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	
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.	**06-0336**

POST-EXCEPTIONS PROPOSED ORDER

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INTRODUCTION

On April 21, 2006, Illinois-American Water Company ("IAWC" or "Illinois-American"), American Water Works Company, Inc. ("AWW" or "American Water"), Thames Water Aqua US Holdings, Inc. ("TWAUSHI") and Thames Water Aqua Holdings GmbH ("Thames GmbH") (collectively the "Joint Applicants" or "Applicants") filed with the Illinois Commerce Commission (the "Commission") their verified Joint Application for Approval of Proposed Reorganization (the "Application") pursuant to Section 7-204 of the Public Utilities Act[1] (the "Act").

The Office of the Attorney General (the "AG"), Village of Homer Glen ("Homer Glen"), City of Champaign ("Champaign"), Village of Bolingbrook ("Bolingbrook"), City of Urbana ("Urbana"), Utility Workers Union of America, AFL-CIO, and Local Unions 640, 500 and 405 (collectively the "UWUA") all intervened in this matter. The Staff of the Commission ("Staff") participated as well. Both the AG and the UWUA separately entered into stipulations with the Joint Applicants, which resolved their respective issues as discussed *infra*.

A trial was held on the remaining issues on March 6, 2007. Joint Applicants, Homer Glen, Champaign, Urbana, Bolingbrook and Staff appeared and were

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[1] 220 ILCS 5/7-204; *see generally* 220 ILCS 5/1-101 *et seq.*

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-Garlisch 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. No witness testified on behalf of Bolingbrook.[2]

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[3], 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 Aktiengesellschaft ("RWE") is a corporation organized and existing under the laws of the Federal Republic of Germany. Its 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, including IAWC, that provide quality water and wastewater services to millions of customers in the

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[2] Bolingbrook proffered testimony of Mr. Michael Drey. Upon the pre-trial motion of the Joint Applicants, it was found to be inadmissible. Bolingbrook did not, in any manner, offer additional testimony.

[3] *See* 220 ILCS 5/3-105.

United States and three Canadian Provinces. From 1947 until January 2003, American Water was a publicly-traded company with its shares listed on the New York Stock Exchange.

THE PROPOSED TRANSACTION

The reorganization at issue in this proceeding (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 the Joint Applicants, RWE has no intention of permitting any person to acquire a controlling interest in American Water through the Proposed Transaction, consistent with Section 7-204 of the Act.

Following the Proposed Transaction, as a publicly-traded company, American Water will become subject to other requirements of the federal securities laws and regulations, as well as the requirements of the stock exchange where American Water's common shares will be listed. 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 audited. American Water will comply with the requirements of the Sarbanes-Oxley Act relating to, *inter alia*, internal controls over financial reporting and external audit of such controls, corporate officer certification of financial and other information, corporate governance requirements, and disclosure of certain financial information.

THE LEGAL STANDARD GOVERNING APPROVAL

Section 7-204 of the Act governs the analysis for the instant Application. Sub-section (b) requires the following findings:

(1) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;

(2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;

(3) 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;

(4) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

(5) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;

(6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;

(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.[4]

In addition, the Commission must rule on:

> (i) the allocation of any savings resulting from the proposed reorganization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.[5]

STATUTORY ANALYSIS

Champaign, Urbana, Homer Glen, and Bolingbrook collectively argue that the Joint Applicants do not satisfy the demands of Sections 7-204(b)(1), 7-204(b)(4), and 7-204(b)(7) of the Act, and therefore that the transaction should not be approved. Champaign, Urbana, and Homer Glen collectively argue in the alternative that, if approval is granted, it should be conditioned upon certain terms that they advance and which are detailed *infra*.

The four municipalities, however, failed to attribute their arguments to any of the sections of the statute they allege have not been met by the Joint Applicants. While this Order assigns their arguments for discussion under the best of the three statutory provisions at issue, any alternate classifications and any further arguments arising thereunder are waived.

Staff, the AG, and the UWUA all assert that the Proposed Transaction should be approved with conditions. As such, they are not asserting that the Joint Applicants have failed to meet the statutory requirements. This position generally applies to each of the

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[4] 220 ILCS 5/7-204(b).

[5] 220 ILCS 5/7-204(c).

statutory requirements in this section of the Order. Their proposed conditions are discussed *infra*.

