

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS-AMERICAN WATER)
COMPANY, AMERICAN WATER)
WORKS COMPANY, INC., THAMES)
WATER AQUA US HOLDINGS, INC., and THAMES)
WATER AQUA HOLDINGS GmbH)
) Docket No. 06-0336
Joint Application For Approval of Proposed)
Reorganization and Change In Control of)
Illinois-American Water Company)
Pursuant To Section 7-204 of the Illinois)
Public Utilities Act.)

**PROPOSED ORDER OF ILLINOIS AMERICAN WATER COMPANY,
AMERICAN WATER WORKS COMPANY, INC.,
THAMES WATER AQUA US HOLDINGS, INC., AND
THAMES WATER AQUA HOLDINGS GMBH**

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On April 21, 2006, Illinois-American Water Company (“IAWC”), American Water Works Company, Inc. (“American Water” or “AW”), Thames Water Aqua US Holdings, Inc. (“TWAUSHI”) and Thames Water Aqua Holdings GmbH (“Thames GmbH”) (collectively, “Joint Applicants”) filed a Verified Application with the Illinois Commerce Commission (“Commission”) in this matter seeking approval of a reorganization (the “Proposed Transaction”) pursuant to Section 7-204 of the Illinois Public Utilities Act (“Act”), 220 ILCS 5/7-204.

On May 12, 2006, the People of the State of Illinois, through the Office of the Illinois Attorney General (“AG”), filed a petition to intervene. On May 15, 2006, the Village of Homer Glen (“Homer Glen”) filed a petition to intervene. Both these petitions were granted on May 24, 2006. On June 19, 2006, the City of Champaign (“Champaign”) filed a petition to intervene. Champaign was granted leave to intervene on June 28, 2006. The Village of Bolingbrook (“Bolingbrook”) sought leave to intervene in this proceeding on July 12, 2006. Bolingbrook was granted leave to intervene on July 31, 2006. The City of Urbana (“Urbana”) sought leave to intervene in this proceeding on July 31, 2006. Urbana’s petition to intervene was granted on October 6, 2006. On October 2, 2006, a Petition for Leave to Intervene was filed by the Utility Workers Union of America, AFL-CIO, and UWUA Local Union Nos. 640, 500 and 405 (collectively, the “UWUA”). The petition to intervene was denied by the ALJ on October 6, 2006. On October 18, 2006, the UWUA filed Petition for Interlocutory Review with the Commission. In a ruling dated November 29, 2006, the Commission granted the UWUA’s petition to intervene.

An agreement was reached between AW and the UWUA resolving the issues of concern to the UWUA. This agreement is reflected in Stipulation Exhibit A (“Union Stipulation”). Joint Applicants filed a Motion for Leave to File Stipulation Exhibit A on February 13, 2007 which was granted at hearing on March 1, 2007. An agreement was also reached between Joint Applicants and the AG resolving all issues raised in this proceeding by the AG. This agreement is reflected in Stipulation Exhibit B (“AG Stipulation”), which was executed on February 22, 2007. In accordance with the terms of the AG Stipulation, the AG agreed to withdraw the testimony of a witness whose testimony had been filed on AG’s behalf. Also, in accordance with the AG Stipulation, Joint Applicants agreed to modify their Rebuttal Testimony to reflect the withdrawal of the testimony of AG’s witness (and to withdraw the pre-filed testimony of one witness that had been submitted by Joint Applicants). The Joint Applicants and the AG filed a Joint Motion for Leave to File the AG Stipulation, Supplemental Stipulation Testimony of Terry L. Gloriod and Revised Rebuttal Testimony on February 23, 2007. The Motion for Leave to File was granted on March 1, 2007.

Pursuant to proper legal notice, pre-hearing conferences were held in this matter before a duly authorized Administrative Law Judge on May 24, August 22, September 12 and November 30, 2006, and on January 30 and March 1, 2007. An evidentiary hearing was held on March 6, 2007. At the hearing, Joint Applicants, Homer Glen, Champaign, Urbana, Bolingbrook and Staff appeared and were represented by counsel. At the hearing, Mr. Terry Gloriod and Ms. Ellen Wolf testified on behalf of the Joint Applicants. Mr. William Marr, Ms. Bonita Pearce and Ms. Kight-Garlich testified on behalf of the Commission Staff. Ms. Mary Niemiec testified on behalf of Homer Glen. Mr. Paul Berg testified on behalf of Champaign, and Mr. William Gray testified on behalf of Urbana.

I. JOINT APPLICANTS’ POSITION

For nearly 60 years, American Water was one of the largest publicly traded water companies in the United States, with its shares listed on the NYSE. In 2003, Thames GmbH and its parent, RWE Aktiengesellschaft (“RWE”), acquired American Water. That transaction was approved in an order issued by the Commission in Docket 01-0832, which was affirmed by the Illinois Appellate Court.

Joint Applicants request that the Commission approve (i) the sale by Thames GmbH of up to 100% of the shares of common stock of American Water in one or more public offerings and (ii) prior to the closing of the initial public offering (“IPO”), the merger of TWAUSHI with and into American Water, with American Water being the surviving corporation. The transactions set forth in (i) and (ii) are hereinafter collectively referred to as the “Proposed Transaction.” Following the Proposed Transaction, American Water will be a publicly traded company that will own operating subsidiaries, including IAWC.

A. The Companies Involved

IAWC is an Illinois corporation with its principal office located in Belleville, Illinois. IAWC is a public utility within the meaning of Section 3 105 of the Act, 220 ILCS 5/3 105, and is organized and operating under the laws of the State of Illinois. IAWC is a wholly owned

subsidiary of American Water and a second tier subsidiary of TWAUSHI. IAWC is a part of American Water's Central Region. IAWC currently owns, operates and maintains potable water production, treatment, storage, transmission and distribution systems and wastewater collection, pumping and/or treatment systems for the purpose of furnishing water and wastewater service for residential, commercial, industrial and governmental users in its various Illinois service areas. IAWC serves approximately 293,000 customers in 125 communities in Illinois.

RWE is a corporation organized and existing under the laws of the Federal Republic of Germany. RWE's principal office is located at Opernplatz 1, 45128 Essen, Federal Republic of Germany.

Thames GmbH is a company organized and existing under the laws of the Federal Republic of Germany, with its headquarters in Essen, Germany. Thames GmbH is a wholly-owned subsidiary of RWE. Thames GmbH owns 100% of the shares of TWAUSHI.

TWAUSHI is a corporation organized and existing under the laws of Delaware and headquartered in Voorhees, New Jersey. It is the intermediate holding company for all of RWE's water businesses in the United States and a wholly-owned subsidiary of Thames GmbH. TWAUSHI and its subsidiaries today have approximately 7,000 employees and provide water, wastewater services and other water resource management services to a population of approximately 18 million people in 29 states and in Canada. TWAUSHI is the direct parent of American Water.

American Water is a Delaware corporation headquartered in Voorhees, New Jersey. The principal business of American Water is the investment in and ownership of the common stock of operating water and wastewater utility companies, such as IAWC, that provide quality water and wastewater services to millions of customers in the United States and three Canadian Provinces. For nearly 60 years, from 1947 until January 2003, American Water was one of the largest publicly-traded water companies in the United States, with its shares listed on the NYSE.

B. The Proposed Transaction

As described above, the Proposed Transaction consists of (i) the sale by Thames GmbH of up to 100% of the shares of common stock of American Water and (ii) prior to the closing of the IPO, the merger of TWAUSHI with and into American Water. The shares will be sold through one or more underwritten public offerings to a broad group of investors, including institutional and retail investors. The IPO and any subsequent public offerings will be conducted according to the rules for underwritten public offerings mandated by the Securities and Exchange Commission ("SEC").

According to Joint Applicants, RWE has no intention of permitting any person to acquire a controlling interest in American Water through the Proposed Transaction. Section 7-204 of the Act prohibits any person from acquiring a controlling interest in American Water without first obtaining approval from the Commission.

Following the Proposed Transaction, as a publicly-traded company, American Water will become subject to other requirements of the federal securities laws and regulations and the requirements of the stock exchange where American Water's common shares will be listed. These requirements will result in greater corporate transparency with respect to the operations of American Water and its subsidiaries. Specifically, such laws and regulations will impose obligations on American Water and its subsidiaries related to financial reporting, accounting, internal controls, general business disclosure, corporate governance, executive compensation reporting, issuance of securities and related financial and business matters. All financial information of American Water and its subsidiaries will have to be reported in accordance with U.S. generally accepted accounting principles ("GAAP") and SEC regulations. The annual consolidated financial statements of American Water will be required to be audited. American Water will comply with the extensive requirements imposed by the recent federal Sarbanes-Oxley legislation, relating to, among other things, internal controls over financial reporting and external audit of such controls, corporate officer certification of financial and other information, corporate governance requirements, and enhanced and expedited disclosure (particularly with respect to certain financial information).

C. Applicable Statutory Authority

The Application is being filed pursuant to Section 7-204 of the Act, which requires Commission approval for transactions that result:

in a change in ownership of a majority of the voting capital stock of an Illinois public utility; or the ownership or control of any entity which owns or controls a majority of the voting capital stock of a public utility; or by which 2 public utilities merge, or by which a public utility acquires substantially all of the assets of another public utility . . .

220 ILCS 5/7-204(a). In approving a proposed reorganization under Section 7-204(b), the Commission is required to find and, for the reasons stated below, the Commission should find in this proceeding, that:

- (1) the Proposed Transaction will not diminish IAWC's ability to provide adequate, reliable, efficient, safe and least cost public utility service;
- (2) the Proposed Transaction will not result in unjustified subsidization of non utility activities by IAWC or its customers;
- (3) costs and facilities are fairly and reasonably allocated between utility and any non utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by IAWC for ratemaking purposes;
- (4) the Proposed Transaction will not significantly impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

- (5) IAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
- (6) the Proposed Transaction is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;
- (7) the Proposed Transaction is not likely to result in any adverse rate impacts on retail customers.

Section 7-204(c) of the Act further requires the Commission to rule on: (1) the allocation of any savings resulting from the Proposed Transaction; and (2) whether the Joint Applicants should be allowed to recover any costs incurred to accomplish the Proposed Transaction, and if so, the amount of costs eligible for recovery and how such costs will be allocated.

