IAWC EXHIBIT 2.0R

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

REBUTTAL TESTIMONY

OF

ELLEN C. WOLF

(Docket 06-0336)

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REBUTTAL TESTIMONY OF

ELLEN C. WOLF

I. WITNESS IDENTIFICATION

Q1. Please state your name.

A. My name is Ellen C. Wolf.

Q2. Are you the same Ellen C. Wolf who prepared Direct Testimony in this proceeding?

A. Yes, I am.

II. PURPOSE OF TESTIMONY

Q3. What is the purpose of your Rebuttal Testimony?

A. The purpose of my Rebuttal Testimony is to respond to certain portions of the testimony submitted in this proceeding by Illinois Commerce Commission ("Commission") Staff witnesses Sheena Kight and Bonita Pearce, and by Scott C. Rubin on behalf of the Office of the Illinois Attorney General ("AG").

III. RESPONSE TO STAFF WITNESSES

Q4. Please summarize the position of Staff witness Kight.

A. In her Direct Testimony, Ms. Kight took the position that the finding required by Section 7-204(b)(4) should be made. In Supplement Direct Testimony, however, Ms. Kight changes her position and states that, "until more information is available regarding the terms, maturity and credit rating of the new debt Applicants plan to issue to refinance RWE debt, I am unable to determine whether the proposed reorganization will impair IAWC's ability to attract capital." Staff witness Kight also indicates a need to review audited financial statements for Thames Water Aqua US Holdings, Inc. ("TWAUSHI") to complete the financial analysis.

Q5. Are the 2005 audited financial statements of TWAUSHI now available?

A. Yes. IAWC Exhibit 2.1R shows the Audited Consolidated Financial Statements of TWAUSHI for the years ended December 31, 2005, and December 31, 2004.

Q6. Please discuss the audited financial statements of TWAUSHI.

A. As a part of the Proposed Transaction, TWAUSHI (the primary components of which are American Water Works Company, Inc. ("American Water" or "AW") and E'Town Corporation) will merge with American Water. American Water will be the surviving corporation. As was the case with the AW 2004 and 2005 financial statements, the 2004 and 2005 TWAUSHI financial statements include a non-cash impairment change, which is explained in IAWC Exhibit 2.1R, pages 10 and 26.

Q7. Does the impairment recorded on TWAUSHI financial statements impact the on-going financial integrity of TWAUSHI?

A. No. There will be no impact of the TWAUSHI impairment on the on-going financial integrity of AW,the surviving corporation. This is due to the decision by RWE to infuse equity to ensure that AW will have at a minimum 45% common equity at the time of the IPO.

Q8. Please discuss the debt which American Water will issue to refinance maturing or callable securities held by RWE or its affiliates?

A. IAWC Exhibit 2.2R, Page 1 (Confidential) shows the components of the total capitalization of TWAUSHI as of December 31, 2005. The Exhibit also shows refinancing activity related to both debt and preferred stock securities for the 2006-2007 period. The Pro Forma Capitalization for American Water as of December 31, 2007 (reflecting completion of the refinancing and TWAUSHI/AW merger) is shown in the right hand column of the Exhibit, Page 1. Notes shown on the Exhibit, Page 1, explain each component of the refinancing activity. In connection with the refinancing, it should be noted that, as Mr. Gemmecke explains, RWE has made a commitment that American Water's equity ratio will be in the range of 45%-55% at the time of the IPO, consisting of common equity and equity-like instruments. RWE has made a further commitment that American Water's common equity ratio will be at least 45% at the time of the IPO. RWE will infuse common equity capital as required to achieve a common equity target at or above this level at the time of the IPO. To date, RWE has infused $1.194 billion of common equity capital. If an additional equity infusion is needed to achieve a common equity ratio of at least 45% at the time of the IPO, the required infusion will be provided. As shown on IAWC Exhibit 2.2R (Confidential), the expected common equity ratio as of December 31, 2007, is within the range of 45%-55%.

Q9. Is information available with regard to specific debt securities issued by American Water Capital Corp. ("AWCC")?

A. Yes. AWCC recently issued senior unsecured notes ("Notes") in the amount of $900 million. The Notes have maturities ranging from seven to fifteen years (specifically, 7, 10, 12 and 15 years), and carry final coupon rates of 5.39% to 5.77%. The Notes rank "pari passu" (i.e., equal) in right of payment with all current and future unsubordinated, unsecured indebtedness of AWCC. The first closing of Senior Notes in the amount of $483 million occurred on December 31, 2006. The second and third closings in the amounts of $314 million and $103 million, respectively, are expected to occur on or around January 31, 2007 and February 15, 2007, respectively.

Q10. Please discuss the available information regarding the credit quality of the Senior Notes.

A. The Notes were issued in a private placement, and not in a public offering. Although AW and AWCC are rated by the ratings agencies, the Notes do not have a credit rating assigned by a credit rating agency. While these Notes have not been rated by any credit rating agency, the spreads are consistent with a corporate rating of "A-". IAWC Exhibit 2.3R shows the final coupon rate applicable to each maturity of the Notes, along with the spread between each final coupon rate and the Quoted Yield of Benchmark U.S. Treasury Notes for each respective maturity. The Exhibit also shows data, including the applicable spread, for fourteen public issuances of debt with assigned Standard & Poor's ("S&P") ratings at approximately the time that the terms of the Notes were finalized. Based on the information shown, the spreads and final coupon rates for the Notes are consistent with an "A-" credit rating. Because the Notes were issued with the buyers' knowledge that American Water is no longer a core holding of RWE and that RWE intends to divest American Water through a public stock sale, the resulting interest rates are strong evidence of the favorable assessment by the capital markets of the post-IPO financial condition and creditworthiness of American Water.