SECTION 7-204(B)(1)

Position of the Joint Applicants

Joint Applicants' witness 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 the largest publicly-traded company in the United States that is focused on the water and wastewater business.

As such, the Joint Applicants assert that American Water will be able to apply extensive resources and expertise in support of its subsidiaries, including IAWC. They state that American Water will be able to provide benefits to IAWC in the form of technical and 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 Joint Applicants contend that the Proposed Transaction will not diminish the provision of those services to IAWC, nor will it 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. To the extent that the Municipalities assert certain problems, IAWC maintains that they have been resolved.

Position of the Municipalities

Champaign complains that it experienced five boil orders during the summer of 2005 due to drops in pressure in IAWC's system. While IAWC maintains that the boil orders arose from interruptions in the supply of electricity to it, Champaign argues that IAWC's solution of maintaining a diesel generator is not least-cost. Champaign witness Burg testified that the boil orders are the subject matter of a complaint filed with the Commission in Docket 05-0599.

Champaign also alleges an incident in which it had difficulty utilizing two fire hydrants. Urbana similarly alleges one incident concerning a fire hydrant that was difficult to open, and further alleges that a recent audit revealed that 41 of 150 fire hydrants needed maintenance. Both Champaign and Urbana argue that IAWC fails to abide by its franchise agreement with each City.

Homer Glen states that, in Commission Dockets 05-0681/06-0094/06-0095 (cons.) and 06-0196, it complained about IAWC's alleged failure to inspect hydrants and valves, as well as the rates and billing practices of IAWC.

Bolingbrook did not advance an argument particular to this section.

Commission Conclusion

Section 7-204(b)(1) requires that "the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service."[6] The Joint Applicants established a *prima facie* case that they meet the requirements of Section 7-204(b)(1). Neither the structure of the Proposed Transaction nor the forward-looking status of IAWC foreshadow a decline in its ability to provide adequate, reliable, efficient, safe and least-cost service at issue in this subsection. None of the allegations advanced by the municipalities establish that Joint Applicants failed to meet the requirements of Section 7-204(b)(1).

Homer Glen's complaints have been addressed in the final Orders entered in the two proceedings referenced above. As such, the determinations in those proceedings, including any remedies, extinguished those issues; they are not outstanding problems that establish an issue under Subsection (b)(1). Furthermore, Homer Glen's evidence in the instant proceeding consists of testimony in this case as to the subject matter of testimony in the two prior cases for the purpose of establishing the problems alleged therein. The instant testimony is hearsay. Although it is in evidence due to the lack of any objection, having been included within an exhibit that was admitted, the hearsay is awarded zero weight.

Urbana alleges that one fire hydrant was difficult to open during an incident on October 25, 2005, and that several hydrants needed repair in 2006. In the 2006 hydrant inspection, all but one of the 150 hydrants were operational, and the remaining hydrant was being removed from service. IAWC states that it promptly repairs any hydrants when notified of the defects by the City, and Urbana witness Gray did not refute that the problems identified in the inspection were remedied. Furthermore, Urbana's position vis-à-vis the requirements of Section 7-204(b)(1) is limited in that it references both administrative rules and its franchise agreement with IAWC, yet it apparently has never sought enforcement for the underlying issue. If there indeed was or is a systematic problem with their hydrants, it is mystifying that Urbana would identify various bases for relief but pursue none of them. Champaign similarly contends that, on one occasion in November, 2005, it experienced difficulty opening two hydrants. Champaign states that the two hydrants have been repaired.

The boil orders are at issue in Docket 05-0599, which is still pending; any remedy as to either the boil orders or the diesel generation is left to that Docket. In any event, it appears from the minimal evidence in the instant case that the boil orders were issued due to changes in system pressure following fluctuations in electricity supplied to IAWC's Champaign West Water Treatment Plant, and that the diesel generation mitigates the possibility of losing system pressure in this manner. Furthermore, the boil

[6] 220 ILCS 5/7-204(b)(1).

orders are limited to the summer of 2005, and apparently are not an ongoing problem. Therefore, while we reach no determination as to any issue being litigated in Docket 05-0599, the boil orders and diesel generation do not signify a failure to meet the requirements of Section 7-204(b)(1).

SECTIONS 7-204(B)(2) AND (B)(3)

Position of Joint Applicants

Joint Applicants assert that 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, Mr. Gloriod states that 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 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 re-approval 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.