D. Section 7-204(b)(1)

Joint Applicants' witness, Mr. Gloriod, testified that the Proposed Transaction would not diminish IAWC's ability to provide adequate, reliable, efficient, safe and least-cost public utility service. According to Joint Applicants, the Proposed Transaction will result in a publicly-traded company that is focused on the water and wastewater business in the U.S.

Mr. Gloriod testified that the Proposed Transaction would result in American Water becoming the largest publicly-traded water company in the United States. As such, American Water will be able to apply extensive resources and expertise in support of its subsidiaries, including IAWC. American Water will be able to provide benefits to IAWC in the form of technical water and wastewater management expertise, reduced costs through mass purchasing agreements, the sharing of relevant experience, and access to advanced research and development. The Service Company will continue to provide IAWC with expert service in the areas of customer service, accounting, administration, engineering, finance, human resources, information systems, operations, risk management, water quality and other services under the Services Agreement in place with IAWC. The provision of these services will not be diminished by the Proposed Transaction.

Moreover, the Proposed Transaction will not adversely affect IAWC's policies with respect to service to customers, employees, operations, financing, accounting, capitalization, rates, depreciation, maintenance, or other matters affecting the public interest or utility operations.

E. Sections 7-204(b)(2) and (b)(3)

According to Mr. Gloriod, the Proposed Transaction will not result in the subsidization of non-utility activities by IAWC or its customers. IAWC does not engage in a significant level of non-utility activity. To the extent that IAWC may engage in such activities in the future, it will continue to maintain its books and records in such a manner as to fairly and reasonably allocate costs and facilities between utility and non utility activities, so as to allow the Commission to identify those costs and facilities that are properly included for ratemaking purposes.

Mr. Gloriod also states that all affiliated interest agreements approved by the Commission to which IAWC is a party will remain in effect unless or until the agreements terminate and/or the Commission approves amended agreements. Pursuant to the Commission's Order in Docket 02-0690, IAWC submitted all of its affiliated interest agreements for reapproval in 2004 and 2005.

Joint Applicants note that no party has suggested that the Proposed Transaction will not meet the requirements of Section 7-204(b)(2) and (b)(3) of the Act.

F. Section 7-204(b)(4)

Joint Applicants' witness, Ms. Wolf, testifies that the Proposed Transaction will not impair the ability of IAWC to maintain a reasonable capital structure that is representative of other utilities. IAWC's capital structure will not change as a result of the Proposed Transaction. Following the Proposed Transaction, the capital structure of IAWC will be consistent with the provisions of Section 6-103 of the Act.

According to Ms. Wolf, 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. 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.

Ms. Wolf states that RWE has revised its core business focus to be on the European power and energy markets, where historically its roots lie. In order to maintain its position among Europe's leading integrated electricity and gas companies in response to fierce competition, growing customer needs, and rising costs both for energy production facilities and many other energy production inputs, RWE is forced to concentrate on its power and energy markets. As a result of these developments, RWE's ability to maintain its competitiveness in its core European businesses is proving far more capital intensive than RWE could have predicted when it acquired American Water. Consequently, RWE decided to sell the water operations of Thames Water in the U.K. and to return American Water to its status as a U.S. publicly-traded company. The Proposed Transaction will allow RWE to focus on its core businesses in its home region, and more importantly for IAWC, will allow American Water to focus on its U.S. water and wastewater systems and customers and avoid the need for competition with other RWE businesses in obtaining capital.

Ms. Wolf explains that, as a publicly-traded company, American Water will be able to access the public capital markets directly and offer investors an involvement in a predominantly U.S.-regulated water utility, and so be better positioned to serve the future needs of its customers. 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 should enhance its access to necessary capital to support the operations of its subsidiaries, including IAWC.

Ms. Wolf states that, in addition to other capital needs, American Water and its subsidiaries, including IAWC, are required to replace aging infrastructure and comply with ever more stringent water quality standards. American Water's status as a publicly-traded company will help assure that American Water and IAWC have ready, cost-effective access to capital to meet such needs.

Under an agreement last approved by the Commission in Docket 04-0582, IAWC is authorized to obtain short and long term debt capital from American Water Capital Corporation ("AWCC") (subject to such further approval of long term debt issuances as the Act requires). This allows IAWC to benefit from the economies of scale associated with system wide debt financing and decreased administrative costs. By "bundling" the financial needs of American Water's operating subsidiaries, AWCC provides cost-effective debt funding. Combined borrowing power increases the efficiencies of borrowing operations and lowers the cost thereof (i.e. bank fees, legal fees, rating costs, SEC registration costs, and others.). After the Proposed Transaction, AWCC will continue to be a subsidiary of American Water, and IAWC may still elect to obtain loans from AWCC as before.

Aside from the effects of merging the operations of TWAUSHI into American Water, there will be no material changes in American Water's revenues or expenses. American Water's balance sheet will remain solid and there will be an ongoing emphasis on service and water quality. American Water will have, at a minimum, 45% common equity at the time of the IPO. American Water's strong commitment to investing the capital required to properly maintain IAWC's operations will be continued.

Ms. Wolf notes that AW's credit rating is currently A-. Ms. Wolf testified that, after the Proposed Transaction, AW's credit rating is expected to remain at an A- level. As shown on IAWC Exhibit 2.2R (Revised), the expected common equity ratio for AW after the Proposed Transaction, as of December 31, 2007, is within the range of 45%-55%. In addition, RWE has made a 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, not including equity-like instruments. RWE has infused \$1.194 billion of common equity capital (in addition to RWE's initial common equity investment in AW).

Ms. Wolf stated that, post-transaction, American Water's Debt to Equity structure will be similar to other water utilities which have Investment Grade ratings (Debt = 45-55%, Equity = 55-45%). As Ms. Wolf indicated, a credit rating is dependent on a multitude of factors, including a company's competitiveness and growth prospects, the caliber of its management, the industry's regulatory framework and how it applies to the company, and quantitative analysis metrics such as Funds from Operations to Total Debt, Pretax Coverage Ratios and Total Debt to Total Capital. Given American Water's plan for Debt to Equity levels at par with other water utilities (and RWE's commitment that American Water's common equity ratio will be at least 45% at the time of the IPO), and assuming timely rate relief and a rate of return similar to the average in the industry, Joint Applicants do not expect to see a change in American Water's credit rating from its current level of A-.

IAWC's capital structure as of December 31, 2004, consisted of approximately 45% equity and 55% debt. Ms. Wolf stated that IAWC's capital structure will not change as a result of the Proposed Transaction. The Proposed Transaction will not impair the ability of IAWC to maintain a reasonable capital structure that is representative of other utilities in the water industry. Thus, according to Ms. Wolf, Joint Applicants have shown that the Proposed Transaction meets the requirements of Section 7-204(b)(4).

G. Section 7-204(b)(5)

Joint Applicants state that, following the Proposed Transaction, IAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities. The Proposed Transaction does not affect the Commission's authority with respect to IAWC or the authority of other governmental agencies as to IAWC's services or facilities. Joint Applicants note that Staff has agreed that the Proposed Transaction meets 7-204(b)(5), and no party has asserted otherwise.

H. Section 7-204(b)(6)

Joint Applicants state that the Proposed Transaction will not affect competition in the State of Illinois because IAWC will continue to operate in its current certificated service territories under the same market conditions that existed prior to the closing of the Proposed Transaction. Joint Applicants point out that Staff has agreed that the Proposed Transaction meets the requirements of 7-204(b)(6), and no party has asserted otherwise.

I. Section 7-204(b)(7)

According to Mr. Gloriod, the Proposed Transaction will not adversely impact IAWC's rates. (IAWC Ex. 1.0, p. 9.) Mr. Gloriod testified that Joint Applicants will not seek recovery in rates of costs of the Proposed Transaction, which are comprised of the SEC registration fee, the NASD filing fee, the stock exchange listing fee, legal fees and expenses of the Proposed Transaction, accounting fees and, expenses of the Proposed Transaction, printing and engraving fees and expenses for the registration statement, Blue Sky fees and expenses, transfer agent fees and expenses, and legal fees for the state regulatory approval process.

In addition, Mr. Gloriod stated that IAWC will continue to operate under its existing tariffs and rate structures (until such time as such tariffs and rate structures are revised in accordance with Illinois law).

J. Section 7-204(c)

As stated above, Joint Applicants seek no recovery in rates of costs of the Proposed Transaction, which are described above. Therefore, Joint Applicants recommend that, under Section 7-204(c) of the Act, the Commission rule that the costs of the Proposed Transaction are not recoverable in rates. In addition, although Joint Applicants do not expect savings to result in Illinois from the Proposed Transaction, Joint Applicants recommend that the Commission rule

that such savings reflected in the test years in future rate cases, if any, should be allocated in full to customers.

K. Conditions

In Docket 01-0832, the Commission approved the acquisition of American Water by Thames GmbH, subject to certain conditions, including, *inter alia*, the following (numbered as they appear in the Commission's Order in Docket 01-0832): (2) "The final corporate structure approved by the Commission shall be the following: IAWC will continue to be a subsidiary of [American Water]; [American Water], through [TWAUSHI], will be a wholly-owned subsidiary of RWE"; and (3) "Commission approval consistent with Section 7-204 of the Act must be sought for any additional changes to the corporate structure involving IAWC." Docket 01-0832, Order, p. 23. Mr. Gloriod testified that these Conditions should be eliminated, since neither American Water nor TWAUSHI will then be subsidiaries of RWE, and any continuing requirement that Illinois American seek approval for a "reorganization" would be imposed by Section 7-204 of the PUA, and not by the Order in Docket 01-0832. Also, as Condition No. 4 of the Commission's Order in Docket 01-0832, IAWC was required to advise the Commission of any change in the corporate credit rating of RWE, Thames GmbH or American Water. Following the Proposed Transaction, the credit rating of RWE and Thames GmbH will no longer affect the credit rating of either American Water or IAWC. Accordingly, Mr. Gloriod proposed in Direct Testimony that IAWC should no longer be required to report changes in the credit rating of RWE or Thames GmbH. (As will be discussed in Rebuttal Testimony, Mr. Gloriod accepted a modified proposal recommended by the Commission Staff with respect to Condition No. 4).