Q11. Is there other available information regarding American Water's credit rating?

A. Yes. IAWC Exhibit 2.4R is an S&P credit rating report issued on November 7, 2006 for American Water indicating a corporate credit rating of "A-". The corporate rating is under Credit Watch until completion of the Proposed Transaction.

Q12. Staff witness Kight notes that the Applicant's claim that American Water "will take steps to ensure that following the Proposed Transaction its balance sheet remains solid and that its capital structure is such that the credit rating for American Water's debt securities will remain at a solid investment grade." She further states that Applicant's defined solid investment grade "as only BBB- or better." Would you comment on this point?

A. I believe there is a misunderstanding of the Joint Applicants' position. Joint Applicants made clear in Data Responses (SK 2-02 and SK 3-01) Joint Applicants' belief that the data provided with the Responses support an "A-" credit rating, which is, of course, a solid investment grade. As noted above, this is, in fact, the corporate rating that American Water received from S&P on November 7, 2006. In a Data Response (SK 4-02), Joint Applicants were asked to define the term "solid investment grade" credit rating. Joint Applicants stated that, the term "solid investment grade" means a rating by the rating agencies that will unequivocally place American Water in an "investment grade" category. Joint Applicants also indicated that, for S&P, securities rated "BBB-" or better are considered "investment grade." In providing this information, however, Joint Applicants did not intend to suggest a belief that AW's credit rating would fall to the lowest investment grade rating.

Q13. Staff witness Kight further states that the information Applicants provided," does not clearly show that American Water will have sufficient cash flows to support an investment grade credit rating of at least "A-." Would you respond?

A. As explained in my Direct Testimony (pages 15-16), Joint Applicants anticipate that, after completion of the Proposed Transaction, American Water will maintain a solid investment grade credit rating. IAWC Exhibit 2.5R is an excerpt from "Standard & Poor's Corporate Credit Ratings Criteria" ("Ratings Criteria"), which explains the rating process. As the Ratings Criteria indicate, in assigning a rating, S&P considers certain numerical "credit statistics" and also non-numerical factors.

IAWC Exhibit 2.2R, Page 2 (Confidential) shows credit statistics for AW (including cash flow ratios) that would be considered by the credit agencies in updating the current AW investment grade rating. These statistics reflect the proposed refinancing shown in IAWC 2.2R, Page 1 (Confidential) and the assumptions noted in IAWC Exhibit 2.2R (Confidential). Also shown on IAWC Exhibit 2.2R, Page 2 (Confidential) are ranges for certain credit statistics that correspond to specific rating levels as indicated in the Ratings Criteria. The AW credit statistics set out in the private placement memorandum distributed in connection with the issuance of the Notes (which, as indicated above, have an implied credit rating of "A-") are comparable to those shown in IAWC Exhibit 2.2R, Page 2 (Confidential).

IAWC Exhibit 2.6R shows historical credit statistics for American Water as of December 31, 2001 and December 31, 2005. At and around the time of the 2001 ratios, AW's credit rating as determined by S&P was "A-", as it is today. The operating and financial data of AW as of December 31, 2005, is the data that was available to S&P when it issued the November 7, 2006 "A-" credit rating for AW that was discussed above. As a comparison of the data shown on IAWC Exhibits 2.2R (Confidential) and 2.6R demonstrates, AW's projected credit statistics are comparable and improving. I would also note that the 2007 Pro Forma capitalization as shown on IAWC Exhibit 2.2R (Confidential) is comparable to that of water utilities that have strong investment grade credit ratings.

Q14. Please address the non-numerical factors that would be considered in assigning a credit rating?

A. As the Ratings Criteria (IAWC Ex. 2.5R) indicate, along with the financial ratios, non-numerical factors also are considered during the ratings process. In this regard, Page 9 of the Ratings Criteria, under "Ratings Process", highlights certain of these factors: "…a thorough review of business fundamentals, including industry prospects for growth and vulnerability to technological change, labor unrest, or regulatory actions". American Water enjoys a "2" (excellent) business risk profile from S&P (Utility business risk profiles are categorized from "1" (excellent) to "10" (vulnerable)).

As discussed at page 10 of the Ratings Criteria, one of the important factors that S&P uses to arrive at a credit rating decision is the quality of management. American Water has proven management and has also added new and returning professionals as senior managers ahead of the IPO. The addition of Don Correll as Chief Executive Officer, with his significant industry and publicly traded company experience, has been well received by industry analysts.

As my Direct Testimony indicates, a credit rating is the opinion of the credit rating entity of the overall general credit worthiness of a company based on an analysis of relevant risks considering both qualitative and quantitative factors. It is not possible to predict with certainty the rating that will be assigned to American Water's securities at a future time. However, based on the data shown on IAWC Exhibit 2.2R (Confidential), and assuming timely rate relief and a rate of return similar to the average in the industry, I believe that AW should maintain a credit rating of "A-" after the Proposed Transaction.

Q15. Staff witness Kight also indicates that Joint Applicants have not proven that a decrease in the credit rating from "A-" to "BBB-" would not significantly impair the ability of Illinois-American Water Company ("IAWC" or "Illinois American Water") to raise necessary capital on reasonable terms. Would you address this point?

