

SUPPLEMENTAL DIRECT TESTIMONY  
OF  
SHEENA KIGHT

FINANCE DEPARTMENT  
FINANCIAL ANALYSIS DIVISION  
ILLINOIS COMMERCE COMMISSION

ILLINOIS-AMERICAN WATER COMPANY  
AMERICAN WATER WORKS COMPANY, INC.  
THAMES WATER AQUA US HOLDINGS, INC  
THAMES WATER AQUA HOLDINGS GmbH

APPLICATION FOR APPROVAL OF REORGANIZATION

DOCKET NO. 06-0336

OCTOBER 26, 2006

1   **1.   Q.   Please state your name and business address.**

2           **A.**   My name is Sheena Kight. My business address is 527 East Capitol  
3           Avenue, Springfield, Illinois 62701.

4   **2.   Q.   Are you the same Sheena Kight who previously filed testimony in**  
5           **this proceeding?**

6           **A.**   Yes, my direct testimony was pre-filed on the Illinois Commerce  
7           Commission's ("Commission") e-docket system on August 7, 2006.

8   **3.   Q.   What is the purpose of your supplemental direct testimony?**

9           **A.**   The purpose of my supplemental direct testimony is to present my  
10          evaluation of the reorganization proposed by Illinois-American Water  
11          Company ("IAWC"), American Water Works Company, Inc. ("American  
12          Water"), Thames Water Aqua US Holdings, Inc. ("TWAUSHI"), and  
13          Thames Water Aqua Holdings GmbH ("Thames GmbH") (collectively, the  
14          "Applicants") under Sections 7-204(b)(4) and 6-103 of the Illinois Public  
15          Utilities Act ("Act"). Section 7-204(b)(4) pertains to the proposed  
16          reorganization's financial implications on IAWC's ability to access the  
17          capital markets on reasonable terms and maintain a reasonable capital  
18          structure.

19 **4. Q. Did you address in your direct testimony (ICC Staff Exhibit 3.0)**  
20 **whether the proposed reorganization will significantly impair IAWC’s**  
21 **ability to access the capital markets to raise necessary capital on**  
22 **reasonable terms?**

23 **A.** Yes, I presented a preliminary recommendation in my direct testimony.  
24 However, at the time my testimony was filed the Applicants had not  
25 completed their responses to two of my data requests.

26 **5. Q. Has additional information come to your attention since the filing of**  
27 **your direct testimony on August 7, 2006 that would impact your**  
28 **initial conclusion on this finding?**

29 **A.** Yes. The additional information provided by the Applicants has led to  
30 concerns regarding the Applicants’ ability to raise necessary capital on  
31 reasonable terms, since following the proposed reorganization, RWE  
32 Aktiengesellschaft (“RWE”) will no longer be a source of capital for  
33 American Water or IAWC. IAWC obtains equity capital through American  
34 Water and short-term and long-term debt capital through AWCC, both  
35 wholly owned subsidiaries of American Water.<sup>1</sup>

36 Although the Applicants claim that American Water “will take steps to  
37 ensure that, following the Proposed Transaction, its balance sheet  
38 remains solid and that its capital structure is such that the credit rating for  
39 AWCC’s debt securities will remain at a solid investment grade,”<sup>2</sup> the

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<sup>1</sup> IAWC Exhibit 2.0, pp. 12-13.

<sup>2</sup> IAWC Exhibit 2.0, p. 14.

40 Applicants define solid investment grade as only “BBB- or better”.<sup>3</sup> A  
41 credit rating of BBB- is much lower than AWCC’s current credit rating of  
42 “A-”, which is the same credit rating AWCC had prior to American Water  
43 becoming a subsidiary of RWE.<sup>4,5</sup> “BBB-“ is the lowest investment grade  
44 credit rating and is three notches lower than an “A-“ credit rating. Further,  
45 the information the Applicants provided does not clearly show that  
46 American Water will have sufficient cash flows to support an investment  
47 grade credit rating of at least A-. The Applicants have not proven that a  
48 decrease in credit rating from “A-“ to “BBB-“ would not significantly impair  
49 IAWC’s ability to raise necessary capital on reasonable terms.<sup>6</sup>

50 In addition, the Applicants plan to refinance \$2,226,100,000 in debt that  
51 was loaned by RWE (“RWE debt”).<sup>7</sup> However, the Applicants have not  
52 determined the timing or the maturity of the debt issues they will use to  
53 refinance the RWE debt. In addition, the interest rate on the refinancing  
54 issues is unknown.<sup>8</sup> Therefore, until more information is available  
55 regarding the terms, maturity, and credit rating of the new debt the  
56 Applicants plan to issue to refinance the RWE debt, I am unable to  
57 determine if the proposed reorganization will impair IAWC’s ability to  
58 obtain capital on reasonable terms.

