each case pursuant to Regulation 14A under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in each case including any successor rule or regulation thereto, including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected; (B) as to any other business that the stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting and any material interest in such business of such stockholder and of any beneficial owner on whose behalf the proposal is made; and (C) as to the stockholder giving the notice and any beneficial owner on whose behalf the nomination or proposal is made (1) the name and address of such stockholder, as they appear on the Corporation's books, and the name, address and phone number of such beneficial owner, (2) the number and class of shares of capital stock of the Corporation which are owned beneficially and of record by such stockholder and such beneficial owner, (3) a description of any and all arrangements or understandings between such stockholder and such beneficial owner, (4) a representation that the stockholder is a holder of record of stock of the Corporation entitled to vote at such meeting and intends to appear in person or by proxy at the meeting to propose such business or nomination and (5) a representation as to whether the stockholder or the beneficial owner, if any, intends or is part of a group which intends (x) to deliver a proxy statement and/or form of proxy to holders of at least the percentage of the Corporation's outstanding capital stock required to approve or adopt the proposal or elect the nominee and/or (y) otherwise to solicit proxies from stockholders in support of such proposal or nomination. The foregoing notice requirements shall be deemed satisfied by a stockholder if the stockholder has notified the Corporation of his or her intention to present a proposal at an annual meeting in compliance with Rule l4a-8 (or any successor thereto) promulgated under the Exchange Act and such stockholder's proposal has been included in a proxy statement that has been prepared by the Corporation to solicit proxies for such annual meeting. The Corporation may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as a director of the Corporation.

(iii) Notwithstanding anything in the second sentence of paragraph (a)(ii) of this Section 7 to the contrary, in the event that the number of directors to be elected to the Board is increased and there is no public announcement made by the Corporation naming all of the nominees for director or specifying the size of the increased Board at least ninety days prior to the first anniversary of the date of the preceding year's annual meeting, a stockholder's notice under this paragraph shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the close of business on the tenth day following the day on which such public announcement is first made by the Corporation.

(b) Special Meetings of Stockholders . Only such business as shall have been brought before the special meeting of the stockholders pursuant to the notice or waiver of notice of the meeting shall be conducted at such meeting. Nominations of persons for election to the Board may be made at a special meeting of stockholders at which directors are to be elected pursuant to the notice or waiver of notice of the meeting (i) by or at the direction of the Board, (ii) by the stockholder or stockholders who called such meeting or (iii) by any other stockholder of the Corporation who is entitled to vote at such meeting, who complies with the notice procedures set forth in this Section 7 and who is a stockholder of record at the time such notice is delivered to the Secretary. Nominations by such other stockholders of persons for election to the Board may be made at such special meeting of stockholders if the stockholder's notice as required by paragraph (a)(ii) of this Section 7 shall be delivered to the Secretary at the principal executive offices of the Corporation not later than the ninetieth day prior to the date of the special meeting (or, if later, the tenth day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the Board to be elected at such meeting). In no event shall the adjournment of a special meeting commence a new time period for the giving of a stockholder's notice as described above.

(c) General . Other than as set forth in Article III, Section 5 hereof, only persons who are nominated in accordance with the procedures set forth in this Section 7 shall be eligible to serve as directors and only such business shall be conducted at a meeting of stockholders as shall have been brought before the meeting in accordance with the procedures set forth in this Section 7. Except as otherwise provided by law, the chairman of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made in accordance with the procedures set forth in this Section 7 and, if any proposed nomination or business is not in compliance with this Section 7, to declare that such defective proposal or nomination shall be disregarded.

SECTION 8. Postponement and Cancellation of Meeting . Any previously scheduled annual or special meeting of the stockholders may be postponed, and any previously scheduled annual or special meeting of the stockholders called by the Board may be canceled, by resolution of the Board upon public notice given prior to the time previously scheduled for such meeting of stockholders.