II. THE STIPULATIONS WITH AG AND UWUA

As discussed above, Joint Applicants entered into the Union Stipulation ("Stipulation Exhibit A") and the AG Stipulation ("Stipulation Exhibit B") (collectively, the "Stipulations"). The parties to the Stipulations negotiated terms that resolved the respective concerns of these parties. Specifically, AW and IAWC agreed in the AG Stipulation to the following:

- (A) IAWC will pass through to IAWC's customers, in future rate cases, any actual savings from efficiencies resulting from the Proposed Transaction and the continued ownership of IAWC by AWW.
- (B) The Proposed Transaction will not adversely affect IAWC's policies with respect to service to customers, employees, operations, financing, accounting, capitalization, rates, depreciation, maintenance, or other matters affecting the public interest or utility operations.
- (C) IAWC will provide safe, adequate and reliable service in fulfillment of its obligations under Illinois and federal law.

- (D) IAWC will continue to make contributions to the state and local economies, and continue IAWC's commitment to be a good corporate citizen in the local communities IAWC serves.
- (E) IAWC will make no attempt to recover through IAWC's rates any costs of the Proposed Transaction, purchase price, goodwill, early termination payment, change in control payment, incentive or retention bonus payment in connection with the Proposed Transaction, either directly or indirectly through American Water Works Service Company, Inc., or any other affiliate, or by any other means.
- (F) IAWC will not recover from IAWC's customers or have IAWC's customers fund any portion of the costs of the Proposed Transaction, including financial, legal, severance payments, regulatory fees, investment services or the installation of the initial procedures for compliance with the Sarbanes -- Oxley Act of 2002 (Pub. L. No. 107-204, 116 Stat. 745, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 ("Sarbanes-Oxley")).
- (G) For three years following the date of the Order, IAWC will maintain its equity-to-capital ratio between 40% and 50%. If the equity-to-capital ratio falls outside of this range, IAWC will notify the Commission in writing within 30 days.
- (H) IAWC will flow through to the benefit of its customers, under the Commission's normal ratemaking procedures, any lower cost of debt applicable to IAWC as a result of its relationship with AWW in future general rate cases.
- (I) IAWC shall inform the Commission of any changes to the corporate credit ratings of AWCC by filing a copy of the complete credit report, within 15 days of publication, with the Chief Clerk of the Commission with a second copy provided to the Finance Department Manager. In addition, the reporting requirement shall be extended to American Water should Moody's Investors Service, Standard & Poor's, or Fitch Ratings rate its indebtedness or overall creditworthiness.
- (J) AW will not issue any debt that pledges as security or otherwise encumbers the assets of IAWC.
- (K) The payment for AW stock will not be recorded on IAWC's books.
- (L) IAWC will not bear any costs incurred to comply with any law, regulation, standard, or practice of the United Kingdom, Federal Republic of Germany, or European Community necessary to complete the Proposed Transaction.

- (M) AW or IAWC will file the following reports with the Commission or provide the relevant Securities and Exchange Commission website where such reports are available: AW's quarterly interim reports to its shareholders; AW's annual reports to its shareholders; and AW's and IAWC's annual audit reports.
- (N) IAWC customers will experience no material adverse change in utility service due to the Proposed Transaction.
- (O) AW and IAWC will fund and maintain IAWC's treatment, transmission, and distribution systems so as to provide service and facilities which are in all respects adequate, efficient, reliable and environmentally safe.
- (P) RWE has made a commitment that AW's common equity ratio will be at least 45% at the time of the IPO. As of December 15, 2006, RWE has infused \$1.194 billion of common equity capital into AW. If any additional equity is needed to achieve a common equity ratio for AW of at least 45% at the time of the IPO, the required infusion into AW will be provided prior to the IPO. The calculation of the common equity ratio will not include equity-like financial instruments. AW will file a balance sheet as of the quarter ended immediately preceding the IPO.

(Stipulation Ex. B, pp. 4-5, ¶ 13.)

AW and IAWC also agreed to the following in the Union Stipulation.

1. For a period of three years from the date of the Commission Order in this case (and after it has first notified IAWC employees), IAWC will notify the Commission, and if applicable, the Utility Workers Union of America, AFL-CIO of a planned reduction of 5% or more in IAWC's work force.

2. AW will continue to fund the pension plans of the union and non-union employees of IAWC in compliance with the Employee Retirement Income Security Act ("ERISA") and the Pension Protection Act of 2006 ("PPA"). IAWC will not seek to recover from its customers any increased pension funding expense or other costs that would be incurred to remedy any violation of ERISA's minimum funding requirements during RWE's ownership if it should be determined that any such violation has occurred. Neither AW nor IAWC is aware of, nor do they believe that, any such violation has occurred.

3. For one year following the occurrence of the IPO, staffing levels for collectively bargained employees will not drop below 90% of the number of collectively bargained individuals employed by IAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis). Likewise, for one year following the occurrence of the IPO, staffing levels for all employees (union and non-union collectively) will not drop below 90% of the number of individuals employed by

IAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis).

4. IAWC agrees to honor all terms and conditions of the existing collective bargaining agreements between IAWC and the applicable local union of the Utility Workers Union of America (the “Collective Bargaining Agreements”) through the termination dates of those agreements. Any successor to IAWC will assume the Collective Bargaining Agreements and all obligations thereunder through the termination dates of those agreements.

(Stipulation Ex. A, pp. 1-2, ¶¶ 1-4.)

In Supplemental Stipulation Testimony, Mr. Gloriod stated that the Stipulations reflect the terms deemed reasonable by the Joint Applicants and, respectively, the UWUA and the AG to resolve all issues of concern to these parties. The Union Stipulation resolves issues of concern to UWUA in this proceeding pertaining to collectively bargained employees, and the UWUA agrees that, subject to the Union Stipulation, the Commission should approve the Joint Applicants’ Verified Application and grant such other approvals as the Commission may determine necessary to effect the Proposed Transaction. (Stipulation Ex. A, p. 2, ¶¶ 5-6.) The AG Stipulation resolves the AG’s concerns in this proceeding (Stipulation Ex. B, p. 6, ¶ 18) and, subject to the conditions in the AG Stipulation, the AG agrees that the Commission should approve the Joint Applicants’ Verified Application and the transactions contemplated therein. (Id., p. 3, ¶ 11.) According to Mr. Gloriod, the Stipulations are in the public interest and should be approved.

III. POSITION OF THE COMMISSION STAFF

A. Testimony of Mr. Marr

With regard to Section 7-204(b)(1) of the Act, Staff witness Marr noted Joint Applicants’ testimony that the proposed reorganization will not diminish the ability of IAWC to provide adequate, reliable, efficient, safe, and least-cost public utility service. Mr. Marr referred to evidence presented by Mr. Gloriod and Ms. Wolf, and to information provided by Joint Applicants in response to data requests. Mr. Marr stated that from his review he found no reason to dispute the Joint Applicants’ assertion that the Proposed Transaction will not diminish the ability of IAWC to provide adequate, reliable, efficient, safe, and least-cost public utility service, as required by Section 7-204(b)(1) of the Act.

Regarding Section 7-204(b)(5) of the Act, Mr. Marr noted Mr. Gloriod’s testimony that IAWC will continue to be subject to the jurisdiction of the Commission following the proposed reorganization, and, therefore, IAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities, as required by Section 7-204(b)(5) of the Act. Mr. Marr noted that, following the Proposed Transaction, IAWC will continue to exist in the same corporate form as it does today. The Proposed Transaction will not require any change in the rules, regulations, and conditions of service tariffs for the provision of water and sewer public utility services applicable to the certificated service areas of IAWC,

which are on file with, and approved by, the Commission. Based on his review, Mr. Marr agreed that IAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities, as required by Section 7-204(b)(5) of the Act.

With regard to Section 7-204(b)(6) of the Act, Mr. Marr noted Mr. Gloriod's testimony that the Proposed Transaction will have no significant adverse effect on competition in the water and sewer public utility service markets in the State of Illinois because IAWC will continue to operate in its current certificated service territories under the same market conditions that existed prior to the closing of the proposed reorganization. Mr. Marr noted that the Proposed Transaction will not eliminate an actual or potential competitor in the water and sewer public utility services markets in the State of Illinois. In light of the fact that no competitor will be eliminated, no concentration in the industry will occur as a result of the proposed reorganization. Mr. Marr agreed with the testimony of Mr. Gloriod that the Proposed Transaction is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction, as required by Section 7-204(b)(6) of the Act. Mr. Marr recommended that the Commission find that the Proposed Transaction meets the requirements of Sections 7-204(b)(1), (b)(5), and (b)(6) of the Act.

B. Testimony of Ms. Kight-Garlich

In her Direct Testimony, Staff witness Kight-Garlich took the position that the finding required by Section 7-204(b)(4) should be made, subject to a condition. Ms. Kight-Garlich testified that Condition No. 4 imposed in Docket 01-0832 should not be eliminated as proposed by Joint Applicants. Ms. Kight-Garlich stated that, although RWE will no longer be affiliated with IAWC, IAWC will continue to obtain capital through its affiliates, AWCC and American Water. Thus, the credit ratings of IAWC's affiliates could directly impact its ability to obtain capital on reasonable terms. Therefore, Ms. Kight-Garlich proposed that the language of Condition No. 4 should be adopted as a Condition in this proceeding, modified to read:

IAWC shall inform the Commission of any changes to the corporate credit ratings of AWCC by filing a copy of the complete credit report, within 15 days of publication, with the Chief Clerk of the Commission with a second copy provided to the Finance Department Manager. In addition, the reporting requirement shall be extended to American Water should Moody's Investors Service, Standard & Poor's, or Fitch Ratings rate its indebtedness or overall creditworthiness.