59 Finally, since the Applicants have not obtained all the other approvals  
60 necessary to complete the merger of TWAUSHI with American Water,<sup>9</sup> the

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<sup>3</sup> Applicants’ response to Staff Data Request SK 4-01.

<sup>4</sup> Standard & Poor’s, Summary: *American Water Capital Corp.*, February 14, 2006. Standard & Poor’s, *American Water Capital Ratings Raised to ‘A’; Off Watch; Thames Water Ratings Affirmed*, July 15, 2003.

<sup>5</sup> An S&P rating of BBB- or higher is considered investment grade.

<sup>6</sup> Applicants’ response to Staff Data Request SK 3-01.

<sup>7</sup> Applicants’ amended response to Staff Data Request SK 3-10.

<sup>8</sup> Applicants’ amended response to Staff Data Request SK 3-10.

<sup>9</sup> Applicants’ response to Staff Data Request SK 3-03.

61 merger of TWAUSHI with American Water is not a certainty. That  
62 uncertainty is important because the Applicants did not perform an  
63 analysis to assess an IPO of American Water if American Water and  
64 TWAUSHI do not merge.<sup>10</sup> Since all the forecasted financial statements  
65 provided by the Applicants assume that the merger is completed by the  
66 time that American Water is sold in an initial public offering, I need the  
67 forecasted financial statements for American Water excluding TWAUSHI  
68 and audited financial statements of TWAUSHI to complete a thorough  
69 analysis. However, the Applicants have said that they did not prepare an  
70 analysis of an IPO of American Water excluding TWAUSHI<sup>11</sup> and that the  
71 2004 and 2005 audited financial statements for TWAUSHI will not be  
72 available until the end of October 2006.<sup>12</sup>

73 **6. Q. In your direct testimony, you concluded that the proposed**  
74 **reorganization satisfies the requirements of Section 7-204(b)(4) of**  
75 **the Act (ICC Staff Exhibit 3.0, page 3, lines 44-45). Have you**  
76 **changed that recommendation?**

77 **A.** Yes. At this time, the Applicants failed to demonstrate that the proposed  
78 reorganization “will not significantly impair the utility’s ability to raise  
79 necessary capital on reasonable terms or to maintain a reasonable capital  
80 structure.”<sup>13</sup> In my judgment, the Applicants have not satisfied the  
81 requirements of Section 7-204(b)(4) of the Act, therefore, Staff currently  
82 cannot recommend that the Commission approve the proposed  
83 reorganization.

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<sup>10</sup> Applicants’ response to Staff Data Request SK 3-04.

84    **7.    Q.    Does this conclude your prepared supplemental direct testimony?**

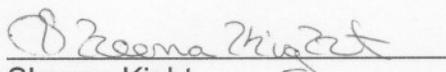
85            **A.    Yes.**

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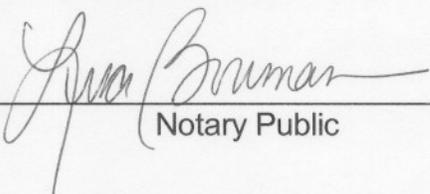
<sup>11</sup> Applicants' response to Staff Data Request SK 3-04.  
<sup>12</sup> Applicants' response to Staff Data Request SK 3-02.  
<sup>13</sup> 220 ILCS 5/7-204.

VERIFICATION

I, Sheena Kight, being first duly sworn, depose and state that I am a Senior Financial Analyst in the Finance Department of the Financial Analysis Division at the Illinois Commerce Commission; that I sponsor the foregoing Supplemental Direct Testimony of Sheena Kight; that I have personal knowledge of the information stated in the foregoing Supplemental Direct Testimony; and that such information is true and correct to the best of my knowledge, information and belief.

  
Sheena Kight  
Illinois Commerce Commission

Subscribed and sworn to before me  
this 20th day of October, 2006.

  
Notary Public