ARTICLE III

Board of Directors

SECTION 1. General Powers . The property, business and affairs of the Corporation shall be managed by or under the direction of the Board, which may exercise all such powers of the Corporation and do all such lawful acts and things as are not by law or by the Restated Certificate of Incorporation directed or required to be exercised or done by the stockholders.

SECTION 2. Number and Term of Office . The number of directors which shall constitute the whole Board shall be fixed from time to time by the Board. Directors need not be stockholders or citizens or residents of the United States of America. Except as provided in Section 5 of this Article III, directors shall be elected at the annual meeting of the stockholders by a plurality of the votes of the shares present in person or represented by proxy at the meeting and entitled to vote in the election of directors. Each of the directors of the Corporation shall hold office until his or her successor shall be elected and shall qualify or until his or her earlier death or resignation or removal in the manner hereinafter provided.

SECTION 3. Resignations . Any director may resign at any time by giving written notice of his or her resignation to the Chairman of the Board, the President or the Secretary. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, then it shall take effect when accepted by action of the Board. Except as aforesaid, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 4. Removal of Directors . Any director or the entire Board may be removed, with or without cause, at any time upon the affirmative vote of holders of a majority of the shares then entitled to vote at an election of directors.

SECTION 5. Vacancies . Vacancies in the Board and newly created directorships resulting from any increase in the authorized number of directors may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director or by the stockholders of the Corporation at the next annual meeting or any special meeting called for the purpose. Each director so chosen shall hold office until his or her successor shall be elected and shall qualify or until his or her earlier death or resignation or removal in the manner as herein provided.

SECTION 6. Place of Meetings . The Board may hold its meetings at such place or places within or without the State of Delaware as the Board may from time to time determine or as shall be designated in the respective notices or waivers of notice thereof.

SECTION 7. Annual and Regular Meetings . The annual meeting of the Board for the purpose of electing officers and for the transaction of such other business as may come before the meeting shall be held as soon as possible following adjournment of the annual meeting of the stockholders at the place of such annual meeting of the stockholders. Notice of such annual meeting of the Board need not be given. The Board from time to time may by resolution provide for the holding of regular meetings and fix the place (which may be within or without the State of Delaware), date and time of such meetings. Notice of regular meetings need not be given; provided , however , that if the

Board shall fix or change the time or place of any regular meeting, notice of such action shall be mailed promptly, or sent by telephone, telegraph, facsimile, electronic mail or other electronic means to each director who shall not have been present at the meeting at which such action was taken, addressed to him or her at his or her usual place of business, or shall be delivered to him or her personally.

SECTION 8. Special Meetings . Special meetings of the Board shall be held whenever called by the Chairman of the Board, the President or at least two of the directors, at such place, date and time as may be specified in the respective notices or waivers of notice of such meetings. Special meetings of the Board may be called on at least twenty-four hours' notice to each director if notice is given to each director personally or by telephone, telegraph, facsimile, electronic mail or other electronic means, or on three days' notice from the official date of deposit in the mail if notice is sent by internationally recognized courier to each director, addressed to him or her at his or her usual place of business. Such notice need not state the purpose of, nor the business to be transacted at, that meeting, except as may otherwise be required by law. Notice need not be given to a director present at a meeting. A meeting may be held at any time without notice if all the directors are present or if those not present waive notice of the meeting in writing either before or after that meeting.

SECTION 9. Quorum and Manner of Acting . Except as provided by law, the Restated Certificate of Incorporation or these Bylaws, a majority of the total number of directors shall be present in person at any meeting of the Board in order to constitute a quorum for the transaction of business at such meeting, and the vote of a majority of those directors present at any such meeting at which a quorum is present shall be necessary for the passage of any resolution or act of the Board. In the absence of a quorum for any such meeting, a majority of the directors present thereat may adjourn such meeting from time to time until a quorum shall be present thereat. Notice of any adjourned meeting need not be given.