In Supplemental Direct Testimony, Ms. Kight-Garlich changed her position and stated 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." Ms. Kight-Garlich also indicated a need to review audited financial statements for TWAUSHI to complete the financial analysis. In Rebuttal Testimony, Joint Applicants responded to Staff concerns. Ms. Kight-Garlich concluded that, subject to a condition discussed below, the Proposed Transaction meets the requirements of Section 7-204(b)(4) of the Act. Ms. Kight-Garlich stated that Ms. Wolf's

Rebuttal Testimony contains information and analysis that is sufficient to support the Applicants' assertion that the proposed reorganization will not significantly impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure.

Ms. Kight-Garlich noted Ms. Wolf's testimony that applicable data supports an "A-" credit rating. Second, Ms. Wolf provided the audited financial statements of TWAUSHI and a financial ratio analysis of TWAUSHI (AW after the merger) before and after the proposed reorganization is completed. According to Ms. Kight-Garlich, the ratio analysis shows that only one of TWAUSHI's ratios, the funds from operation to interest coverage ratio ("FFOIC"), is currently within the S&P benchmark guidelines for an "A" rating. Ms. Kight-Garlich stated, however, that, with AW's recent and proposed financial restructuring, the other two ratios are projected to be within the BBB or A range in 2007 through 2011. Ms. Kight-Garlich testified that, to make certain that TWAUSHI/AW will have sound financial ratios to attract investors, the Applicants stated that RWE has committed that TWAUSHI/AW's "common equity ratio will be at least 45% at the time of the IPO." According to Ms. Kight-Garlich, common equity ratio of at least 45% would result in debt to capitalization ratio in the "A" range and should improve the financial ratios.

Finally according to Ms. Kight-Garlich, Ms. Wolf provided the interest rates from recent debt issuances by AWCC, which raises debt for AWCC and its subsidiaries. The interest rates AWCC attained are consistent with "A-" rated debt. According to S&P, the financial commitments on A-rated obligations have a strong probability to be met. Since the anticipated IPO of AW was known at the time of the recent financing, Ms. Kight-Garlich stated that the interest rates on the new debt indicate that debt investors expect that AWCC's financial strength will be sufficient to support an "A-" rating, which in turn, indicates that AWCC would be able to raise capital on reasonable terms after the proposed reorganization. Ms. Kight-Garlich testified that the information and commitments the Applicants provided alleviated her concerns regarding the Applicants' ability to raise necessary capital on reasonable terms. Ms. Kight-Garlich stated specifically that RWE's commitment that AW's common equity ratio would be no lower than 45% at the time of its IPO, if carried out, would alleviate her concern regarding the Applicants' ability to meet Section 7-204(b)(4) of the Act. Since this commitment is necessary for the proposed reorganization to meet the requirements of Section 7-204(b)(4) of the Act, Ms. Kight-Garlich recommended that this commitment should be a Condition for the Commission's approval of the Proposed Transaction. The Condition is:

AW's common equity ratio shall be at least 45% at the time of the IPO. The calculation of the common equity ratio shall not include equity-like financial instruments.

C. Testimony of Ms. Pearce

Regarding Sections 7-204(b)(2) and (3) of the Act, Staff witness Pearce noted Mr. Gloriod's testimony that IAWC does not engage in a significant level of non-utility activity, and to the extent that it does, the Company will continue to maintain its books and records in such a manner as to fairly and reasonably allocate costs and facilities between utility and non-utility activities, so as to allow the Commission to identify those costs and facilities that are

properly included for ratemaking purposes. (IAWC Exhibit 1.0, lines 155-159) Furthermore, Mr. Gloriod asserts that the affiliated interest agreements that have been approved by the Commission to which IAWC is a party will remain in effect until termination or amendment with Commission approval. Ms. Pearce stated that she has no reason to believe that the Proposed Transaction will result in additional non-utility activity, or to lessen the identification of utility and non-utility activities. Given that the affiliate agreements approved by the Commission will remain in effect, Ms. Pearce stated her belief that IAWC has satisfied the requirements in Section 7-204(b)(2) and (3) of the Act.

With regard to Section 7-204(b)(7) of the Act, Ms. Pearce noted Mr. Gloriod's testimony that IAWC will continue to operate under its existing tariffs and rate structures and will honor all its customer and regulatory obligations. Additionally, Ms. Pearce noted that Joint Applicants have not requested recovery of any of the costs of the proposed reorganization in rates. Accordingly, Ms. Pearce concluded that it does not appear that the reorganization would produce any adverse rate impact.

With regard to Section 7-204(c) of the Act, Ms. Pearce stated that the Joint Applicants have addressed the issue of allocation of savings from the Proposed Transaction. Mr. Gloriod states: ". . . Joint Applicants do not expect savings to result in Illinois from the Proposed Transaction." Ms. Pearce recommends that, under Section 7-204(c), the Commission should rule that such savings reflected in the test years in future rate cases, if any, should be allocated in full to customers. Ms. Pearce stated that Staff agrees that any savings identified should be passed on to the ratepayers. Ms. Pearce further noted Mr. Gloriod's testimony that the Joint Applicants seek no recovery in rates of costs of the Proposed Transaction. Therefore, Ms. Pearce concluded that, under Section 7-204(c) of the Act, the Commission should find that the costs of the Proposed Transaction are not recoverable in rates. Ms. Pearce recommended that the Commission:

1. Find that the proposed reorganization meets the requirements of Section 7-204(b)(2) of the Act, which states that the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;
2. Find that the proposed reorganization meets the requirements of 7-204(b)(3) of the Act, which states that costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes; and
3. Find that the proposed reorganization meets the requirements of Section 7-204(b)(7) of the Act, which states that the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

Ms. Pearce stated that, regarding Section 7-204(c) of the Act, the Commission should find that:

- The Joint Applicants do not anticipate that any savings will result from the proposed reorganization; accordingly, any savings that may occur in future rate case test years shall be allocated entirely to customers; and,
- The Joint Applicants do not seek recovery in rates of the costs associated with the Proposed Transaction; accordingly, the costs of the Proposed Transaction are not recoverable in rates.

In Supplemental Direct Testimony, Staff witness Pearce noted the Supplemental Direct Testimony of Staff witness Ms. Kight-Garlich, and stated that “if IAWC’s ability to raise capital is negatively impacted by the reorganization, there could possibly be an adverse impact on rates charged to retail customers” and she could not conclude that there would be no adverse rate impacts pursuant to Section 7-204(b)(7). Staff witness Pearce’s statement was based solely on Staff witness Ms. Kight-Garlich’s Supplemental Direct Testimony regarding IAWC’s ability to attract capital on reasonable terms. As discussed above, Staff witness Kight-Garlich concluded in Rebuttal Testimony that the Proposed Transaction would not adversely impact Joint Applicant’s ability to attract capital on reasonable terms. As a result, in her Rebuttal Testimony, Staff witness Pearce stated that her “previous concern related to potential adverse rate impacts has been alleviated,” and that the Proposed Transaction meets the requirements of Section 7-204(b)(7) of the Act.

D. Staff’s Initial Brief

In its Initial Brief, Staff indicates that, based on the testimony of the Staff witnesses summarized above, the Proposed Transaction should be approved subject to the two Conditions recommended by Ms. Kight-Garlich.

IV. THE POSITION OF HOMER GLEN, CHAMPAIGN AND URBANA (THE “MUNICIPALITIES”)

A. Homer Glen

Homer Glen’s witness, Ms. Niemiec, testified that Homer Glen formed a Sewer & Water Task Force comprised of citizens of the Village in early 2004 because of concerns of the Village about the cost of water and sewer service from IAWC. Ms. Niemiec stated that the Task Force met at least monthly until December 2005, and that representatives of IAWC attended some of the meetings.

Ms. Niemiec noted that Homer Glen received complaints concerning high water bills. According to Ms. Niemiec, Homer Glen requested that the residents forward the complaints to the ICC, and conducted a public forum. Ms. Niemiec stated that, as a result of the public forum and complaints, Homer Glen filed a formal complaint against IAWC at the ICC. The complaint was assigned Docket No. 06-0095, and was consolidated with a similar complaint case filed by the Illinois Attorney General, Docket No. 06-0094 and a complaint filed by a customer, Docket 05-0681. Ms. Niemiec noted that she and several residents filed testimony in the consolidated docket (“Docket 05-0681”). According to Ms. Niemiec, an expert witness in that

case retained jointly by Homer Glen and the Attorney General testified that there were problems with IAWC's billing practices. Ms. Niemiec indicated that Docket No. 06-0196 is a purchased water reconciliation case. Ms. Niemiec asserted that, as in Docket No. 05-0681, a Joint Homer Glen/Attorney General witness testified in Docket 06-0196.

Ms. Niemiec asserted that, based upon the Village's Sewer & Water Task Force interim findings, the findings by the Homer Glen/Attorney General expert witness in Docket No. 05-0681, and the findings by the Homer Glen/Attorney General expert witness in Docket No. 06-0196, IAWC is not currently providing adequate, efficient and least-cost utility service to the Village's residents.

Ms. Niemiec stated that, in this proceeding, IAWC does not explain or offer any indication that IAWC would seek to either reduce its rates or provide more efficient service to lower its costs to serve Homer Glen. Ms. Niemiec also asserted that the testimony of the Homer Glen/Attorney General witness in Docket 05-0681 shows that IAWC's current billing practices apparently are outdated and do not have the ability to accurately bill customers for service.

Ms. Niemiec asserted, as she did in Docket 05-0681, that, in 2005, IAWC improperly back billed its customers for service. Ms. Niemiec claimed that IAWC refused to agree to any third party audit to verify the refunds that IAWC made were adequate. Ms. Niemiec maintains that, in Docket 05-0681, Homer Glen presented residents who testified as to their treatment by IAWC. According to Ms. Niemiec, the Commission Staff testified in Docket 05-0681 that IAWC had no records concerning the maintenance of critical valves in Homer Glen.

Ms. Niemiec notes Joint Applicants' evidence indicating that, as a result of the transaction, American Water, the parent of IAWC "will be better positioned to focus on maintaining, developing and growing the water and wastewater business of its subsidiaries, including IAWC." Ms. Niemiec states that, based on past performance, she is dubious about this statement since IAWC also states that it is not changing the local management of the company. Ms. Niemiec notes Joint Applicants' evidence that, as to the transaction that is the subject of this docket, the "amount of any such savings cannot be quantified." Ms. Niemiec asserts that, if IAWC contends the transaction will benefit customers, IAWC should agree as part of this docket to pass the savings onto customers and to lower rates reflecting the benefits that IAWC contends will result from the transaction. Ms. Niemiec also testified that she is not offering an opinion as to whether the transaction should or should not be approved.