A. As discussed above, Joint Applicants believe AW's A-rating should be maintained by AW. Joint Applicants also do not believe that a rating as low as "BBB-" is realistic to expect. However, if the credit rating were to move to "BBB+" (which is not expected), the expected increase in the cost of debt would be minimal. As shown in IAWC Ex. 2.7R, during the 1996-2006 period, the interest rate spread for securities issued by "A-" utility issuers as compared to "BBB+" issuers for ten-year notes was, on average, seven basis points.

Q16. Staff witness Kight further suggests that the merger of TWAUSHI with American Water is not a certainty. In light of this, Ms. Kight concludes that forecasted financial statements for American Water, excluding other components of TWAUSHI, and audited financial statements of TWAUSHI are needed to complete a thorough analysis. Would you comment?

A. The Proposed Transaction will not take place until all the approvals for the TWAUSHI/American Water merger are in place. Accordingly, Joint Applicants believe that separate forecasted financial statements for AW, excluding other components of TWAUSHI, are not required. As explained above, audited financial statements and projected financial information for TWAUSHI are provided in IAWC Exhibits 2.1R and 2.2R (Confidential).

Q17. Do you believe that the Proposed Transaction will impair the ability of IAWC to attract capital on reasonable terms through American Water?

A. For the reasons stated above and in my Direct Testimony, I do not.

Q18. Staff witness Pearce indicates that she is unable to conclude that there will be no adverse rate impacts in accord with Section 7-204(b)(7) of the Act. Would you comment?

A. Yes. It is my understanding that Staff witness Pearce's recommendation is based solely on Staff witness Kight's testimony. Ms. Pearce concludes that, if IAWC's ability to raise capital is negatively impacted by the Proposed Transaction, there could possibly be an adverse impact on rates. Because I believe there is no adverse impact on IAWC's ability to attract capital for the reasons discussed above, Ms. Pearce's concern also should be resolved.

IV. RESPONSE TO TESTIMONY OF SCOTT C. RUBIN

Q19. Please summarize Mr. Rubin's overall recommendation in this case.

A. Mr. Rubin recommends that the Commission impose conditions on its approval of the Proposed Transaction. The principal condition proposed by Mr. Rubin is that "RWE be required to pay 20% of the proceeds from the IPO to AW". Initially, Mr. Rubin also recommended that the Commission investigate certain preferred stock issued by American Water. In Supplemental Direct Testimony, however, Mr. Rubin recognized that the allegations he raised regarding the preferred stock are incorrect and that his recommendation should be disregarded. Mr. Rubin also suggested certain conditions related to operating matters based on testimony he submitted in other proceedings. The proposed conditions related to operating matters are addressed by Mr. Gloriod.

Q20. At pages 7 and 8, beginning at line 180, Mr. Rubin summarizes what he characterizes as three major reasons for RWE's decision with regard to the Proposed Transaction. Would you comment on this testimony?

A. As discussed in my Direct Testimony and the Rebuttal Testimony of Mr. Gemmecke, the primary business reason for the IPO is the strategic need to focus on RWE's core energy markets in Europe. It is important to note, however, that, in addition to the business reasons which led RWE to determine that the Proposed Transaction should be completed, there are also benefits from the Proposed Transaction for Illinois American Water and its customers, which are discussed in my Direct Testimony and the Direct Testimony of Mr. Gloriod.

Q21. At page 9, beginning at line 223, Mr. Rubin references risks associated with American Water's non-regulated water and wastewater operations. Will the Proposed Transaction affect these risks?

A. No. The Proposed Transaction will not affect the regulated or the non-regulated activities of American Water. Further, as Mr. Gloriod points out, Illinois American Water does not conduct any significant non-regulated activity.

Q22. Why does Mr. Rubin recommend that RWE pay 20% of the IPO proceeds to American Water?

A. Mr. Rubin incorrectly contends that a capital contribution by RWE of 20% of the IPO proceeds is needed to alleviate alleged problems that he attributes to RWE's ownership of American Water, as evidenced by (a) higher capital investment requirements in the future; (b) a decline in AW's pension funding ratio; and (c) purported service-related problems at IAWC.

Q23. Is there any basis for Mr. Rubin's recommendation?

A. No, there is not. RWE has been a responsible owner and manager of American Water. As will be discussed, capital spending by American Water increased under RWE's ownership. Also, under RWE ownership, American Water's contributions to its pension plan always met or exceeded the contribution requirements of the Employee Retirement Income Security Act ("ERISA"). As Mr. Gloriod discusses, Mr. Rubin's allegations regarding service issues are not valid and are the topic of other proceedings pending before the Commission. The Commission's ability to address Mr. Rubin's allegations in the other proceedings is unaffected by the Proposed Transaction. Mr. Rubin's recommendation that RWE contribute 20% of the stock sale proceeds to AW is unwarranted. RWE will take steps to assure that AW has a sound capital structure, including, as necessary, the infusion of equity to achieve an equity ratio in the range of 45% to 55%. As discussed above, the 2007 Pro Forma Capital Structure for the divested entity is shown on IAWC Exhibit 2.2R (Confidential).

Q24. At pages 9-10 of his Direct Testimony, Mr. Rubin contends that, because AW projects increased levels of capital investment, AW has not been investing adequately to maintain its facilities. Would you comment on this testimony?