SECTION 10. Organization . The Board shall elect a Chairman of the Board from among the directors. Meetings of the Board shall be presided over by the Chairman of the Board, or such other person as the Board may determine. The Secretary shall act as secretary of the meeting, and in his or her absence such other person as the person presiding over the meeting may appoint.

SECTION 11. Action by Written Consent . Any action required or permitted to be taken at any meeting of the Board or of any committee thereof may be taken without a meeting if all members of the Board or of such committee, as the case may be, consent thereto in writing, and such writing or writings are filed with the minutes of the proceedings of the Board or such committee.

SECTION 12. Meetings by Telephone, etc. Any one or more members of the Board, or any committee designated by the Board, may participate in a meeting of the Board, or such committee, by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting pursuant to this Section shall constitute presence in person at such meeting.

SECTION 13. Compensation . Each director, in consideration of his or her serving as such, shall be entitled to receive from the Corporation such amount per annum or such fees for attendance at meetings of the Board or of any committee, or both, as the Board shall from time to time determine. The Board may likewise provide that the Corporation shall reimburse each director or member of a committee for any expenses incurred by him or her on account of his or her attendance at any such meeting. Nothing contained in this Section shall be construed to preclude any director from serving the Corporation in any other capacity and receiving compensation therefor.

ARTICLE IV

Committees

SECTION 1. Committees . The Board shall, by resolution passed by a majority of the directors, designate a compensation committee, a nominating and governance committee, an audit committee and, if so desired from time to time, other committees to serve at the pleasure of the Board. Each committee shall consist of two or more of the directors of the Corporation, which to the extent permitted by law and provided in such resolution or these Bylaws shall have and may exercise the powers of the Board in the management and affairs of the Corporation. Such committee(s) shall have such name(s) as may be determined from time to time by resolution adopted by the Board. Each committee shall keep regular minutes of its meetings and report the same to the Board when required. The Board may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of the committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he, she or they constitute a quorum, may unanimously appoint another member of the Board to act at the meeting in place of any such absent or disqualified member.

SECTION 2. Committee Rules . Each committee of the Board may fix its own rules of procedure and shall hold its meetings as provided by such rules, except as may otherwise be provided by the resolution of the Board designating such committee or the charter adopted by the Board for such committee. In the absence of such rules, each committee shall conduct its business in the same manner as the Board conducts its business pursuant to Article III of these Bylaws.

ARTICLE V

Officers

SECTION 1. Number . The principal officers of the Corporation shall be designated by the Board and shall consist of a President, such number of Vice Presidents as the Board may determine from time to time, a Treasurer, a Secretary and such number of Assistant Treasurers and Assistant Secretaries as the Board may determine from time to time. The Board may, in its discretion, create such offices and confer such titles as Chief Executive Officer, Chief Financial Officer or Chief Operating Officer and designate any Vice President by a number or numbers or a word or words (including, without limitation, the words “Executive” and “Senior”) added before or after such title. The Board may appoint, and authorize the appointment of, such other officers of the Corporation as the Board deems necessary who shall have such authority and shall perform such duties as these Bylaws or as the Board may prescribe. Any number of offices may be held by the same person, except that no person may simultaneously hold the offices of President and Secretary.

SECTION 2. Term of Office . Each officer shall hold office until his or her successor is duly elected and qualified or until his or her earlier death or resignation or removal in the manner hereinafter provided.

SECTION 3. Removal and Resignation . All officers and agents of the Corporation shall be subject to removal, with or without cause, at any time by the affirmative vote of a majority of the Board, or, except in the case of any officer elected by the Board, by any committee or superior officer upon whom such power may be conferred by the Board. Designation of an officer shall not itself create contract rights. Any officer may resign at any time by giving written notice of his or her resignation to the President or the Secretary, and such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, shall take effect when accepted by action of the Board. Except as aforesaid, the acceptance of such resignation shall not be necessary to make it effective.