Commission Conclusion

In the absence of any contested issue, the Commission concurs that the Joint Applicants have met the requirements of Section 7-204(b)(2) and Section 7-204(b)(3) of the Act.

SECTION 7-204(B)(4)

Position of Joint Applicants

Joint Applicants' witness 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. Ms. Wolf states that RWE has revised its core business focus to be on the European power and energy markets, where its roots lie. RWE's ability to maintain its competitiveness in its core European businesses is proving more capital intensive than predicted when RWE 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 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. For the future, under continuing RWE ownership, American Water's operations and access to capital may become increasingly restricted due to the changed focus of RWE. Should that occur, continued RWE ownership may lessen IAWC's future ability to provide cost-effective service.

Ms. Wolf explains that, as a publicly-traded company, American Water will not have to compete for RWE's capital and the substantial capital requirements related to restructuring of the European energy markets. American Water and its subsidiaries, however, are required to replace aging infrastructure and comply with water quality standards. Joint Applicants contend that, 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.

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). Combined borrowing power increases the efficiencies of borrowing operations and lowers transaction costs. This allows IAWC to benefit from the economies of scale associated with system-wide debt financing and decreased administrative costs. 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, Joint Applicants state that there will be no material changes in American Water's revenues or expenses. American Water's balance sheet will remain solid. American Water will have, at a minimum, 45% common equity at the time of the IPO. American Water will continue its commitment to invest the necessary capital to properly maintain IAWC's operations.

Ms. Wolf notes that AWW's credit rating is currently "A-." Ms. Wolf testified that, after the Proposed Transaction, AWW'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 AWW 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 already has infused $1.194 billion of common equity capital (in addition to its initial common equity investment in AWW).

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. As Ms. Wolf explained, 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 financial ratios. 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).

Position of the Municipalities

The four Municipalities charge that the Joint Applicants touted the enhanced ability to raise capital as a main reason to approve the purchase of American Water by RWE in Docket 01-0832. They contend that RWE's change in focus is little more than an attempt to sell the water unit to avoid a large and growing capital requirement to maintain aging infrastructure, which will in turn drain RWE's capital. Bolingbrook points out that AWW, on a national level, must fund more in capital projects in the next five years than it did in the previous ten. Poor management and low profits in the United States, they allege, contributed to RWE's desire to cast off a weak performer.

The Municipalities argue that AWW and IAWC benefited from the "A" credit rating of RWE, which allowed for the issuance of capital at a lower cost due to RWE's comparative financial strength. Prior to the acquisition by RWE, AWW maintained an "A-" rating, and this additional risk translated into marginally higher capital costs. The announcement of RWE's change in focus and the Proposed Transaction, they note, already led to higher capital costs and a downgrade in AWW's credit rating to "A-." The Municipalities argue that, during its ownership, RWE provided for AWW's capital needs. The detrimental effect of the transaction forecast, they argue, can be avoided by requiring RWE to continue to maintain ownership.

The four Municipalities also argue that the proposed condition requiring notice within 30 days if the equity ratio falls outside 40-50% lacks any teeth. After the Proposed Transaction closes, the Municipalities fear that the capital structure will become burdened with debt and that the costs of capital will rise as a result. They contend that AWW historically had an equity ratio below that range.

Commission Conclusion

Section 7-204 requires that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure."[7] As a preliminary matter, there is no disagreement that American Water will be considered investment grade after the Proposed Transaction.

The argument raised by the Municipalities is that RWE issuances are rated "A" while American Water issuances are rated "A-." The Municipalities contend that grade "A" issuances have a lower cost than "A-" issuances do, all other things equal. There is no substantial argument against that general principle. The question instead is whether, and how, it applies to the instant situation.

The Joint Applicants assert that RWE has announced a shift in its business focus away from the water business. RWE already has sold other water businesses it previously owned. The Joint Applicants further contend, and Ms. Wolf so testified, that capital which formerly flowed from RWE in previous years is less likely to be available in the future. The Commission finds little reason to doubt this assessment, and, by downgrading AWW to "A-," rating agencies signaled a similar belief in the substance of the position advocated by Joint Applicants.

The relevant inquiry for the purpose of comparing costs of capital, therefore, is the existing "A-" rating for AWW today and the forecast "A-" for AWW after the Proposed Transaction. Given that there is no difference in the ratings between now and after the Proposed Transaction, there is no basis to conclude that ratepayers will face higher capital costs due to the transaction. Also, a rating of "A-" is considered to be investment grade. In the absence of additional evidence, there also is not a basis to conclude that the utility's ability to raise necessary capital on reasonable terms will become impaired by the Proposed Transaction.