A. Mr. Rubin erroneously contends that AW's investment was inadequate under RWE's ownership. The water industry, however, faces many challenges including, principally, the need to replace or rehabilitate aging infrastructure to meet increasingly stringent environmental and drinking water standards and to assist state agencies in addressing the problems of small, troubled and non-viable water and wastewater systems. As much of the nation's water related infrastructure reaches the end of its useful life in the coming decades, considerable spending will be necessary to modernize water systems across the country. This fact was acknowledged and quantified by the United States Environmental Protection Agency ("EPA") in its Drinking Water Infrastructure Needs Survey and Assessment (June 2005), wherein the EPA estimated that $276.8 billion (in 2003 dollars) of investment will be needed over the next 20 years to install, upgrade and replace drinking water infrastructure alone.

Far from indicating a cause for concern, American Water's projected future capital spending is an indication of American Water's responsible approach in addressing the expected service requirements and infrastructure replacement needs of its operating subsidiaries. Mr. Rubin's speculation that American Water has not invested adequately in facilities is baseless. The following is a summary of American Water's investment in capital improvements over the past five years. These figures demonstrate American Water's ongoing commitment to the needs of its operations.

2002: $364 million
2003: $491 million
2004: $486 million
2005: $497 million
2006: $637 million (estimate)

These data confirm that, during the period when RWE has owned American Water, American Water's capital spending has been at a high level; in fact the highest in American Water's history. This belies Mr. Rubin's assertion that American Water has neglected the needs of its operating subsidiaries. As my Direct Testimony makes clear, American Water's status as a publicly traded company will help assure that American Water and Illinois American Water have ready, cost-effective access to capital to meet these needs.

Q25. In his Supplemental Direct Testimony, Mr. Rubin states that there is a troubling pattern of American Water continually revising its projected capital expenditures. Would you comment on this testimony?

A. American Water has a rigorous planning process to assure that capital projects are performed as required. Revisions of the type referenced by Mr. Rubin are made during the planning process. Such revisisons are not unusual, nor do they indicate that AW has ignored its capital investment responsibilities or failed adequately to forecast its capital investment needs in the future. Circumstances change constantly, and AW continuously updates its capital investment projections and priorities to reflect these changing circumstances. It would be irresponsible for AW not to do so.

Q26. What problem does Mr. Rubin allege with respect to AW's pension funding?

A. Mr. Rubin contends that AW's pension plan is not adequately funded and that the pension funding ratio, as he calculates it, has declined precipitously since RWE acquired AW. Mr. Rubin reaches these conclusions by comparing the fair value of plan assets divided by the projected benefit obligation or "PBO" for the year ending December 31, 2001 (76.8%) to the ratios for the years ending December 31, 2004 (60.7%) and 2005 (56.5%).

Notably, all of these data were extracted from American Water's annual reports, which reflect asset valuations and benefit obligations computed on the basis of Statement of Financial Accounting Standards No. 87 ("SFAS-87").

Q27. Is there any basis for Mr. Rubin's contention?

A. Absolutely not. Mr. Rubin ignores the fact that required funding levels are based on ERISA, not SFAS 87, and that there are significant differences between ERISA funding requirements and the financial reporting requirements of SFAS-87. All of his data are based on the latter. The adequacy of pension plan funding is controlled by federal law, namely, ERISA, and not by SFAS-87. Likewise, a company's minimum pension funding obligation is dictated by ERISA. In contrast, SFAS-87 represents a set of Generally Accepted Accounting Principles ("GAAP") accounting rules for the purpose of displaying information on financial statements. Those accounting rules do not measure the level of contributions that a plan sponsor must make under ERISA. A "funding ratio" of less than 100% calculated on the basis of SFAS-87 data, as Mr. Rubin has done, is not evidence of inadequate funding. SFAS-87 simply takes a snap shot, at one moment in time, of the discounted value of future obligations and future earnings on plan assets over the relatively long projected benefit pay-out period. In contrast, ERISA funding rules actually prescribe the minimum level of funding required by the applicable law and regulations, and are designed to secure the adequacy of pension funding levels over the long term.

Q28. Please explain AW's pension funding policy.

A. There are actuarially-determined minimum contribution amounts that a plan sponsor must make in order to comply with ERISA. Prior to AW's acquisition by RWE, and during the entire time period of RWE ownership, it has been AW's policy to make the contributions required by ERISA. At no time following its acquisition by RWE did AW contribute less than the amount actuarially determined under ERISA's requirements. Thus, contrary to Mr. Rubin's allegation, AW did not neglect its pension funding obligations under RWE ownership.

Q29. Why is the ERISA minimum required contribution the correct measure to review when determining appropriate funding levels?

A. The contribution rules under ERISA prescribe the methodology for determining the cash contributions that are required each year to a pension plan. The rules establish a rational and systematic way for plan sponsors to contribute to the pension plan to ensure long-term benefit security for the plan participants, i.e., per the law, the plan is sufficiently funded and should be able to provide the promised benefits at retirement. At the most basic level, the rules currently in place view pension plans as very long term obligations of the sponsor and require that the plan is funded based on this notion (known as the "accrued liability"). However, as an added layer of protection for plan participants, the minimum funding rules also require that the plan maintain minimum solvency levels (known as the "current liability"), otherwise, accelerated contributions are required.

Q30. What was the funding status of AW's pension plan under ERISA-based calculations for the period 2000 to 2005?