SECTION 4. President . The President, subject to the direction of the Board, shall have such powers and perform such duties as pertain to the office of President and as the Board may from time to time prescribe, shall have the direction of all subordinate officers, agents and employees and may assign such duties to such other officers as he or she deems appropriate, and shall perform such other duties and exercise such other powers as may from time to time be prescribed by these Bylaws or the Board.

SECTION 5. Vice Presidents . Each Vice President shall have such powers and perform such duties as the Board or the President may from time to time prescribe and shall perform such other duties as may be prescribed by these Bylaws. At the request of the President, or in case of his or her absence or inability to act, any of the Vice Presidents shall perform the duties of the President and, when so acting, shall have all the powers of, and be subject to all the restrictions upon, the President.

SECTION 6. Treasurer . The Treasurer shall have charge and custody of, and be responsible for, all funds and securities of the Corporation, and shall deposit all such funds in the name of the Corporation in such banks, trust companies or other depositories as shall be selected in accordance with the provisions of these Bylaws. He or she shall disburse the funds of the Corporation as may be ordered by the Board, making proper vouchers for such disbursements, and shall render to the Board whenever required to do so, and shall present at the annual meeting of the stockholders, if called upon to do so, a statement of all his or her transactions as Treasurer. He or she shall have such powers and perform such duties as pertain to the office of Treasurer and shall perform such other duties as may from time to time be assigned to him or her by the Board.

SECTION 7. Secretary . The Secretary shall keep the records of the proceedings of all meetings of the stockholders and the Board or any committees thereof. He or she shall affix the seal of the Corporation to all deeds, contracts, bonds or other instruments requiring the corporate seal when the same shall have been signed on behalf of the Corporation by a duly authorized officer and shall be the custodian of all contracts, deeds, documents and all other indicia of title to properties owned by the Corporation and of its other corporate records (except accounting records). He or she shall have such powers and perform such duties as pertain to the office of Secretary and shall perform such other duties as may from time to time be assigned to him or her by the Board.

SECTION 8. Other Officers, Assistant Officers and Agents . Officers, assistant officers and agents, if any, other than those whose duties are provided for in these Bylaws, shall have such authority and perform such duties as may from time to time be prescribed by resolution of the Board or by the person responsible for appointing such officers, assistant officers and agents, as the case may be.

SECTION 9. Execution of Contracts and Instruments . Notwithstanding the foregoing description of the duties and powers of corporate officers, the Board may from time to time limit or qualify such duties and powers by an instrument designated by the Board or pursuant to the Board's delegated authority as a corporate delegation of authority, and the duties and powers of the Corporation's officers shall be so limited. The Board may also from time to time specifically authorize one or more officers or agents of the Corporation to enter into such contracts, execute such instruments and take such other actions in the name of and on behalf of the Corporation for such specific purposes and in connection with such specific matters and transactions as the Board in its discretion may determine. Any instrument may be executed on behalf of and in the name of the Corporation: (a) by the Chairman of the Board, the President, the Chief Executive Officer (if any), the Chief Financial Officer (if any), the Chief Operating Officer (if any) or any Vice President, together with the Secretary, the Treasurer or any Assistant

Secretary, or any Assistant Treasurer, in each case, subject to any instrument that the Board or those authorized by it may designate as a "corporate delegation of authority", (b) by such officers specifically authorized to act by Board resolution for a specific purpose or (c) by any other person authorized to do so by, and subject to the limits stated in, the instrument that the Board or those authorized by it may designate as a "corporate delegation of authority", and such persons shall be deemed agents of the Corporation for such purposes. Except as otherwise designated or expressly authorized by these Bylaws, or an instrument properly designated as a "corporate delegation of authority" no officer, employee or agent shall have any power or authority to bind the Corporation by any contract or engagement or to pledge its credit or to render it liable pecuniarily for any purpose or to any amount.

SECTION 10. Security . The Board may require any officer, agent or employee of the Corporation to provide security for the faithful performance of his or her duties, in such amount and of such character as may be determined from time to time by the Board.