Ms. Niemiec recommended that, if the ICC approves the transaction, the Commission should:

1. Require IAWC to file a plan with the ICC and the Village setting a schedule and milestones for IAWC to reduce its water rates so that the rates are within the mid-range of water rates for privately owned water utilities.
2. Require IAWC to conduct an independent third party audit of its billing practices and programs and to refund with interest all overcharges uncovered as a result of the audit.

3. Require IAWC to file a plan with the ICC and the Village setting a schedule and milestones for IAWC to reduce the “unaccounted for” water component of its purchased water.
4. Require IAWC to give the Village the option to purchase the portion of IAWC’s system in the Village if IAWC is unable to reduce its water rates as set out in No. 1 above within the next two (2) years and/or reduce its “unaccounted for” water to less than 5 percent within two (2) years.

Ms. Niemiec also asserts that Homer Glen, along with three neighboring communities, has retained experts to value the portion of the IAWC system in Homer Glen and those communities. According to Ms. Niemiec, under recent legislation, Homer Glen, as well as other communities, has the opportunity to acquire the system from IAWC through condemnation and the Village is seriously considering that option.

B. Champaign

Champaign’s witness, Mr. Berg, stated that IAWC, through it and its predecessor entities, has been providing water to the City of Champaign since 1884 when the City Council signed a 30-year franchise agreement with Union Water Supply Company. Mr. Berg stated that Champaign’s primary interest in this proceeding is not in who owns the water company.

According to Mr. Berg, for many years, predecessors to IAWC did an admirable job of providing quality water to the residents of Champaign. Mr. Berg asserted, however, that, after RWE acquired IAWC, the Company went through a significant reorganization, apparently to reduce costs. Mr. Berg suggested that a number of employees did not retain their jobs. As a result, Mr. Berg stated that there was a deterioration of the quality of service provided in Champaign.

Mr. Berg asserted that, in the summer of 2005, Champaign experienced five boil orders as the result of significant drops in pressure in the water system. Mr. Berg noted that those boil orders are the subject of a complaint filed by Champaign at the ICC in Docket 05-0599. According to Mr. Berg, Champaign has not received information that makes it believe that IAWC has corrected the issues that caused those boil orders. Mr. Berg noted, however, that IAWC operates portable generators 24 hours a day, 7 days a week to guard against further electric pump outages which could lead to a drop in water pressure and another boil order.

Mr. Berg indicated that, in November 2005, the Champaign Fire Department responded to a fire and found that it could not remove the caps on the two fire hydrants nearest to the fire. Mr. Berg states that, while the two hydrants in the November 2005 fire have been repaired, Champaign has not received documentation that fire hydrants are being properly maintained.

Mr. Berg stated that, during the period after the last reorganization, the Champaign District was without a general manager. Also, according to Mr. Berg, during that time, a water tower was out of service for maintenance for almost 18 months. Even though IAWC had the tower out of service, Mr. Berg states that IAWC did not service a valve associated with the

tower. Mr. Berg further maintains that IAWC has not complied with a provision of the Franchise Agreement that requires IAWC to provide the Champaign Fire Department with information concerning the inspection and repair of fire hydrants.

Mr. Berg also notes that, for 2005 and 2006, IAWC gave the City a copy of its capital projects for the year as required by the Franchise Agreement, but that the list was delivered late in each year. Mr. Berg notes that IAWC has advised that, to provide additional water supply for the future, IAWC has designed and is ready to build a new water treatment plant in the Champaign District. According to Mr. Berg, IAWC has refused to provide the details or the planning criteria to Champaign concerning this plant.

Mr. Berg notes Joint Applicants' testimony that the reorganization will not adversely impact the ability of the Company to adequately provide capital to properly maintain and operate the system. According to Mr. Berg, Champaign has not been able to verify IAWC's statements. Mr. Berg also notes Joint Applicants' testimony that IAWC does not expect to see savings as a result of the Proposed Transaction, and that IAWC will continue to apply the present rates until revised rates are approved. Mr. Berg states that this statement is not encouraging that the Proposed Transaction will not have an adverse rate impact.

Mr. Berg also suggests that Champaign's rates are impacted by the amount of lost water on the system. According to Mr. Berg, citizens are paying excess rates in order to produce and pump water that benefits no one. Mr. Berg asserts that Champaign has not seen any action by IAWC that indicates it is performing the type of maintenance necessary to reduce lost water.

Mr. Berg recommends the following conditions in any approval of the reorganization:

1. Require Illinois-American Water to file and implement a plan with the Commission and the City of Champaign setting a schedule and milestones for resolving all issues related to low pressure issues in the Champaign system.
2. Require Illinois-American Water to file and implement a plan with the Commission and the City of Champaign setting a schedule and milestones to provide detailed information related to the maintenance of the system as required to confirm the life safety and health aspects of the system operation.
3. Require Illinois-American Water to file and implement a plan with the Commission and the City of Champaign setting a schedule and milestones for assuring that unaccounted for water is not excessive and to correct any deficiencies.
4. Require Illinois-American Water to develop a capital investment plan for the Champaign system and to present the plan on an annual basis to the City for public review, comment and updating. The plan should include milestones that the Company must meet. This is necessary to ensure that IAWC is adequately investing in the system and maintaining the infrastructure.

5. Require Illinois-American Water to annually inspect the fire hydrants in Champaign and to conduct flow tests for each hydrant. The Company should be required to file with the City of Champaign the schedule for such inspections and testing and provide annually to the City of Champaign a written report containing the results of such inspection and testing along with a plan to correct defects found during such inspections and testing.

C. Urbana

According to Urbana's witness, Mr. Gray, IAWC, through it and its predecessor entities, has been providing water to the City of Urbana for over 100 years. Mr. Gray states that the City's approval or opposition to a change of ownership depends on how this transaction is structured and what the impact of the reorganization will be on City of Urbana residents. Mr. Gray states that the City believes that IAWC will raise rates for water in the near future.

Mr. Gray testifies that, for many years, IAWC did a good job of providing quality water to the residents of Urbana. Mr. Gray states that the City and IAWC enjoyed a good working relationship; there were no major problems. Mr. Gray maintains, however, that, after RWE acquired Illinois American Water, IAWC went through a significant reorganization, apparently to reduce costs and increase profitability. According to Mr. Gray, IAWC reduced its local staff. As a result, Mr. Gray maintains that Urbana saw a deterioration in the quality of service provided to our residents.

Mr. Gray states that, on October 25, 2005, the Urbana Fire Department responded to a vehicle/structure fire at 1105 N. Harvey Street, Urbana. Mr. Gray states that a firefighter was unable to open a hydrant while fighting a fire. Mr. Gray notes that IAWC requested the addresses of nonfunctioning fire hydrants. According to Mr. Gray, Urbana inspected 150 hydrants in a three (3) day canvass late this summer. According to Mr. Gray, the Urbana Fire Chief found one fire hydrant that failed to operate, sixteen (16) fire hydrant caps with missing gaskets, nine (9) fire hydrant caps with defective gaskets, eight (8) leaking fire hydrant and seven (7) fire hydrant found to have settled below minimum allowed heights. Mr. Gray asserts that IAWC refuses to provide fire hydrant inspection reports.

Mr. Gray notes IAWC's testimony that the Proposed Transaction will not adversely impact the ability of the Company to adequately provide capital to properly maintain and operate the system. Mr. Gray asserts that Urbana has not been able to verify IAWC's statements.

Mr. Gray states that Urbana is concerned that there appears to be an issue as to whether the Company has fully funded its pension liabilities. Mr. Gray also states that Urbana does not know what IAWC's future capital requirements are. According to Mr. Gray, the Company has not given Urbana any information as to its capital plans locally or on a statewide basis.

Mr. Gray notes Joint Applicants' testimony that IAWC does not expect to see any savings as a result of this reorganization and that the company will continue to use the same rates until revised rates are approved. Mr. Gray states that this statement is not encouraging that the Proposed Transaction will not have an adverse rate impact for the residents in Urbana.

Mr. Gray also states that Urbana has been told that IAWC plans to build a new water plant west of Urbana. According to Mr. Gray, the City has not been informed as to how this construction will affect rates and the City has not received any analysis from IAWC as to the need to build the facility or whether the size of the facility is appropriate.

Mr. Gray recommends that, if the Proposed Transaction is approved:

1. That IAWC be required to prepare and to present to Urbana, as well as other municipalities affected, the Company's capital improvements plan for an annual review by Urbana and other municipalities.
2. That IAWC be required to fully fund any pension plan liabilities from the proceeds of any IPO or other offering or proceeds received from the reorganization of the Company and that none of these costs be passed on to ratepayers.
3. Require IAWC to file and implement a plan with the Commission and the City of Urbana setting a schedule and milestones to provide detailed information related to the maintenance of the system as required to confirm the life safety and health aspects of the system operation.
4. Require IAWC to file and implement a plan with the Commission and the City of Urbana setting a schedule and milestones for assuring that unaccounted for water is not excessive and to correct any deficiencies.
5. Require IAWC to develop a capital investment plan for the Urbana system and to present the plan on an annual basis to the City for public review, comment and updating. The plan should include milestones that the Company must meet. This is necessary to ensure that IAWC is adequately investing in the system and maintaining the infrastructure.
6. Require IAWC to annually inspect the fire hydrants in Urbana and to conduct flow tests for each hydrant. The Company should be required to file with the City of Urbana the schedule for such inspections and testing and provide annually to the City of Urbana a written report containing the results of such inspection and testing along with a plan to correct defects found during such inspections and testing.

D. Initial Brief of the Municipalities

In a combined Initial Brief, Homer Glen, Champaign and Bolingbrook ("the Municipalities") assert that IAWC has not met its burden of proof with regard to the findings required by Sections 7-204(b)(1), (4) and (7). In support of their assertions, the Municipalities reference the testimony discussed by the witnesses who testified on behalf of each municipality, as summarized above in the applicable Section of this Order.