A. These data are set forth in the table below for pension plan years of 2001 through 2005 (all values, except percents, are in thousands of dollars):

	2001	2002	2003	2004	2005
Actuarial Accrued Liability	265,803	288,890	379,974	430,686	506,998
Actuarial Value of Assets	319,920	315,635	392,386	440,667	465,911
Funded Percentage	120.4%	109.3%	103.3%	102.3%	91.9%

As the data show, the Actuarial Value of Assets for the plan exceeded the Actuarial Accrued Liability for plan years 2000 through 2004. For plan year 2005, assets were 92% of the liabilities. Based on ERISA criteria, AW's plan is, and has been, financially sound.

Q31. What, then, is the basis for Mr. Rubin's claim that there has been a precipitous decline in funding levels?

A. The decline Mr. Rubin calculated is a function of his use of SFAS-87 data, not ERISA-based calculations. For the reasons I previously explained, his reliance upon SFAS-87 data is misplaced for purposes of determining the adequacy of funding levels. In addition, even if one were to use SFAS-87 data as the basis for such calculations, the decline in the pension funding ratio that Mr. Rubin attributes to RWE ownership results from the starting point he selected, i.e., December 31, 2001, which is more than a year before RWE closed on its acquisition of American Water. Furthermore, Mr. Rubin did not analyze the year-to-year change in AW's pension funding ratio. Had he done so, it would have been evident that the changes in the pension funding ratio that he attributed to the period of RWE ownership actually occurred before RWE's acquisition, as the data below show:

Year-End	Funding Ratio
2000	89.9%
2001	76.8%
2002	59.7%
2003	60.9%
2004	60.7%
2005	56.6%

Q32. Why did AW's pension funding ratio, calculated on the basis of SFAS-87 data, change?

A. As I explained before, SFAS-87 calculations, which formed the basis for all of the data that Mr. Rubin used, take a snapshot at a point in time. That picture reflects the inter-play of the factors considered by SFAS-87. The stock market declined dramatically in 2000, 2001 and again in 2002, which depressed the valuation of plan assets. At the same time, long-term interest rates also declined dramatically. Such long-term interest rates are the basis for the discount rates used to calculate the present value of future pension obligations. Accordingly, the present value of those obligations also increased significantly. These economic factors created a "perfect storm" that produced unprecedented declines in the funding ratios, calculated on the basis of SFAS-87 data, of all companies during this period. Indeed, a review of SEC 10-K data for seven publicly traded water companies (American States Water Co., Aqua America, California Water Service Group, Connecticut Water Service, Middesex Water Company, SJW Corp. and York Water Co.) shows that each one of the companies experienced a significant decline in its pension funding ratio over the 2001-2005 period. For example, Aqua America's pension funding ratio, calculated on SFAS-87 data, as reported in Aqua's SEC 10-K Reports, declined from 94.7% at year-end 2001 to 65.5% at year-end 2005. For SJW Corporation, the pension funding ratio based on SFAS 87 data declined during the period from 91.9% to 60.2%. In other words, it is not that AW paid less into its pension funds which led to the change in the funding ratio; the reason for the change was changed market conditions which increased the amount of the pension obligation and decreased the value of pension fund assets.

Q33. What do you conclude from these data?

A. As previously discussed, the adequacy of a plan sponsor's pension funding should be assessed under the standards of ERISA, not the "snapshot" taken by SFAS-87. That having been said, even if one were to consider SFAS-87 data (which I believe would be an error), the conclusions drawn by Mr. Rubin are unsupported and incorrect because: (1) the decline in AW's SFAS-87 funding ratio occurred before the RWE acquisition; and (2) the decline in AW's funding ratio mirrors the decline of the ratios of the rest of the water industry.

Q34. Mr. Rubin suggests at pages 11 and 12 of his Direct Testimony that funding requirements established by recent pension legislation will require AW to make up a "funding shortfall by 2015". Would you comment?

A. The new funding rules under the Pension Protection Act ("PPA") are effective in 2008, and generally require that companies contribute the amount of benefit that will be earned during the year plus a seven-year amortization of the underfunded obligation. For purposes of the PPA, the unfunded obligation is based on the obligation and asset measures specifically defined by the PPA and will not be the same as the current SFAS-87 measures. The underlying theoretical intent of the new law is to achieve full funding, based on assets and obligations defined under PPA, in seven years. However, as new gains and losses arise each year, these new gains and losses will also be amortized over a new seven year period. If, for example, capital markets perform better than expected, AW may be fully funded under the PPA prior to 2015. Alternatively, if capital markets perform worse than expected, AW may be fully funded under the PPA subsequent to 2015. Mr. Rubin appears to imply that AW is "locked into" funding the SFAS-87 pension benefit obligation by 2015 – neither his definition of the unfunded obligation (based on SFAS 87 measures of obligation) nor the precise year are correct.

Q35. Please explain your position regarding Mr. Rubin's assertion that RWE should contribute 20% of the IPO proceeds to AW.

A. As indicated above, Mr. Rubin contends that such a contribution is necessary to make up for inadequate capital expenditures and insufficient pension funding during the period of RWE ownership. For the reasons discussed above, the premises for Mr. Rubin's recommendation are wrong. Neither AW's capital investment nor its pension funding was inadequate during the period of RWE ownership. Furthermore, Mr. Rubin fails to take into account RWE's intention to ensure that AW has a strong capital structure, and infuse common equity capital as needed to achieve that goal.