Although the Municipalities argue that RWE responsibly provided the necessary capital to IAWC in the past, there is no guarantee that they will continue to do so in the event that the Proposed Transaction is denied and IAWC continues to be an unwanted subsidiary. Furthermore, the grade "A" rating of RWE is irrelevant if it ultimately is not available to IAWC, as the evidence in this matter suggests and as the market as a whole apparently believes.

The last issue for this subsection concerns whether the reorganized utility will maintain a reasonable capital structure. The record reflects commitments by Joint Applicants that American Water's equity ratio will be at least 45% at the time of the IPO; that IAWC's equity ratio will be within the range of 40-50% for a period of at least three years from the date of this Order; and that IAWC will notify the Commission within 30 days of any deviations from this range. The Municipalities complain that the

[7] 220 ILCS 5/7-204(b)(4).

commitments of the Joint Applicants are illusory. We do not agree. The commitments that the Joint Applicants accepted during the course of this proceeding are reflected in this Order. The Conditions attached to the approval of the Proposed Transaction in this Order are subject to enforcement under the Act, as are any terms in any Order issued by the Commission. Furthermore, when the capital structure of IAWC is at issue in future rate cases, it still must be reasonable within the meaning of Section 9-201 of the Act.[8]

In light of the foregoing, the Commission does not find a failure by the Joint Applicants to meet the requirements of Section 7-204(b)(4) of the Act.

SECTION 7-204(B)(5)

Position of Joint Applicants

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 concurs that the Proposed Transaction meets 7-204(b)(5), and no party has asserted otherwise.

Commission Conclusion

In the absence of any contested issue, the Commission concurs that the Joint Applicants have met the requirements of Section 7-204(b)(5) of the Act.

SECTION 7-204(B)(6)

Position of Joint Applicants

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

Commission Conclusion

In the absence of any contested issue, the Commission concurs that the Joint Applicants have met the requirements of Section 7-204(b)(6) of the Act.

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[8] 220 ILCS 5/9-201 *et seq*. (requiring the utility to establish the justness and reasonableness of each component recovered in rates).

SECTION 7-204(B)(7)

Position of Joint Applicants

The Joint Applicants assert that the Proposed Transaction will not adversely impact IAWC's rates. Mr. Gloriod testified that Joint Applicants will not seek recovery in rates of the 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.

The Joint Applicants reply to Urbana that their pension plan is ERISA-compliant. They argue that, "per the law, the plan is sufficiently funded."[9] As such, they contend that the pension funding does not pose any adverse rate impact. They also aver that pension funding needs are unrelated to the Proposed Transaction, and that any condition requiring that the proceeds from the IPO to be used to fund the pension would be a taking without just compensation.

Position of the Municipalities

The Municipalities complain that there will be an increase in rates following the Proposed Transaction, and that any savings as a result of the transaction are not tracked. The Municipalities assert that, if the Proposed Transaction is so beneficial, the Joint Applicants should commit to no increase in rates for a period after it closes. Instead, they already have planned to file in late 2007 for a rate increase.

The Municipalities also assert that the costs associated with adequate investment in AWW's infrastructure are very large. They further allege that Staff failed to identify savings, to propose an accounting system to track savings, or to consider the timing of the next rate case. The Municipalities additionally suggest that the Joint Applicants' witnesses profit from the transaction, so their testimony should be discounted.

Bolingbrook adds that the Proposed Transaction will result in ongoing Sarbanes-Oxley costs. Bolingbrook contends that such costs are an adverse rate effect within the meaning of Section 7-204(b)(7), and, as such, the entire transaction should be rejected.

Urbana additionally asserts that IAWC's pension plan is not fully funded, and urges that any approval be conditioned upon full funding of pension liabilities. Urbana asserts that unfunded liabilities that were allowed to accrue during RWE's ultimate

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[9] IAWC ex. 2.0R-rev at 10 (Wolf); Jt. App's Init. Br. at 10.

ownership should not be passed on to ratepayers. Instead, they should be funded from the proceeds of the Initial Public Offering or other offering, or otherwise from the reorganization of the Joint Applicants, prior to the distribution of those proceeds to RWE shareholders.