ARTICLE VI

Proxies, Checks, Drafts, Bank Accounts, Etc.

The President, or any other officer designated by the Board as having such authority, shall have authority from time to time to exercise in the name and on behalf of the Corporation the powers and rights which the Corporation may have as the holder of stock or other securities or interests in any other corporation or business entity and to vote or consent in respect of such stock, securities or interest; the President or such designated officers may designate an agent or agents to perform such function and may instruct the person or persons so appointed as to the manner of exercising such powers and rights; and the President or such designated officers may execute or cause to be executed in the name and on behalf of the Corporation and under its corporate seal, or otherwise, such written proxies, powers of attorney or other instruments as they may deem necessary or proper in order that the Corporation may exercise its said powers and rights. All checks and drafts on the Corporation bank accounts and all bills of exchange and promissory notes, and all acceptances, obligations and other instruments for the payment of money, shall be signed by such officer or officers or agent or agents or other employee or employees as shall be thereunto authorized from time to time by the Board. Third parties shall be entitled to rely on the authority delegated by the Board or pursuant to its delegated authority in an instrument designated as a “corporate delegation of authority” as to all matters governed by this Article VI.

ARTICLE VII

Books and Records

The books and records of the Corporation may be kept at such places within or without the State of Delaware as the Board may from time to time determine.

ARTICLE VIII

Seal

The corporate seal shall have inscribed thereon the name of the Corporation and the words “Corporate Seal Delaware 1936.” In lieu of the corporate seal, when so authorized by the Board or a duly empowered committee thereof and permitted by law, a facsimile thereof may be impressed or affixed or reproduced.

ARTICLE IX

Fiscal Year

The fiscal year of the Corporation shall end on the 31 st day of December in each year, unless changed by resolution of the Board.

ARTICLE X

Indemnification

SECTION 1. Right to Indemnification. The Corporation shall indemnify to the fullest extent authorized by the Delaware General Corporation Law, as the same exists or may hereafter be amended, each person who was or is a party or is threatened to be made a party to or is involved in any action, suit or proceeding, whether civil, criminal, administrative or investigative (a “Proceeding”), by reason of the fact that he or she is or was or had agreed to become a director or officer of the Corporation or an employee of the Corporation specifically designated by the Board as an indemnified employee, or is or was serving or had agreed to serve at the request of the Corporation as a director, officer, partner, member, trustee or agent, or such an employee, of another corporation, partnership, limited liability company, joint venture, trust or other enterprise (including the heirs, executor, administrators or estate of such person), whether the basis of such Proceeding is alleged action in an official capacity as a director, officer, partner, member, trustee, agent or employee, or in any other capacity while serving as a director, officer, partner, member, trustee, agent or employee, against all expense, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes, penalties and amounts paid or to be paid in settlement) reasonably incurred or suffered by such person in connection with such service; provided , however , that except as provided in Section 2 of this Article X the Corporation shall indemnify any such person seeking indemnification in connection with a Proceeding (or part thereof) initiated by such person only if such Proceeding was authorized by the Board, either generally or in the specific instance.

SECTION 2. Expenses . The right to indemnification shall include the advancement of expenses incurred by any person described in Section 1 of this Article X in defending any such Proceeding in advance of its final disposition in accordance with procedures established from time to time by the Board; provided , however , that the director, officer, partner, member, trustee, agent or employee shall deliver to the Corporation an undertaking to repay all amounts so advanced if it shall ultimately be determined by final judicial decision from which there is no further right to appeal that he or she is not entitled to be indemnified for such expenses under this Article X or otherwise, such undertaking to be in form and substance reasonably acceptable to the Corporation and which may further specify the conditions upon which indemnification for expenses is available given the facts and circumstances of such Proceeding.