Additionally, requiring payment of what amounts to an "exit fee" for the privilege of selling utility stock would be viewed by the investment community as a regulatory penalty on investors who wish to monetize their investment. In my view, such a payment would constitute an unprecedented confiscation of investor property which would deter future investment in the common stock of AW and any other public utility or utility holding company operating in Illinois, as investors would fear that their investments could be subject to future confiscation. Credit rating agencies could also view this outcome negatively, considering it as evidence of increased regulatory risk and possibly leading to a downgrade in AW's credit ratings. In other words, adopting Mr. Rubin's recommendations would increase the perceived risk of equity investments in Illinois public utilities, increasing the cost of capital. Those increased capital costs would flow through to Illinois ratepayers in the form of higher rates.

The Proposed Transaction involves a sale by Thames GmbH, a subsidiary of RWE, of its common shares of American Water. These common shares are the property of Thames GmbH and Thames GmbH is entitled to all of the proceeds that result from the sale of its property. For the reasons I have discussed, a requirement that a portion of such proceeds be paid to American Water would be inappropriate and indefensible.

Q36. Please explain further the reasons why Mr. Rubin's recommendation is unnecessary.

A. IAWC Exhibit 2.2R (Confidential) shows the divested entity's Pro Forma capital structure at December 31, 2007, reflecting changes that will occur in advance of the IPO as a result of refinancing activity and to meet the desired 45% to 55% equity range in the capital structure. As shown, as a result of the refinancing, total debt will decrease and total equity will increase. The amounts of these changes are shown on IAWC Exhibit 2.2R (Confidential). As this data shows, AW will have a strong capital structure after the Proposed Transaction, and a contribution of IPO proceeds is not required to maintain AW's sound financial condition and ability to attract capital on reasonable terms.

Q37. According to Mr. Rubin, it is unclear whether funds to refinance $1.75 billion dollars in preferred stock will be raised from the IPO or from the issuance of new debt. Would you comment on this statement?

A. During RWE ownership, American Water received all external funds – equity and debt – directly or indirectly from RWE. This included the preferred stock. Now that American Water is preparing to be an independent, publicly listed company it will provide funding to support its operations from internally generated funds and U.S. public market sources. This will include a refinancing of the RWE preferred stock through the issuance of new securities (as shown on IAWC Ex. 2.2R (Confidential)). The existing preferred stock will not be refinanced with proceeds from the IPO.

Q38. Is Mr. Rubin correct in suggesting at Page 12 of his Direct Testimony that all of AW's debt held by RWE will be refinanced as a result of the Proposed Transaction?

A. No. In his Direct Testimony (Pages 12), Mr. Rubin wrongly suggests that the Proposed Transaction will necessitate the refinancing of approximately $2.6 billion of debt held by RWE. However, $370 million of this amount is short-term debt, $1.605 billion of debt is going to mature by its terms in the fourth quarter of 2006, and an additional $212 million of debt held by RWE is going to mature in the first half of 2007. In other words, all of that debt matures in the ordinary course and not as a result of the IPO. Stated differently, AW would have to refinance $2.187 billion of debt held by RWE even if no IPO were to occur.

Q39. At page 13, beginning at line 315, Mr. Rubin suggests that the Proposed Transaction is likely to increase American Water's cost of capital, making it more difficult and expensive for American Water to raise the capital it needs to address its deficiencies. Would you comment on this statement?

A. First, I disagree with Mr. Rubin's assertion that American Water has "deficiencies". American Water and its subsidiaries have capital requirements and, as I have discussed, the Proposed Transaction should enhance American Water's ability to meet those requirements.

Mr. Rubin presents no analysis of what AW's cost of capital will be after the Proposed Transaction is completed. To support his contention that the Proposed Transaction is "likely" to increase AW's cost of capital, Mr. Rubin (Direct Testimony, Page 13) points only to the S&P credit rating of American Water Capital Corporation, AW's financing subsidiary, in November, 2005. For the reasons explained in detail above, it is my expectation that the debt securities of AW should maintain the current "A-" credit rating after the Proposed Transaction. Mr. Rubin offers nothing to show that this expectation is unreasonable. Accordingly, there is no basis for Mr. Rubin's position that American Water's cost of capital would increase as a result of the Proposed Transaction.

Also, it is important to note that the pre-November, 2005 credit rating that American Water enjoyed as a core holding of RWE may not exist in the future if the Proposed Transaction does not occur. Mr. Rubin's testimony suggests that RWE's credit quality will always provide more favorable debt terms than a water utility with access to the U.S. capital markets. This inference, however, ignores the potential consequences of RWE's anticipated broader exposure to European energy markets and the effect of that increased exposure of RWE's credit profile, especially given RWE's lack of access to the U.S. public capital markets. RWE has publicly acknowledged that it is expected to face increased ratings pressure due to its decision to expand into riskier energy operations. Absent the Proposed Transaction, these factors could result in a lower credit rating from pre-November 2005 levels.

Q40. At page 12, beginning at line 282, Mr. Rubin asserts that the IPO will not help American Water address any of the "challenges" he discusses and that it is likely that the IPO would worsen American Water's ability to raise capital that it needs to make significant progress in these areas. Would you comment on this testimony?