Staff Position

Staff responds that several of the arguments advanced by the Municipalities rely on a misinterpretation of the requirements of Section 7-204(b)(7). It notes that the realization of savings or benefits is not a criteria of Section 7-204, and therefore the absence of such savings or other benefits, in itself, is not an adverse impact within the meaning of the instant subsection. Staff also notes that the Municipalities' argument that there is no account to track savings is inconsistent with the structure mandated by the Uniform System of Accounts, with which the Joint Applicants must comply. Instead, Staff explains that "savings" are realized as lower costs in the next rate case, because the revenue requirement calculated in such rate case incorporates costs and a return on investment. Staff notes that the Joint Applicants did not seek recovery of the costs of the Proposed Transaction. Finally, Staff states that there is nothing in Section 7-204(b)(7) that precludes a utility from requesting a rate increase following approval of a proposed reorganization.

Commission Conclusion

Section 7-204(b)(7) requires that "the proposed reorganization is not likely to result in any adverse rate impacts on retail customers."[10] The Joint Applicants state that they will not seek to recover the costs of the Proposed Transaction from ratepayers. Furthermore, the status of IAWC as a subsidiary of AWW will not change as a result of the Proposed Transaction.

We concur with Staff that Section 7-204(b)(7) requires that no adverse rate impacts, i.e., costs or other externalities, be imposed on ratepayers, and that this is not the same as requiring that demonstrable benefits be traceable to the reorganization. Staff correctly points out that, if such benefits do accrue from the transaction, they will be realized through lower costs in the test year of the next rate case, and not an ongoing cash account mechanism.

Furthermore, IAWC's stated intention to file a rate case later in 2007 is not evidence of an adverse rate impact within the meaning of this subsection. The utility will have to establish its costs in that case. It already has stated that the costs of the Proposed Transaction will be excluded. Furthermore, the previous rate case was filed in 2002, so existing rates already have been in effect for several years.

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[10] 220 ILCS 5/7-204(b)(7).

The Municipalities assert that the witnesses for the Joint Applicants are not credible because they will profit if the Proposed Transaction is approved. It is true that they will receive bonuses that are contingent upon the approval of the reorganization and upon their continued work for the reorganized entity. All of the witnesses in this case, however, had a financial or professional interest in testifying. In short, testifying in this matter was a duty related to their respective jobs; we therefore decline the argument of the Municipalities.

Bolingbrook alleges that compliance with the Sarbanes-Oxley Act will impose new costs if the reorganization is approved, and that such costs constitute an adverse rate impact. They do not. Whether such costs are recovered at all is a matter for a future rate case, and therefore they are not properly attributed to the proposed reorganization itself. By extension, the Sarbanes-Oxley costs do not fall within the scope of Section 7-204(b)(7).

Finally, Urbana asserts that the pension liabilities should be fully funded before the proceeds of the reorganization are distributed to RWE's shareholders. The Joint Applicants contend that they have complied with the requirements of ERISA, and that contention is supported by the testimony of Ms. Wolf. They explain that American Water, the pension plan sponsor, has maintained a consistent funding policy since before the acquisition by RWE and this policy requires that the minimum funding requirements of ERISA be met. Joint Applicants also note that the cost of funding the pension plan is an ongoing utility operating expense that is unaffected by the Proposed Transaction, and therefore is unrelated to Section 7-204(b)(7) of the Act. We therefore accept the Joint Applicants' assertion that pension liability was not sufficiently connected as an adverse rate impact to the Proposed Transaction, and the condition proposed by Urbana on this point will not be adopted.

SECTION 7-204(C)

Position of Joint Applicants

Joint Applicants state that they do not seek to recover in rates the costs of the Proposed Transaction, including 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. 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 they do not expect savings to result in Illinois from the Proposed Transaction, Joint Applicants recommend that the Commission rule that any such savings reflected in the test years in future rate cases should be allocated in full to customers.

Commission Conclusion

In the absence of any contested issue, the Commission concurs that the costs of the Proposed Transaction are not recoverable in rates, and that, to the extent that the

Proposed Transaction results in any savings in the test year of future rate cases, such savings shall be allocated in full to customers.

COMMISSION CONCLUSION ON SECTION 7-204 REQUIREMENTS

The Joint Applicants have established, as a general matter, that the Proposed Transaction should be approved, subject to any conditions which may be imposed. The proposed conditions are discussed in the remainder of this Order.

