

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

**REVISED**

**REBUTTAL TESTIMONY**

**OF**

**ELLEN C. WOLF**

**(Docket 06-0336)**

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REVISED REBUTTAL TESTIMONY OF  
ELLEN C. WOLF

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**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-Garlich and Bonita Pearce and City of Urbana Witness William Gray.

**III. RESPONSE TO STAFF WITNESSES**

**Q4. Please summarize the position of Staff witness Kight-Garlich.**

A. In her Direct Testimony, Ms. Kight-Garlich took the position that the finding required by Section 7-204(b)(4) should be made. In Supplement Direct Testimony, however, Ms. Kight-Garlich 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-

30 Garlisch also indicates a need to review audited financial statements for Thames Water  
31 Aqua US Holdings, Inc. ("TWAUSHI") to complete the financial analysis.

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

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

35 **Q6. Please discuss the audited financial statements of TWAUSHI.**

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

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

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

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

50 A. IAWC Exhibit 2.2R (Revised), Page 1 (Confidential) shows the components of the total  
51 capitalization of TWAUSHI as of December 31, 2005. The Exhibit also shows

52 refinancing activity related to both debt and preferred stock securities for the 2006-2007  
53 period. The Pro Forma Capitalization for American Water as of December 31, 2007  
54 (reflecting completion of the refinancing and TWAUSHI/AW merger) is shown in the  
55 right hand column of the Exhibit, Page 1. Notes shown on the Exhibit, Page 1, explain  
56 each component of the refinancing activity. In connection with the refinancing, and as  
57 set forth in the Stipulation Between Joint Applicants and the Office of the Illinois  
58 Attorney General (Stipulation Exhibit B) (the "AG Stipulation"), it should be noted that  
59 RWE has made a commitment that American Water's equity ratio will be in the range of  
60 45%-55% at the time of the IPO, consisting of common equity and equity-like  
61 instruments. RWE has made a further commitment that American Water's common  
62 equity ratio will be at least 45% at the time of the IPO. RWE will infuse common equity  
63 capital as required to achieve a common equity target at or above this level at the time of  
64 the IPO. To date, RWE has infused \$1.194 billion of common equity capital. As set  
65 forth in the AG Stipulation, if an additional equity infusion is needed to achieve a  
66 common equity ratio of at least 45% at the time of the IPO, the required infusion will be  
67 provided. As shown on IAWC Exhibit 2.2R (Revised) (Confidential), the expected  
68 common equity ratio as of December 31, 2007, is within the range of 45%-55%.

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

71 A. Yes. AWCC recently issued senior unsecured notes ("Notes") in the amount of \$900  
72 million. The Notes have maturities ranging from seven to fifteen years (specifically, 7,  
73 10, 12 and 15 years), and carry final coupon rates of 5.39% to 5.77%. The Notes rank  
74 "pari passu" (i.e., equal) in right of payment with all current and future unsubordinated,

75 unsecured indebtedness of AWCC. The first closing of Senior Notes in the amount of  
76 \$483 million occurred on December 31, 2006. The second and third closings in the  
77 amounts of \$314 million and \$103 million, respectively, are expected to occur on or  
78 around January 31, 2007 and February 15, 2007, respectively.

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

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

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

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

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

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

118 **Q13. Staff witness Kight-Garlich further states that the information Applicants**  
119 **provided," does not clearly show that American Water will have sufficient cash**

120 **flows to support an investment grade credit rating of at least "A-." Would you**  
121 **respond?**

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

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

139 IAWC Exhibit 2.6R shows historical credit statistics for American Water as of  
140 December 31, 2001 and December 31, 2005. At and around the time of the 2001  
141 ratios, AW's credit rating as determined by S&P was "A-", as it is today. The  
142 operating and financial data of AW as of December 31, 2005, is the data that was

143 available to S&P when it issued the November 7, 2006 "A-" credit rating for AW  
144 that was discussed above. As a comparison of the data shown on IAWC Exhibits  
145 2.2R (Revised) (Confidential) and 2.6R demonstrates, AW's projected credit  
146 statistics are comparable and improving. I would also note that the 2007 Pro  
147 Forma capitalization as shown on IAWC Exhibit 2.2R (Revised) (Confidential) is  
148 comparable to that of water utilities that have strong investment grade credit  
149 ratings.

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

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

159 As discussed at page 10 of the Ratings Criteria, one of the important factors that  
160 S&P uses to arrive at a credit rating decision is the quality of management.

161 American Water has proven management and has also added new and returning  
162 professionals as senior managers ahead of the IPO. The addition of Don Correll  
163 as Chief Executive Officer, with his significant industry and publicly traded  
164 company experience, has been well received by industry analysts.

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

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

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

185 **Q16. Staff witness Kight-Garlich further suggests that the merger of TWAUSHI with**  
186 **American Water is not a certainty. In light of this, Ms. Kight-Garlich concludes**  
187 **that forecasted financial statements for American Water, excluding other**

188 **components of TWAUSHI, and audited financial statements of TWAUSHI are**  
189 **needed to complete a thorough analysis. Would you comment?**

190 A. The Proposed Transaction will not take place until all the approvals for the  
191 TWAUSHI/American Water merger are in place. Accordingly, Joint Applicants believe  
192 that separate forecasted financial statements for AW, excluding other components of  
193 TWAUSHI, are not required. As explained above, audited financial statements and  
194 projected financial information for TWAUSHI are provided in IAWC Exhibits 2.1R and  
195 2.2R (Revised) (Confidential).

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

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

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

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

208 **IV. RESPONSE TO WILLIAM GRAY**

209 **Q19. City of Urbana witness William R. Gray expressed concern (p. 7) that there is an**  
210 **issue as to whether the Company has fully funded its pension liabilities. Please**  
211 **explain AW's pension funding policy.**

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

218 **Q20. Why is the ERISA minimum required contribution the correct measure to review**  
219 **when determining appropriate funding levels?**

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

230 **Q21. What was the funding status of AW's pension plan under ERISA-based calculations**  
231 **for the period 2000 to 2005?**

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

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

234  
235 As the data show, the Actuarial Value of Assets for the plan exceeded the Actuarial  
236 Accrued Liability for plan years 2000 through 2004. For plan year 2005, assets were  
237 92% of the liabilities. Based on ERISA criteria, AW's plan is, and has been, financially  
238 sound.

239 **Q22. Are there new requirements affecting AW's funding of its pension plan?**

240 A. New funding rules under the Pension Protection Act ("PPA") are effective in 2008, and  
241 generally require that companies contribute the amount of benefit that will be earned  
242 during the year plus a seven-year amortization of the underfunded obligation. The  
243 underlying theoretical intent of the new law is to achieve full funding, based on assets  
244 and obligations defined under PPA, in seven years.

245 **Q23. After the Proposed Transaction, will AW continue to fund its pension plan in**  
246 **accordance with applicable requirements?**

247 A. Yes.

248 **Q24. Does this conclude your testimony?**

249 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 Revised Rebuttal Testimony of Ellen C. Wolf, IAWC Exhibit 2.0R-REV ("Revised Rebuttal Testimony") and the Exhibits referenced therein; (3) I have personal knowledge of the information stated in the Revised 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 23<sup>rd</sup> day of February, 2007.

*Linda Stapleton*  
Notary Public

My commission expires: April 11, 2011

SWORN TO AND SUBSCRIBED  
BEFORE ME ON THIS DATE

FEB 23 2007

LINDA K. STAPLETON  
Notary Public of New Jersey  
Commission Expires 4/11/2011