A. Mr. Rubin is incorrect. As discussed in my Direct Testimony, the Proposed Transaction should enhance IAWC's ability to attract capital on reasonable terms and maintain a balanced capital structure, as compared to the circumstances IAWC would face under continued ownership by RWE. As my Direct Testimony makes clear, for the future, under continuing RWE ownership, American Water's operations and access to capital may become increasingly restricted due to changed circumstances affecting RWE. Should that occur, continued RWE ownership may lessen IAWC's future ability to provide cost-effective service.

Q41. Is Mr. Rubin correct in suggesting in testimony at page 12, beginning at line 286, that the IPO will not itself raise additional capital for American Water?

A. Yes. As noted above, the IPO involves the sale by Thames GmbH of its common shares of American Water. Because it is Thames GmbH that is selling shares of common stock that it owns, there is no reason to expect that American Water would receive capital as a result of the IPO. To the extent that the IPO proceeds are less than RWE's acquisition cost, the risk of loss will not be borne by American Water or the ratepayers of its subsidiary utility companies.

Q42. Is Mr. Rubin correct in suggesting as he does in testimony at page 12, beginning at line 287, that American Water projects that it will incur costs for financial advisors

and attorneys and also in connection with establishing systems to comply with Sarbanes Oxley?

A. American Water will incur costs for attorneys in connection with the Proposed Transaction and for consultants to comply with Sarbanes Oxley regulations. American Water, however, will not incur any costs related to a financial advisor for the IPO. American Water does not propose to recover from the ratepayers of operating subsidiaries, including Illinois American Water, costs related to the Proposed Transaction as described by Mr. Gloriod or costs incurred to establish systems for compliance with Sarbanes Oxley.

Q43. Is Mr. Rubin correct as he suggests at page 13, beginning at line 302, that "making American Water a stand-alone company will not solve anything"?

A. No. First, I note that there is no problem that needs to be "solved." As explained in my Direct Testimony, as a U.S. publicly-traded company, American Water will be better positioned to serve the future needs of its customers. As a publicly-traded company, American Water will be able to access the capital markets directly and offer investors an involvement in a predominantly U.S.-regulated water utility. It can do so based on American Water's focus on the water and wastewater business. On a going-forward basis, American Water will not have to compete for RWE's capital and the substantial capital requirements related to restructuring of the European energy markets. As a result of the Proposed Transaction, American Water's access to the public U.S. debt and equity markets, to which RWE does not have access, should enhance its ability to attract necessary capital to support the operations of its subsidiaries, including IAWC.

Q44. At page 13, beginning at line 302, Mr. Rubin suggests that the Proposed Transaction will remove a level of corporate oversight that could be important in rehabilitating American Water's operations. Is he correct in this regard?

A. Mr. Rubin's suggestion that there is a need to "rehabilitate" American Water's operations is misleading. While there is an industry wide need for increased capital expenditures related to the replacement of infrastructure and compliance with environmental regulations, these needs of the AW system have long been recognized and addressed appropriately by American Water. American Water has had significant capital expenditure programs in place for several years with regard to these matters, and those programs will continue in the future after completion of the Proposed Transaction. Mr. Rubin is also incorrect in his remarks about corporate oversight. As a result of the Proposed Transaction, the number of levels of corporate management in the holding company structure in which Illinois American Water participates will be reduced. This reduction, however, will not remove oversight that is important to American Water's operations. Both before and after the Proposed Transaction, the management of American Water and its operating subsidiaries have been responsible for operating and capital expenditure matters.

Through American Water Works Service Company, Inc. (the "Service Company"), IAWC has access to experienced personnel and resources, as required to support its operation. As my direct testimony indicates, the availability of Service Company support will be unaffected by the Proposed Transaction. The Proposed Transaction is not expected to result in any change in American Water's management structure or American Water's ability to address system requirements. Furthermore, it is important to note that

RWE's water and wastewater related expertise resided primarily with Thames. RWE, however, has sold Thames. Thus, to the extent there was a corporate oversight of AW from Thames, it will not exist in the future, whether or not the Proposed Transaction occurs.

Q45. At page 13, beginning at line 310, Mr. Rubin suggests that the IPO will divert management's attention away from problems, not only during the next year when the IPO process takes place, but beyond that, as management copes with the "new responsibilities of being a publicly-traded company". Is Mr. Rubin correct in this regard?

A. The IPO will require the attention of certain management personnel. This, however, will not affect IAWC's ability to provide service, and, as I have discussed, the IPO will facilitate American Water's future ability to attract capital. Management always will have reporting responsibilities to their shareholders, either one (RWE) or many (as a publicly traded company). Reporting to shareholders on the state of their investments is an integral part of raising needed capital to finance necessary projects. In addition, coping with responsibilities of being a publicly-traded company will not be a new experience for American Water. For over 60 years prior to its acquisition by RWE, American Water was a publicly traded company. While compliance with Sarbanes Oxley provisions may be new, it will also improve corporate governance, transparency, and confidence in the corporate and financial integrity of the Company which will benefit shareholders, customers and employees.

Q46. Is it correct that the issuance of preferred stock was guaranteed by American Water and each of American Water's existing and subsequently acquired or organized

domestic subsidiaries and any parent holding companies of American Water, as Mr. Rubin suggests at page 16, beginning at line 373?

A. No. As Mr. Rubin observes in his Supplemental Direct Testimony, his initial testimony regarding this allegation was incorrect. The guarantor of the preferred stock issuance is TWAUSHI. There is no guarantee of the preferred stock by American Water or any of its operating subsidiaries.

Q47. Is Mr. Rubin correct in suggesting, as he does at page 16, beginning at line 376, that there is a guaranty from IAWC that is "very troubling if not outright illegal"?