In their Initial Brief, the Municipalities also reference provisions of certain RWE Board Minutes for a meeting at which the Proposed Transaction was discussed. The Municipalities note that the Board Minutes refer to American Water's then-existing management.

V. INITIAL BRIEF OF BOLINGBROOK

In this proceeding, Bolingbrook did not sponsor the testimony of a witness. According to Bolingbrook, Illinois-American's access to capital markets increased as a result of the RWE acquisition. According to Bolingbrook, the record in this case clearly shows that RWE has been a good corporate parent and that Illinois ratepayers have benefited from RWE's ownership of IAWC. According to Bolingbrook, RWE has decided that American Water and IAWC are no longer core corporate holdings of RWE. Bolingbrook states that the immediate impact of the RWE divestiture announcement was a downgrading of AWCC's credit rating. Bolingbrook states that Joint Applicants ignore the fact that Illinois ratepayers have been damaged by RWE's implementation of its divestiture strategy.

According to Bolingbrook, under continued RWE ownership, RWE's changing corporate focus, if any, is unlikely to have any new negative effect on Illinois ratepayers. Bolingbrook notes that the Commission found in Docket 01-0832 that the RWE acquisition would enhance American Water's and Illinois-American's ability to raise capital and maintain a reasonable capital structure. Bolingbrook asserts that, if the Proposed Transaction is not approved, RWE would be legally obligated under the Public Utilities Act to provide sufficient support to Illinois-American to enable Illinois-American to continue to provide safe, reliable, adequate and efficient service. Bolingbrook further maintains that none of the purported benefit of the Proposed Transaction to Illinois ratepayers withstands scrutiny.

Based on the evidence submitted by the Municipalities, Bolingbrook asserts that the finding required by Section 704(b)(1) of the Act is not supported. Bolingbrook also asserts that Joint Applicants also have not supported the finding required under Section 7-204(b)(4). Bolingbrook further maintains that Joint Applicants have not shown that the proposed transaction is not likely to result in any adverse rate impact.

With regard to impairment of Illinois-American's ability to maintain a reasonable capital structure, Bolingbrook asserts that as a stand-alone company, American Water has been unable to maintain a reasonable capital structure. With regard to adverse future rate impact, Bolingbrook maintains that, if the proposed transaction is approved, ratepayers will lose the benefit of RWE's higher credit rating. Bolingbrook further asserts that, in the future, IAWC will propose and the Commission will allow recovery of ongoing Sarbanes-Oxley compliance costs in rates.

VI. JOINT APPLICANTS' RESPONSE

A. Response to Commission Staff

Joint Applicants are in agreement with the position of the Commission Staff that the Proposed Transaction should be approved, subject to two Conditions. As discussed above, Staff

witness Kight-Garlich testified that the language of Condition No. 4 of the Order in Docket 01-0832 should not be eliminated as Mr. Gloriod proposed in Direct Testimony, and should be adopted as a condition in this proceeding, with the modification described above. In Rebuttal Testimony, Mr. Gloriod indicated that Joint Applicants accept as a Condition in this proceeding, the language of modified Condition No. 4, as proposed by Ms. Kight-Garlich. In Surrebuttal Testimony, Ms. Wolf indicated that Joint Applicants accept the language of the Condition recommended by Ms. Kight-Garlich in her Rebuttal Testimony regarding RWE's commitment that the common equity ratio of American Water (not including equity-like securities) be at least 45% at the time of the IPO.

B. Response Regarding Service Matters Raised by the Municipalities

1. Homer Glen

In response to the testimony of Ms. Niemiec, Mr. Gloriod points out that Ms. Niemiec's allegations are unrelated to the Proposed Transaction. Mr. Gloriod also notes that IAWC and the AG have entered into a Stipulation in Docket 05-0681 ("Docket 05-0681 Stipulation"), which addresses issues raised by Ms. Niemiec (and resolves the AG's concerns related to the joint AG/Homer Glen witness' testimony). The Docket 05-0681 Stipulation was entered into the Docket 05-0681 record on March 14, 2007. In addition, in Docket 06-0196, all matters at issue, including the issues raised by the AG's and Homer Glen's joint witness, were resolved and a final order ("06-0196 Order") has been entered in that case. As Mr. Gloriod indicates, in the 06-0196 Order, the Commission noted IAWC's adoption of tariff maximums for unaccounted-for water ("UFW") in IAWC's service areas served by purchased water (Docket 06-0196 Order, p. 2). Mr. Gloriod notes that the Commission also adopted a recommendation that the Commission monitor IAWC's efforts to reduce UFW in conjunction with the UFW tariff filings under Section 8-306 of the Act (described in more detail below). (*Id.*) Thus, according to Joint Applicants, the issues raised by Ms. Niemiec have been addressed in these other proceedings.

As the record in this proceeding shows, IAWC demonstrated in Docket 05-0681 that many of Ms. Niemiec's concerns were baseless. The record in this proceeding also shows that, to the extent that customers in Homer Glen, or elsewhere, raised valid concerns, IAWC has taken appropriate steps. For example, Ms. Niemiec (HG Ex. 2.0, p. 2) refers to "improperly" back billed customers. As Mr. Gloriod indicates, however, no party in Docket 05-0681 identified a single IAWC customer who was improperly back billed. As IAWC's evidence in this proceeding and Docket 05-0681 shows, IAWC took proactive steps to address the possibility that improper back billing may have occurred (in connection with a meter exchange program) and provided credits to certain customers to ensure that no improper back billing occurred. Also, in the Docket 05-0681 Stipulation, IAWC agreed to retain an independent auditor to review IAWC's back bill audit and resulting credits.

Mr. Gloriod further notes that IAWC's position in the Docket 05-0681 proceeding is not affected by the Proposed Transaction. After the Proposed Transaction, IAWC will remain subject to the Commission's jurisdiction and the Commission's ability to enter appropriate orders in that proceeding is entirely unaffected by the Proposed Transaction.

Ms. Niemiec also repeats concerns expressed in Dockets 05-0681 and 06-0196 about levels of UFW in Homer Glen. As discussed above, the Docket 06-0196 Order resolved these concerns. In this proceeding, Mr. Gloriod explained in detail that the levels of UFW in Homer Glen are not excessive. As Mr. Gloriod indicates, UFW levels in the range of 15-20% are viewed as acceptable by the American Water Works Association (“AWWA”) and other regulatory authorities, and IAWC is already taking steps to address levels of UFW both system-wide and in Homer Glen. Thus, as Mr. Gloriod stated, there is no basis for Ms. Niemiec’s concern. Further, Joint Applicants state that Niemiec’s concern with regard to UFW is unrelated to the Proposed Transaction. Mr. Gloriod also points out that the desire of Homer Glen to acquire a part of IAWC’s system by condemnation also has no bearing on the Proposed Transaction.

2. Champaign

Mr. Gloriod notes that Mr. Berg provides no evidence showing that the allegations he raises are related to the Proposed Transaction. Mr. Berg states, at line 50 on page 3 of his Direct Testimony, that “Champaign’s primary interest is not in who owns the water company,” Mr. Gloriod notes that nothing in Mr. Berg’s testimony suggests that Proposed Transaction would not meet the approval standards under Section 7-204. Further, nothing related to the Proposed Transaction affects IAWC’s ability or need, if any, to respond to or address any of the issues raised by Mr. Berg.

As Mr. Gloriod points out, Mr. Berg’s allegations regarding service are also baseless. Mr. Berg alleges that following the purchase of AW by RWE, a significant reorganization of personnel caused jobs to be relocated and service to deteriorate in Champaign. As Mr. Gloriod explained, however, the total number of employees working in the Champaign District in 2004 was 67; currently IAWC employs 63 employees in the Champaign District and will add two more positions in 2007. This change in the number of employees in the Champaign District is unrelated to the ownership of IAWC’s parent. IAWC also has employees in other locations supporting the operations in the Champaign District that were not in place in 2004. Moreover, as Mr. Gloriod explains, the personnel reorganization that was done in 2004 was aimed at consolidating management into regions and did not impact field service personnel. As Mr. Gloriod indicates, there is no evidence (contrary to Mr. Berg’s allegations) that IAWC’s Champaign District was ever without adequate management staff.

Mr. Gloriod further notes that Mr. Berg’s allegations regarding boil orders have been raised in two other Commission proceedings, Docket 05-0681 and Docket 05-0599, and are being addressed in those proceedings. In particular, as Mr. Gloriod indicates, Docket 05-0599 is focused entirely on Champaign’s allegations regarding boil orders, and so there is no reason to address those issues in this case. Mr. Gloriod testified that the evidence in Docket 05-0599 will show that there is no ongoing problem with boil orders or system pressures in Champaign. During the summer of 2005, the Champaign West Water Treatment Plant experienced numerous power supply interruptions, which caused pressure drops in the system when electric motors dropped offline. Even though the pressure drops were of short duration, Mr. Gloriod stated that the IEPA determined that boil order regulations required that IAWC issue a boil order, which IAWC did. Mr. Gloriod stated that, after review of the system following these brief power

supply interruptions, IAWC made changes to its facilities and switched a portion of its pumping system to an internal power source powered by a diesel generator so as to insulate its system from the AmerenIP power supply. Since these changes were made, no boil orders have been issued in Champaign relating to power interruptions, despite the fact that some additional nineteen power supply interruptions have occurred.

Mr. Gloriod testified with regard to hydrant maintenance that, in 2006, all fire hydrants were inspected in the Champaign District and there is no evidence of any malfunctioning hydrants. Thus, to the extent that audits of hydrant inspections in the Champaign District by the Commission Staff in Docket 05-0681 showed that hydrants in the audit sample had not been inspected as required, IAWC has acted to correct this issue. According to Mr. Gloriod, IAWC will inspect fire hydrants in its Champaign District (and throughout Illinois) on an annual basis in accordance with Commission rules. In addition, in the Docket 05-0681 Stipulation, IAWC confirmed that it would conduct fire flow tests in the Champaign District within one year of an order being entered in that docket. Currently, the Champaign District enjoys the highest possible Insurance Services Offices (“ISO”) fire protection rating for its water system, so there are no fire safety issues. Mr. Gloriod stated that IAWC has complied with, and will continue to comply with, all applicable provisions of Champaign Franchise Agreement with regard to fire hydrants.