SECTION 3. Continuation of Rights . The rights of indemnification provided in this Article X shall be in addition to any rights to which any person may otherwise be entitled by law or under any Bylaw, agreement, vote of stockholders or disinterested directors, or otherwise. Such rights shall continue as to any person who has ceased to be a director, officer, partner, member, trustee, agent or employee and shall inure to the benefit of his or her heirs, executors and administrators, and shall be applicable to proceedings commenced after the adoption hereof, whether arising from acts or omissions occurring before or after the adoption hereof.

SECTION 4. Contract Rights . The obligations of the Corporation to indemnify a director, officer, partner, member, trustee, agent or employee under this Article X, including the duty to advance expenses, shall be considered a contract between the Corporation and such individual, and no modification or repeal of any provision of this Article X shall affect, to the detriment of the individual, such obligations of the Corporation in connection with a claim based on any act or failure to act occurring before such modification or repeal.

SECTION 5. Insurance and Funding . The Corporation may purchase and maintain insurance to protect any person against any liability or expense asserted against or incurred by such person in connection with any Proceeding, whether or not the Corporation would have the power to indemnify such person against such liability or expense by law or under this Article X or otherwise, provided that such insurance is available on acceptable terms, which determination shall be made by the Board. The Corporation may create a trust fund, grant a security interest or use other means (including, without limitation, a letter of credit) to insure the payment of such sums as may become necessary to effect indemnification as provided herein.

SECTION 6. Severability . If this Article X or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the Corporation shall nevertheless indemnify and hold harmless each director and officer and any other person indemnified pursuant to this Article X as to all expense, liability and loss (including attorneys' fees, judgments, fines, ERISA excise taxes, penalties and amounts paid or to be paid in settlement) with respect to any Proceeding to the full extent permitted by any applicable portion of this Article X that shall not have been invalidated and to the fullest extent permitted by applicable law.

ARTICLE XI

Shares and Their Transfer

SECTION 1. Certificates for Shares . The shares of the Corporation shall be represented by certificates, or shall be uncertificated shares evidenced by a book-entry system, or a combination of both. Certificates shall be signed by, or in the name of the Corporation by, (i) the President or a Vice President and (ii) the Secretary or an Assistant Secretary, certifying the number and class of shares of the Corporation owned by the holder of such certificate. If such a certificate is countersigned (a) by a transfer agent or an assistant transfer agent other than the Corporation or its employee or (b) by a registrar other than the Corporation or its employee, the signature of any such President, Vice President, Secretary or Assistant Secretary may be a facsimile. In case any officer(s) who have signed, or whose facsimile signature(s) have been used on, any such certificate(s) shall cease to be such officer(s) of the Corporation, whether because of death, resignation or otherwise, before such certificate(s) have been delivered by the Corporation, such certificate(s) may nevertheless be issued and delivered as though the person or persons who signed such certificate(s) or whose facsimile signature(s) have been used thereon had not ceased to be such officer(s) of the Corporation.

SECTION 2. Record . A record shall be kept of the name of the person, firm or corporation owning each share of stock of the Corporation, including, in the case of stock represented by each certificate for stock of the Corporation issued, the number of shares represented by each such certificate, and the date thereof, and, in the case of cancellation, the date of cancellation. Except as otherwise expressly required by law, the person in whose name shares of stock stand on the books of the Corporation shall be deemed the owner thereof for all purposes as regards the Corporation.

SECTION 3. Transfers of Stock . Transfers of stock shall be made only upon the transfer books of the Corporation kept at an office of the Corporation or by transfer agents designated to transfer shares of the stock of the Corporation. Except when a certificate is issued in accordance with Section 4 of this Article XI, in the case of stock represented by a certificate, an outstanding certificate for the number of shares involved shall be surrendered for cancellation before a new certificate is issued therefor.

SECTION 4. Lost, Destroyed or Mutilated Certificates . In the case of an alleged loss or destruction or the mutilation of a certificate representing stock of the Corporation, a new certificate may be issued in place thereof, in the manner and upon such terms as the Board may prescribe.