A. No. Any guarantee from IAWC would have needed to be approved by the Illinois Commerce Commission. IAWC is not a guarantor to the preferred stock. There is nothing troubling or illegal about the preferred stock issuance.

Q48. Is Mr. Rubin correct in suggesting, as he does at page 16, beginning at line 381, that there is a guaranty that violates express provisions in the order issued by the Kentucky Public Service Commission which approved RWE's purchase of American Water?

A. No. As discussed above, there has been no guarantee whatsoever of the preferred stock issuance to which Mr. Rubin refers by Kentucky American Water or any other operating subsidiary of American Water.

Q49. Is Mr. Rubin correct in suggesting at page 14, line 329 that the Proposed Transaction will be detrimental to American Water?

A. No. In light of its significantly changed circumstances, RWE is attempting to place American Water, on a going forward basis, in the best position to assure long term access to necessary capital by returning it to publicly traded status and full access to the U.S. debt and equity markets. Contrary to Mr. Rubin's position, it would be a failure to provide such access through the Proposed Transaction, thereby requiring American Water to remain a fourth tier subsidiary of an ultimate parent that has refocused its core business away from water and wastewater that would be detrimental to American Water in the long run.

Q50. At page 23, beginning at line 522, Mr. Rubin recommends that, if the Proposed Transaction is approved, it be subject to certain additional conditions. He states that without these conditions, he would conclude that American Water lacks the financial, managerial and technical fitness to own and operate a public utility in Illinois. Would you comment on his proposed conditions?

A. Yes. I will comment primarily on condition Number 4 regarding the cost of debt, while Mr. Gloriod will primarily respond to the other conditions Mr. Rubin recommends.

Mr. Rubin recommends that for the next five years, in any IAWC rate case, the cost of debt should be at the lower of IAWC's actual cost of debt or the cost of debt for an "A-" rated public utility. Such a condition is inappropriate.

First, Mr. Rubin ignores the fact that AWCC's current debt rating is "A-", which is the basis upon which investors will loan funds to AWCC, with or without the Proposed Transaction. As discussed above, there is no reason to believe that American Water's bond rating would deteriorate as a result of the Proposed Transaction. Further, there is no evidence that, continuing as an RWE subsidiary, American Water's bond ratings would remain as they currently are over the next five years. Given RWE's significant new challenges in maintaining and advancing its position in its core European energy markets, and depending on its success in doing so, RWE's own credit ratings could deteriorate over the next five year period, thus adversely affecting American Water's ratings if it were to remain an RWE subsidiary. If American Water continued to be part of RWE, it would be viewed as a fourth tier subsidiary of an entity that no longer has a core focus on the water and wastewater industries.

In addition, there are many factors that could negatively impact American Water's credit rating other than the fact of its divestiture from RWE. It would be entirely unfair to prohibit Illinois American Water from recovering its true cost of capital which could change (up or down) because of a host of factors over which neither it nor American Water have any control. For example, the U.S. investor-owned utility industry as a whole could find itself with an increasing risk profile as a result of tort class actions based on alleged water quality issues. The industry could also be adversely impacted by new U.S. EPA water quality requirements which increase capital and operational costs over what they are currently projected to be. These are only two of many factors which could negatively impact the cost of capital for the investor-owned water and wastewater industry as a whole. In addition, there are a host of other factors which could affect the cost of capital for American Water or Illinois American Water specifically, such as attempts by municipal or other government entities to condemn assets, state-specific environmental law that could impose greater quality requirements, source of supply constraints, mandatory usage restrictions or any other matters that could negatively impact Illinois American or American Water revenues or costs.

How and whether any of these or other matters might impact the Commission's determination of an appropriate allowed rate of return should be the subject of specific rate proceedings where the evidence bearing on the issue can be properly reviewed. A blanket prohibition preventing Illinois American Water from recovering its true market-based cost of capital, regardless of the factors which impact that cost of capital, would be improper regulatory policy. While Mr. Rubin claims that such a condition would "insulate" IAWC's customers from the adverse effect on IAWC's bond ratings of its divestiture from RWE, it would also adversely impact customers by increasing the perceived risk of investing in Illinois American Water or American Water, thus increasing the cost of that capital or constraining its availability to IAWC.

Several factors indicate that Mr. Rubin's proposed conditions are not necessary. These include, among others, American Water's long history of and current provision of high quality, safe, and reliable water service through its operating subsidiaries to millions of customers throughout the U.S., including Illinois; the expertise and economies of scale provided by the American Water, including the Research and Development capabilities of American Water's National Laboratory located in Illinois; the comprehensive regulations of this Commission and its enforcement powers; and the powers of the U.S. and Illinois Environmental Protection Agencies.

Q51. Does this conclude your testimony?

A. Yes, it does.

VERIFICATION

I, Ellen C. Wolf, certify that (1) I am Senior Vice President and Chief Financial Officer of American Water Works Company, Inc.; (2) I sponsor the attached Rebuttal Testimony of Ellen C. Wolf ("Rebuttal Testimony") and the Exhibits referenced therein; (3) I have personal knowledge of the information stated in the Rebuttal Testimony and referenced Exhibits; and (4) such information is true and correct to the best of my knowledge, information and belief.

Ellen C Wolf
Ellen C. Wolf

SUBSCRIBED AND SWORN
to before me this 22nd
day of January, 2007.

Notary Public