Mr. Gloriod noted that Mr. Berg’s assertion that IAWC has refused to provide details or planning criteria to Champaign concerning plans for the new water treatment plant are also incorrect. IAWC demonstrated, through a detailed summary of meeting dates with or correspondence provided to Champaign, which included information regarding the proposed treatment plant, that IAWC has provided Champaign with details and planning criteria regarding the new treatment plant.

With regard to the recommendation that IAWC develop a capital investment plan for Champaign, Mr. Berg does not provide any connection between this recommendation and the Proposed Transaction. Moreover, the terms of the Champaign Franchise Agreement provide: “the parties shall seek input from one another in the compilation of their respective five year capital improvement plans and in scheduling improvements”. Mr. Gloriod stated that, although capital planning information has been provided, to the extent that it was not provided in strict accordance with the timeframe specified in the Champaign Franchise Agreement, IAWC will provide capital planning information on a timely basis in the future.

3. Urbana

Mr. Gloriod notes that Mr. Gray provided no evidence showing that the allegations he raises with regard to service are related to the Proposed Transaction or supporting his contentions that the Proposed Transaction will result in a deterioration of IAWC’s service. Nothing in Mr. Gray’s testimony suggests that Proposed Transaction would not meet the approval standards under Section 7-204. Further, nothing related to the Proposed Transaction affects IAWC’s ability or need, if any, to respond to or address any of the issues raised by Mr. Gray.

With regard to Mr. Gray’s concern about staffing levels, Mr. Gloriod notes that, as discussed above, staffing levels in the Champaign District are consistent with 2004 levels, taking

into account the personnel reorganization that was done in 2004 and aimed at consolidating management into regions (but which did not impact field service personnel).

With regard to Mr. Gray's allegations about hydrant maintenance and inspections (Urbana Ex. 2.0, pp. 2-4), Mr. Gloriod explains that these allegations are unfounded. Urbana is part of IAWC's Champaign District. As Mr. Gloriod indicated, in 2006, all fire hydrants were inspected in the Champaign District system (which includes Urbana) and there is no evidence of any malfunctioning hydrants. According to Mr. Gloriod, IAWC will continue to inspect fire hydrants in its Champaign District (and throughout Illinois) on an annual basis in accordance with Commission rules. Mr. Gloriod stated that IAWC has complied with, and will continue to comply with, all provisions of the Urbana Franchise Agreement with regard to hydrants.

As Mr. Gloriod indicated, IAWC participated in the hydrant inspection described by Mr. Gray, and determined that all but one of the 150 hydrants were operational (the one remaining hydrant was being removed from service). Mr. Gloriod stated that IAWC promptly repairs any hydrants that it is notified by Urbana are defective. Furthermore, IAWC is not aware of any hydrant in Urbana that, at present, requires repair. Mr. Gloriod notes that, in the Docket 05-0681 Stipulation, IAWC has agreed to conduct specific fire flow tests for the Champaign District (which includes Urbana) within one year of an order being entered in that Docket. Mr. Gloriod also stated that IAWC provides regular hydrant reporting to Urbana in accordance with the Urbana Franchise Agreement.

Mr. Gloriod noted that Mr. Gray provides no evidence that UFW in Urbana is excessive. According to Mr. Gloriod, AW and IAWC are taking steps to address UFW in their operations, and the level of UFW recoverable in rates was addressed through the tariff filing made in accordance with Section 8-306 of the Act, capping UFW for IAWC's service areas. The above-described actions being taken generally by IAWC concerning UFW are equally applicable to Urbana.

C. Pension Funding

Ms. Wolf explained that Mr. Gray's position regarding pension funding is unsupported. Ms. Wolf points out that there are actuarially-determined minimum contribution amounts that a plan sponsor must make in order to comply with the Employee Retirement Income Security Act ("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, Ms. Wolf explains that AW did not neglect its pension funding obligations under RWE ownership. Because AW's pension funding was in strict accordance with applicable requirements, the funding status of the pension plan is unrelated to RWE's ownership of the AW or the Proposed Transaction.

According to Ms. Wolf, after the Proposed Transaction, AW will continue to fund its pension plan in accordance with applicable requirements. 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 any underfunded obligation. Ms. Wolf explained that the underlying theoretical intent of the new law is to achieve full funding, based on assets and obligations defined under PPA, in seven years. As a result, Ms. Wolf indicates that there is no concern with pension funding levels.

D. Rate Impact

Mr. Gloriod points out that Ms. Niemiec's proposal regarding IAWC's rates is unrelated to the Proposed Transaction. Further, as Mr. Gloriod indicates, there is no basis for the Commission to conclude based on the record in this proceeding that IAWC's rates are inappropriate. The rates that Ms. Niemiec complains of were approved in Docket 02-0690, a rate proceeding in which all of the procedures and ratemaking principles established by Illinois law were applied. Joint Applicants note that, under Illinois law, rates set by the Commission must produce revenues sufficient to cover the utility's operating expenses and provide a reasonable return on the utility's investment in property devoted to the provision of utility service. *Illinois Bell Tel. Co. v. Illinois Commerce Comm'n*, 414 Ill. 275, 286 (1953); *Business & Prof. People for the Pub. Interest v. Illinois Commerce Comm'n*, 146 Ill. 2d 175, 195-96 (1991). Joint Applicants note that Ms. Niemiec provides no evidence with regard to IAWC's operating expenses, rate base, rate of return, or any component of IAWC's revenue requirement, and, therefore, does not demonstrate that IAWC's rates for water or sewer service are excessive, unjust, or unreasonable.

With respect to the allegations of Mr. Berg and Mr. Gray, Mr. Gloriod points out that there is again no correlation between the Proposed Transaction and IAWC's rates. No costs of the Proposed Transaction will be passed to ratepayers, and if any savings result they will accrue to the benefit of the ratepayer. Mr. Gloriod notes that, Mr. Berg's assertion that, because there are no savings from the Proposed Transaction, the Proposed Transaction will have an adverse impact on rates is unsupported by evidence or logic.

With regard to the new water plant which Urbana says will impact rates, Mr. Gloriod explains that any rate impacts of a new water treatment plant or other capital improvements are not related to the Proposed Transaction, and would be subjected to the scrutiny of the Commission in a rate proceeding.

E. Buyout Option

Joint Applicants note that IAWC has no interest in selling a portion of its system to Homer Glen. Furthermore, Joint Applicants point out that an option to purchase is a valuable property right, and a grant by the Commission of such a property right would be inappropriate and contrary to law. U.S. Const. Am. V (nor shall private property be taken for public use without just compensation).

F. Response to Initial Briefs of Municipalities and Bolingbrook

According to Joint Applicants, Bolingbrook's argument in its Initial Brief that the Proposed Transaction would impair IAWC's ability to attract capital and harm ratepayers is

based on the premise that IAWC would benefit from future ownership by RWE because RWE has a higher credit rating than American Water and, in the past, has provided capital to AW (and thus to IAWC). However, Joint Applicants have demonstrated in this proceeding that RWE is not expected to be a future source of capital for AW or IAWC (after the completion of the equity infusion as part of RWE's commitment that AW's equity ratio will be at least 45% at the time of the IPO). Joint Applicants note that no witness has offered any evidence that RWE would continue to be a source of capital for AW, with or without the closing of the Proposed Transaction.

As Joint Applicants point out, Bolingbrook seeks to compare the future condition of AW without RWE ownership to the past condition of AW with RWE ownership. Joint Applicants note that such a comparison is not relevant under the standards of Section 7-204 of the Act. As Joint Applicants indicate, undisputed evidence shows that circumstances have changed and that there is no scenario, with or without the Proposed Transaction, in which RWE is expected to be a future source of capital for AW.

Bolingbrook asserts that RWE's decision to sell American Water has already "damaged" Illinois ratepayers. As Joint Applicants indicate, this argument is based on the premise, discussed above, that American Water can continue to benefit under RWE ownership (essentially, that, somehow, AW can go back to being a core holding of RWE if the Proposed Transaction is not completed). Joint Applicants note that this premise is unsupported.

Bolingbrook argues that RWE's change in focus will not impact Illinois ratepayers because RWE must comply with the Act and will be obligated under the Act to provide support to IAWC. As Joint Applicants indicate, however, RWE is not a public utility under the Act and RWE is not obligated under the Act to invest in the common stock or debt securities of AW and/or IAWC in the future (whether or not the Proposed Transaction closes).

In support of its position that the Proposed Transaction does not meet the requirements of Section 7-204(b)(1) of the Act, Bolingbrook adopts the position taken by the Municipalities. As discussed above, Joint Applicants have responded to the Municipalities on this issue. Joint Applicants note Bolingbrook's assertion that RWE has been a "good corporate parent," and that IAWC's ratepayers have benefited from RWE ownership. As Joint Applicants point out, Bolingbrook asserts in one portion of its brief that RWE ownership has been beneficial for IAWC and, in connection with Section 7-204(b)(1), asserts the opposite.

Bolingbrook also makes reference to IAWC's projected capital expenditures in the next five years, and states that, if earnings do not cover those expenditures, "even more funds from the capital markets will be required." As Joint Applicants point out, however, IAWC's capital needs are a reason why the Proposed Transaction should be approved, so that IAWC can access the public capital markets in the U.S. rather than facing restricted capital access as non-core holding of RWE.

Regarding Section 7-204(b)(7), Bolingbrook argues that ongoing Sarbanes-Oxley costs will be passed to IAWC's customers as a result of the Proposed Transaction. Joint Applicants proposed, however, that the Commission should rule in this case that "Joint Applicants do not

seek recovery in rates of the costs associated with the Proposed Transaction; accordingly, the costs of the Proposed Transaction are not recoverable in rates.” To the extent that IAWC seeks to recover costs unrelated to the Proposed Transaction in a future rate case, Joint Applicants note that such recovery will be subject to Commission approval and IAWC will be required to support cost recovery under established ratemaking principles.