ARTICLE XII

General Provisions

SECTION 1. Section Headings . Section headings in these Bylaws are for convenience of reference only and shall not be given any substantive effect in limiting or otherwise construing any provision herein.

SECTION 2. Inconsistent Provisions . In the event that any provision of these Bylaws is or becomes inconsistent with any provision of the Corporation's Certificate of Incorporation, the General Corporation Law of the State of Delaware or any other applicable law, such provision of these Bylaws shall not be given any effect to the extent of such inconsistency but shall otherwise be given full force and effect.

ARTICLE XIII

Amendments

These Bylaws, or any of them, may be altered, amended or repealed by the Board, or by the stockholders of the Corporation as provided in the Corporation's Restated Certificate of Incorporation.

AMENDMENT 2008-1
TO THE
NONQUALIFIED SAVINGS AND
DEFERRED COMPENSATION PLAN FOR
EMPLOYEES OF
AMERICAN WATER WORKS COMPANY, INC.
AND ITS DESIGNATED SUBSIDIARIES

Pursuant to the authority reserved to the American Water Works Company, Inc. Board of Directors (the "Board") under Section 8.01 of the Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and Its Designated Subsidiaries (the "Plan"), the Board hereby amends the Plan, effective as of August 1, 2008, as follows:

1. The third sentence of the full paragraph under Article I of the Plan is hereby amended in its entirety to read as follows:

   "Certain Group I Employees shall also be eligible for certain Special Contribution(s) under the Plan."

2. The sixth sentence of the full paragraph under Article I of the Plan is hereby amended in its entirety to read as follows:

   "Certain Group III Employees shall also be eligible for certain Special Contribution(s) under the Plan."

3. Section 2.53 of the Plan is hereunder amended in its entirety to read as follows:

   " **Section 2.53 " Special Contribution "** means the amount credited to the Plan for a Group I Employee and Group III Employee by AWW pursuant to Sections 4.01(d) and 4.03(c), respectively. The Group I Employees and Group III Employees who shall be eligible to receive the Special Contribution shall only be those who are designated as eligible to receive such pursuant to Sections 4.01(d) and 4.03 (c), respectively, and the corresponding Exhibits."

4. Section 4.01(d) of the Plan is hereby amended in its entirety to read as follows:

   "(d) Special Contributions .

   (i) As soon as administratively practicable following the Effective Date, AWW shall make a Special Contribution to the Special Contribution Account of each Group I Employee who is designated to receive the Special Contribution on the attached Exhibit E; provided, however, that each such specifically designated Group I Employee must be employed by the Employer on the Effective Date and qualify as a Group I Employee on such date. The Special Contribution pursuant to this clause (i) for each Group I Employee shall be equivalent in value to the amount set forth for such Group I Employee on the attached Exhibit E. Any Group I Employee who is not listed on the attached Exhibit E shall not be eligible to receive the Special Contribution pursuant to this clause (i). The Special Contribution provided for in this clause (i) shall be a one-time contribution.

(ii) As soon as administratively practicable on or after August 1, 2008, AWW shall make a Special Contribution to the Special Contribution Account of each Group I Employee who is designated to receive the Special Contribution on the attached Exhibit F; provided, however, that each such specifically designated Group I Employee must be employed by the Employer on August 1, 2008 and qualify as a Group I Employee on such date. The Special Contribution pursuant to this clause (ii) for each such Group I Employee shall be equivalent in value to the amount set forth for such Group I Employee on the attached Exhibit F. Any Group I Employee who is not listed on the attached Exhibit F shall not be eligible to receive the Special Contribution pursuant to this clause (ii). The Special Contribution provided for in this clause (ii) shall be a one-time contribution."

5. Section 4.03(c) of the Plan is hereby amended in its entirety to read as follows:

"(c) Special Contributions .