CONDITIONS PROPOSED BY THE PARTIES

Conditions proposed by the parties are labeled with letters for purpose of discussion. The Conditions adopted in this matter are enumerated in the Ordering Paragraphs.

CONDITIONS IMPOSED IN DOCKET 01-0832

In Docket 01-0832, the Commission approved the acquisition of American Water by Thames GmbH, subject to certain conditions, including the following: (Condition 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 (Condition 3) "Commission approval consistent with Section 7-204 of the Act must be sought for any additional changes to the corporate structure involving IAWC."[11] The Joint Applicants assert that these Conditions should be eliminated. Upon the closing of the transaction at issue, neither American Water nor TWAUSHI will remain subsidiaries of RWE, and any continuing requirement that IAWC seek approval for a "reorganization" would be imposed by Section 7-204 of the Act, and not by the Order in Docket 01-0832. No party objected to the elimination of these conditions.

Also, as Condition (4) of the Order in 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. Staff's proposal to update this condition was agreed to by Joint Applicants and is set forth below. Accordingly, the agreed, updated condition will be imposed in this Order and supersedes Condition 4 in Docket 01-0832.

CONDITIONS RECOMMENDED BY STAFF

Staff did not enter into a stipulation with the Joint Applicants, but recommends that the transaction be approved subject to two conditions. The Joint Applicants have stated they agree with the two conditions proposed by Staff.

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[11] Order, 01-0832, at 19.

S-A. AWW'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 instruments.[12]

S-B. 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.[13]

STIPULATIONS

UWUA-Joint Applicants

The UWUA and the Joint Applicants reached a stipulation which settled any and all issues which the UWUA would have raised. The UWUA support approval of the Application subject to four conditions; they did not present any evidence or otherwise participate in the trial. The terms of the stipulation are:

UW-A. For a period of three years from the date of this Order (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.

UW-B. AWW 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

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[12] Equity-like financial instruments possess features of both debt and common equity. There is no standard definition for equity-like instruments or a standardized methodology for rating agencies to determine the amount of debt or common equity a financial instrument is assigned. Rating agencies determine the amount of debt and common equity credit assigned on an individual security basis. The percentage of common equity assigned by rating agencies for a particular security is subjective and can change over time. Furthermore the percentage of common equity assigned can vary among rating agencies. For example, a hybrid security could receive 75% common equity treatment and 25% debt treatment from S&P this year, but only receive 50% common equity treatment and 50% debt treatment a year from now. In addition, an issuance could receive 75% common equity treatment and 25% debt treatment from S&P but only 50% common equity treatment and 50% debt treatment from Moody's. Therefore, no portion of an equity-like instrument should be included when calculating the common equity ratio.

[13] This condition updates and supersedes Condition 4 in Docket 01-0832.

requirements during RWE's ownership if it should be determined that any such violation has occurred. Neither AWW nor IAWC is aware of, nor do they believe that, any such violation has occurred.

UW-C. 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 the number of individuals employed by IAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis).

UW-D. 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.

AG-Applicants

The AG and the Joint Applicants reached a stipulation which settled the issues that the AG raised.[14] The AG supports approval of the Application subject to the terms of the instant stipulation; she did not present any evidence or otherwise participate in the trial. The terms of the stipulation are:

AG-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.

AG-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.

AG-C. IAWC will provide safe, adequate, and reliable service in fulfillment of its obligations under Illinois and federal law.

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[14] The municipalities of Champaign, Urbana, and Homer Glen refer to this stipulation as "non-unanimous." (Reply Br. at 5.) By failing to raise the substantive issues themselves, however, Champaign, Urbana, and Homer Glen waived them.

AG-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.

AG-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.

AG-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.[15]

AG-G. For three years following the date of this 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.

AG-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 rate cases.

AG-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.[16]

AG-J. AWW will not issue any debt that pledges as security or otherwise encumbers the assets of IAWC.

AG-K. The payment for AWW stock will not be recorded on IAWC's books.

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[15] Pub. L. No. 107-204, 116 Stat. 745, also known as the Public Company Accounting Reform and Investor Protection Act of 2002 ("Sarbanes-Oxley").

[16] Condition AG-I mirrors condition S-B. Both S-B and AG-I will ultimately be adopted as Condition 2.

AG-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.