With regard to the RWE Supervisory Board Minutes (the “Minutes”) referenced by the Municipalities, Joint Applicants note that the Municipalities reference selected passages of the Minutes at which the Proposed Transaction was discussed. The Municipalities, however, disregard other portions of the Minutes which reflect discussions that are inconsistent with the Municipalities’ position. Joint Applicants also note that the Municipalities’ discussion of the Board Minutes mischaracterizes the record.

Joint Applicants point out that, in ignoring RWE’s changed focus, the Municipalities adopt the same false premise as Bolingbrook does, namely that IAWC’s cost of capital will increase because AW’s credit rating is lower than RWE’s. As discussed above, Joint Applicants have shown that RWE is not expected to be a future source of capital for AW.

The Municipalities’ Initial Brief references various service-related allegations discussed above that were raised in their respective witnesses’ testimonies. As Joint Applicants indicate, the Municipalities establish no connection between the service matters they allege and the Proposed Transaction, and do not demonstrate that the Proposed Transaction would diminish IAWC’s ability to provide adequate, reliable, efficient, safe and least-cost public utility service. Joint Applicants also note that each of the service-related allegations of the Municipalities is either baseless or resolved.

The Municipalities assert that the Proposed Transaction will increase rates. Joint Applicants have demonstrated, however, that the Proposed Transaction will not result in adverse rate impacts. Joint Applicants also note that the Municipalities have not demonstrated any adverse rate impact that would result from the Proposed Transaction.

With regard to savings, Joint Applicants point out that they have agreed that the Commission should rule that any savings reflected in the test years in future rate cases should be allocated in full to customers. The Municipalities also stated that no accounts to track and capture any savings have been proposed. In this regard, Joint Applicants note that no witness proposed establishing such accounts and that none is appropriate.

Joint Applicants point out that the proposed conditions of the Municipalities are unrelated to the Proposed Transaction. Joint Applicants maintain that each of these conditions are either based on concerns that have been resolved, or are the subject of existing franchise agreements, existing Commission rules and requirements, or other proceedings.

VII. COMMISSION CONCLUSION

As a result of the Proposed Transaction, American Water would become the largest publicly-traded water company in the U.S. As such, American Water, through American Water

Works Service Company, Inc. ("Service Company"), should be able to apply extensive resources and expertise in support of its subsidiaries, including IAWC. As the evidence shows, no material change in American Water's operations as they relate to IAWC should result from the Proposed Transaction and the Proposed Transaction should not adversely impact IAWC's provision of service and will produce benefits for IAWC's customers. The record shows that the Proposed Transaction will provide American Water with direct access to the public equity and debt capital markets in the U.S., maintaining American Water's ability to finance investments in the infrastructure of its subsidiaries, including IAWC. The evidence also shows that the Proposed Transaction should not impair the ability of American Water or IAWC to raise necessary capital on reasonable terms. In fact, 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.

Joint Applicants have demonstrated that the Proposed Transaction meets the requirements of Section 7-204 of the Act. Joint Applicants have shown that AW will be financially sound following the Proposed Transaction and IAWC will be able to continue to attract capital on reasonable terms and maintain a reasonable capital structure. Joint Applicants have also shown that the Proposed Transaction will not diminish IAWC's ability to provide adequate, reliable, efficient, safe and least-cost public utility service, and that the Proposed Transaction will not have an adverse impact on rates.

The Staff testified that the findings required by Section 7-204(b) are supported by the evidence, and Staff recommends that the Proposed Transaction be approved, subject to two Conditions accepted by Joint Applicants which will be discussed. Furthermore, Joint Applicants have entered into the Stipulations with the UWUA and the AG, under which concerns of those parties have been resolved. The Commission finds, for the reasons given by Joint Applicants, that the Stipulations are supported by the evidence, in the public interest and should be approved.

The allegations made by each of the Municipalities with regard to IAWC's level of service have no connection to the Proposed Transaction. The evidence also shows that the issues raised by Homer Glen with regard to Docket 05-0681 and Docket 06-0196 are addressed in those respective dockets, and are not related to the Proposed Transaction. These parties present no evidence showing that IAWC's ability to provide service would be adversely affected by the Proposed Transaction. The evidence presented by Joint Applicants shows that AW and IAWC have addressed the allegations of these parties where appropriate. Each of the Municipalities also make allegations regarding the impact of the Proposed Transaction on IAWC's rates. However, none of the Municipalities present evidence showing that rates will be adversely affected by the Proposed Transaction. The Commission also notes that there is no basis to believe, as Urbana suggests, that AW's pension plan is underfunded. Because Joint Applicants have shown that the Proposed Transaction meets the requirements of Section 7-204, the Proposed Transaction should be approved. For the reasons given by Joint Applicants, the recommendations and positions of Homer Glen, Champaign, Urbana and Bolingbrook are rejected.

Staff witness Kight-Garlich recommends that the Commission adopt as a Condition in this proceeding the language of Condition No. 4 from the Order in Docket 01-0832, with a modification. As proposed by Ms. Kight-Garlich, the Condition is as follows:

IAWC shall inform the Commission of any changes to the corporate credit ratings of AWCC by filing a copy of the complete credit report, within 15 days of publication, with the Chief Clerk of the Commission with a second copy provided to the Finance Department Manager. In addition, the reporting requirement shall be extended to American Water should Moody's Investors Service, Standard & Poor's, or Fitch Ratings rate its indebtedness or overall creditworthiness.

Staff witness Ms. Kight-Garlich also proposed as a second Condition the following:

[American Water's] common equity ratio shall be at least 45% at the time of the IPO. The calculation of the common equity ratio shall not include equity like financial instruments.

Joint Applicants accepted the two Conditions proposed by Staff witness Kight-Garlich, and the Commission finds that the two Conditions are reasonable and should be approved. As proposed by the Joint Applicants, Conditions 2, 3, and 4 of the Order in Docket 01-0832 are eliminated.

Under section 7-204(c), Staff proposed the following findings:

Joint Applicants do not anticipate that any savings will result from the proposed reorganization; accordingly, any savings that may occur in future rate case test years shall be allocated entirely to customers"; and,

Joint Applicants do not seek recovery in rates of the costs associated with the Proposed Transaction; accordingly, the costs of the Proposed Transaction are not recoverable in rates.

According to Joint Applicants, the costs of the Proposed Transaction include, "the SEC registration fee, the NASD filing fee, the stock exchange listing fee, legal fees and expenses of the Proposed Transaction, accounting fees and, expenses of the Proposed Transaction, printing and engraving fees and expenses for the registration statement, Blue Sky fees and expenses, transfer agent fees and expenses, and legal fees for the state regulatory approval process." Joint Applicants accepted the findings recommended by Staff, and the Commission concludes that the proposed findings under Section 7-204(c) should be adopted. Based on the evidence presented by Joint Applicants and Staff, the Commission further finds that, following the Proposed Transaction, the capital structure of IAWC will be consistent with the provisions of Section 6-103 of the Act.

VIII. FINDINGS AND ORDERING PARAGRAPHS

Having considered the entire record herein and being fully advised in the premises, the Commission is of the opinion and finds that:

- (1) IAWC is engaged in the business of providing water and/or sanitary sewer services to the public in the State of Illinois and, as such, is a public utility within the meaning of Section 3-105 of the Act;
- (2) the Commission has jurisdiction over IAWC and the subject matter herein;
- (3) the recitals of fact and conclusions reached in the Commission Conclusion Section (Section VII) of this Order are supported by the evidence of record and are hereby adopted as findings of fact;
- (4) the evidence of record demonstrates that the Proposed Transaction is in the public interest and is not detrimental to the interests of IAWC's customers;
- (5) pursuant to Section 7-204(b) of the Act, and based on application of the 2007 Conditions:
 - (A) the Proposed Transaction will not diminish the ability of IAWC to provide adequate, reliable, efficient, safe, and least-cost public utility service;
 - (B) the Proposed Transaction will not result in the unjustified subsidization of non-utility activities by IAWC or its customers;
 - (C) costs and facilities will be fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by IAWC for ratemaking purposes;
 - (D) the Proposed Transaction will not impair the ability of IAWC to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
 - (E) IAWC will remain subject to all applicable laws, regulations, rules, decisions, and policies governing the regulation of Illinois public utilities;
 - (F) the Proposed Transaction is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and
 - (G) the Proposed Transaction is not likely to result in any adverse rate impacts on IAWC's retail customers;

(6) the Verified Application for approval of the Proposed Transaction should be approved, subject to the two Conditions proposed by Staff and stated in the Commission Conclusion Section (Section VII) above;

(7) any savings that may occur from the Proposed Transaction in future rate case test years shall be allocated entirely to ratepayers; and the costs of the Proposed Transaction as detailed in the Commission Conclusion Section (Section VII) above are not recoverable in rates;

(8) Conditions 2 and 3, as stated in the Order in Docket 01-0832, are no longer applicable, and Condition 4 stated in the Order in Docket 01-0832 should be adopted as a condition in this proceeding as modified by Staff and stated in the Commission Conclusion Section (Section VII) above;

(9) the terms of Stipulation Exhibits A and B, as detailed above, are supported by the record, in the public interest and should be approved;

(10) the capitalization of IAWC will be unchanged as a result of the Proposed Transaction and, as a result, the capitalization of IAWC will be consistent with the provisions of Section 6-103 of the Act;

(11) all objections, motions, and petitions in this proceeding that have not specifically been ruled on should be disposed of in a manner consistent with the findings and conclusions herein.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the Proposed Transaction described herein, subject to the two Conditions referenced in Findings (6) and (8), should be, and hereby is, approved.

IT IS FURTHER ORDERED that Conditions 2, 3 and 4 as stated in the Order issued by the Commission in Docket 01-0832, are no longer applicable.

IT IS FURTHER ORDERED THAT the terms of Stipulation Exhibit A and Stipulation Exhibit B, as detailed above, are hereby adopted and approved.

IT IS FURTHER ORDERED that any objections, motions, or petitions in this proceeding that have not specifically been ruled on shall be disposed of in a manner consistent with the findings and conclusions herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.800, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this _____ day of _____, 2007.