(i) As soon as administratively practicable following the Effective Date, AWW shall make a Special Contribution to the Special Contribution Account of each Group III Employee who is designated to receive the Special Contribution on the attached Exhibit E; provided, however, that each such specifically designated Group III Employee must be employed by the Employer on the Effective Date and qualify as a Group III Employee on such date. The Special Contribution pursuant to this clause (i) for each such Group III Employee shall be equivalent in value to the amount set forth for such Group III Employee on the attached Exhibit E. Any Group III Employee who is not listed on the attached Exhibit E shall not be eligible to receive the Special Contribution pursuant to this clause (i). The Special Contribution provided for in this clause (i) shall be a one-time contribution.

(ii) As soon as administratively practicable on or after August 1, 2008, AWW shall make a Special Contribution to the Special Contribution Account of each Group III Employee who is designated to receive the Special Contribution on the attached Exhibit F; provided, however, that each such specifically designated Group III Employee must be employed by the Employer on August 1, 2008 and qualify as a Group III Employee on such date. The Special Contribution pursuant to this clause (ii) for each such Group III Employee shall be equivalent in value to the amount set forth for such Group III Employee on the attached Exhibit F. Any Group III Employee who is not listed on the attached Exhibit F shall not be eligible to receive the Special Contribution pursuant to this clause (ii). The Special Contribution provided for in this clause (ii) shall be a one-time contribution."

6. The introductory paragraph of Exhibit E to the Plan is hereby amended in its entirety to read as follows:

"The following sets forth the Group I Employees and Group III Employees who shall be eligible to receive the one-time Special Contribution as set forth in Sections 4.01(d)(i) and 4.03(c)(i), respectively, and the amount of the Special Contribution that each such Group I Employee and Group III Employee shall be eligible to receive pursuant to such Sections, respectively:"

7. A new Exhibit F shall be added to the Plan to read as follows:

"EXHIBIT F

SPECIAL CONTRIBUTION

The following sets forth the Group I Employees and Group III Employees who shall be eligible to receive the one-time Special Contribution as set forth in Sections 4.01(d)(ii) and 4.03(c)(ii), respectively, and the amount of the Special Contribution that each such Group I Employee and Group III Employee shall be eligible to receive pursuant to such Sections, respectively:

Employee Name	Type of Employee	Amount of Special Contribution
Correll, Donald L.	Group I	$16,480
Wolf, Ellen C.	Group I	$13,356
Monica, Laura	Group I	$4,085
Settelen, John	Group I	$69
Twadelle, Andrew	Group I	$1,000
Young, John S.	Group III	$4,594
Gloriod, Terry L.	Group III	$2,100
Lynch, Walter	Group III	$2,200
Bigelow, John R.	Group III	$990
Townsley, Paul G.	Group III	$1,271
Patrick, George W.	Group III	$1,126

8. In all respects not modified by this Amendment 2008-1, the Plan is hereby ratified and confirmed.

* * * * * *

IN WITNESS WHEREOF , and as evidence of the adoption of this Amendment 2008-1 to the Plan set forth herein, the Board has caused this instrument to be executed this 25th day of July, 2008.

American Water Works Company, Inc. Board of Directors

/s/ George W. Patrick

By: George W. Patrick
Senior Vice President, General Counsel and Secretary

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

(Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Donald L. Correll, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Water Works Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2008

By: /s/ Donald L. Correll
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER AND CHIEF ACCOUNTING OFFICER

(Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended,
as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002)

I, Ellen C. Wolf, certify that:

1. I have reviewed this quarterly report on Form 10-Q of American Water Works Company, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: November 6, 2008

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

Exhibit 32.1

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of American Water Works Company, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Donald L. Correll , President and Chief Executive Officer of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Donald L. Correll
Donald L. Correll
President and Chief Executive Officer
(Principal Executive Officer)

November 6, 2008

Exhibit 32.2

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the quarterly report of American Water Works Company, Inc. (the “Company”) on Form 10-Q for the period ended September 30, 2008, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Ellen C. Wolf, Senior Vice President and Chief Financial Officer, of the Company, hereby certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

November 6, 2008