AG-M. AWW or IAWC will file the following reports with the Commission or provide relevant Securities and Exchange Commission website where such reports are available: AWW's quarterly interim reports to its shareholders; AWW's annual report to its shareholders; and AWW's and IAWC's annual audit reports.

AG-N. IAWC customers will experience no material adverse change in utility service due to the Proposed Transaction.

AG-O. AWW 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.

AG-P. RWE has made a commitment that AWW'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 AWW. If any additional equity is needed to achieve a common equity ratio for AWW of at least 45% at the time of the IPO, the required infusion into AWW will be provided prior to the IPO. The calculation of the common equity ratio will not include equity-like financial instruments. AWW will file a balance sheet as of the quarter ended immediately preceding the IPO.[17]

CONTESTED CONDITIONS PROPOSED BY THE MUNICIPALITIES

Having rejected the contention of the municipal intervenors that approval of the Proposed Transaction should be denied, the remaining question is which, if any, of the contested conditions should be approved. To the extent that particular arguments underlying these proposed conditions were offered, they are discussed in the Statutory Analysis portion of this Order and will not be repeated here.

Bolingbrook

Bolingbrook did not advance any such conditions.

[17] Portions of condition AG-P are similar to condition S-A. The two conditions are not identical, however.

Champaign

Champaign requests the following conditions be attached to any approval of the Proposed Transaction:

MC-A. Require IAWC 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.

MC-B. Require IAWC 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.

MC-C. Require IAWC 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.

MC-D. Require IAWC 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.

MC-E. Require IAWC to annual 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.

Urbana

For Urbana the requested conditions are:

MU-A. Require IAWC 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.

MU-B. Require IAWC 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.

MU-C. 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.

MU-D. 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.

MU-E. 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.

MU-F. 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.

Homer Glen

For Homer Glen, the conditions requested are:

MHG-A. Require IAWC to file a plan with the Commission 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, not the highest in the state.

MHG-B. 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.

MHG-C. Require IAWC to file a plan with the Commission and the Village setting a schedule and milestones for IAWC to reduce the unaccounted-for water component of its purchased water.

MHG-D. Require IAWC to give the Village the option to purchase the portion of IAWC's system in the Village to 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 per cent within two (2) years.

Commission Conclusion

This section of the Order implements the conclusions reached *supra* as applied to the contested conditions. Discussion of the arguments is not repeated here.

Unaccounted-for Water

The issue of unaccounted-for water levels has been resolved with the tariff filing made pursuant to recent legislation.[18] The tariff renders moot Proposed Conditions MC-C, MU-D, and MHG-C.

Fire Hydrant Inspections

This issue already was adjudicated, and the relief granted, in a separate proceeding.[19] Therefore, the issue, including any enforcement, will be left to that Docket. Accordingly, Proposed Conditions MC-E and MU-F are denied.

Maintenance and Capital Investment Plans

The evidence indicates that these plans are the subject matter of certain terms in the Franchise Agreements between IAWC and Champaign and Urbana respectively. It is not clear to what degree the two Municipalities sought to enforce these terms of their Franchise Agreements. It is clear, however, that the evidence in the instant case does not support the imposition of these conditions. Therefore, Proposed Conditions MC-B, MC-D, MU-A, MU-C, and MU-E are all denied without prejudice, provided, however, that Urbana lacks standing to enforce the rights of "other municipalities affected" as stated in Proposed Condition MU-A.

Pension Liability

As discussed under Section 7-204(b)(7) *supra*, Proposed Condition MU-B is not adopted.

Champaign Pressure

This issue is being litigated in pending Docket 05-0599. It therefore is inappropriate to grant the relief requested in this Docket, and, in any event, the evidence in the instant Docket would not support the imposition of this condition. Proposed Condition MC-A therefore is denied without prejudice.

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[18] P.A. 94-0950. On February 7, 2007, the Commission allowed IAWC's tariff to take effect.

[19] *See* Order (April 18, 2007), 05-0681/06-0094/06-0095 (cons.), at 20. ("We order IAWC to complete hydrant testing, valve testing and fire flow tests or the substitute ISO test described above and maintenance inspection for all of the Chicago Metro and Champaign areas within one year of the final order in this case. The Company will file a report on e-Docket within sixty (60) days of completing the inspection, detailing the inspection, identifying the individual hydrants inspected by number, maintenance performed, problems found, and any corrective action performed. The report will also include all information required under Section 600.140(c) (i.e., date of installation, size, make and model (if known), location, number and history of maintenance where applicable).")

Homer Glen Rates and Audits

This issue already was adjudicated, and the relief granted in part and denied in part.[20] It therefore is not appropriate to impose Proposed Conditions MHG-A and MHG-B in the instant Docket, and they are denied.

Homer Glen Purchase Option

The Commission concurs with the Joint Applicants that an option to purchase is a valuable property right. Homer Glen failed to state any basis in Illinois law that would entitle it to such relief. As such, Proposed Condition MHG-D will not be adopted in this proceeding.

FINDINGS AND ORDERING PARAGRAPHS

Joint Applicants have demonstrated that the Proposed Transaction meets the requirements of Section 7-204 of the Act. Joint Applicants have shown that AWW 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.

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 sewerage 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 the parties and the subject matter herein;

(3) pursuant to Section 7-204(b) of the Act, and based on the application of the 21 Conditions adopted herein:

(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;

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[20] *See* Order (April 18, 2007), 05-0681/06-0094/ 06-0095 (Cons.), at 27-28, 45-46, 49.

(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;

(4) 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 above are not recoverable in rates;

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

(6) the Proposed Transaction therefore is not contrary to the public interest and is not detrimental to the interests of IAWC's customers;

(7) approval of the Proposed Transaction should be granted, subject to the 21 Conditions as set forth and enumerated below; (said conditions are identified for discussion in the prefatory portion of this Order as S-A and S-B; UW-A through UW-D; and AG-A through AG-P); and

(8) Conditions 2, 3, and 4 imposed in the Order in Docket 01-0832 are superseded by the terms of this Order.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the Proposed Transaction described herein is approved, subject to the following 21 Conditions:

Condition 1. The common equity ratio of American Water Works Company, Inc. ("AWW") shall be at least 45% at the time of the initial public offering (IPO). The calculation of the common equity ratio shall not include equity-like instruments.

Condition 2. Illinois-American Water Company ("IAWC") shall inform the Commission of any changes to the corporate credit ratings of American Water Capital Corporation ("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.

Condition 3. 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.

Condition 4. 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.

Condition 5. IAWC will provide safe, adequate, and reliable service in fulfillment of its obligations under Illinois and federal law.

Condition 6. 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.

Condition 7. 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.

Condition 8. 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.

Condition 9. For three years following the date of this 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.

Condition 10. 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 rate cases.

Condition 11. AWW will not issue any debt that pledges as security or otherwise encumbers the assets of IAWC.

Condition 12. The payment for AWW stock will not be recorded on IAWC's books.

Condition 13. 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.

Condition 14. AWW or IAWC will file the following reports with the Commission or provide relevant Securities and Exchange Commission website where such reports are available: AWW's quarterly interim reports to its shareholders; AWW's annual report to its shareholders; and AWW's and IAWC's annual audit reports.

Condition 15. IAWC customers will experience no material adverse change in utility service due to the Proposed Transaction.

Condition 16. AWW 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.

Condition 17. RWE has made a commitment that AWW'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 AWW. If any additional equity is needed to achieve a common equity ratio for AWW of at least 45% at the time of the IPO, the required infusion into AWW will be provided prior to the IPO. The calculation of the common equity ratio will not include equity-like financial instruments. AWW will file a balance sheet as of the quarter ended immediately preceding the IPO.

Condition 18. For a period of three years from the date of this Order (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.

Condition 19. AWW 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 AWW nor IAWC is aware of, nor do they believe that, any such violation has occurred.

Condition 20. 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 the number of individuals employed by IAWC on January 1, 2007 (excluding those employees hired on a temporary or limited duration basis).

Condition 21. 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.

IT IS FURTHER ORDERED that Conditions 2, 3, and 4 as stated in the Order entered by the Commission in Docket 01-0832 are superseded by the terms of this Order.

IT IS FURTHER ORDERED that, in the event of a conflict between this Order and the Stipulation filed by Illinois American Water Company and the Office of the Illinois Attorney General, this Order shall control.

IT IS FURTHER ORDERED that, in the event of a conflict between this Order and the Stipulation filed by Illinois American Water Company and the Utility Workers Union of America, this Order shall control.

IT IS FURTHER ORDERED that this Order is public, and not confidential, in nature.

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.

DATED: June 15, 2007

Ian Brodsky,
Administrative Law Judge