ILLINOIS COMMERCE COMMISSION

DOCKET NO. 07-0371

IAWC EXHIBIT NO. MJH-1.0

DIRECT TESTIMONY OF MICHAEL J. HOFFMAN

ILLINOIS-AMERICAN WATER COMPANY

Q. Please state your name and business address.

A. Michael J. Hoffman, 727 Craig Road, Saint Louis, Missouri 63141.

Q. By whom are you employed and in what capacity?

A. I am employed by American Water Works Service Company ("Service Company") as a Finance Manager. The Service Company is a subsidiary of American Water Works Company, Inc. ("AWW") that provides shared services to American's water utility subsidiaries.

Q. What is your educational background?

A. I graduated from the University of Illinois with a Bachelor of Science degree in Accounting in 1995. I passed the CPA exam in 1995 and the Series 62 exam in 1995.

Q. Please describe your business experience.

A. From 1995 to 1997, I worked for Goldman, Sachs & Co. as a financial analyst in the Investment Banking Division where I worked on various financings and mergers and acquisitions. From 1997 to 1998, I worked as an associate for a private equity fund called Charterhouse Group International where I worked with several portfolio companies and provided expertise related to financings and acquisitions. From 1998 to 2002, I worked for Interliant, Inc. and its successors in jobs ranging from Director of Mergers and Acquisitions, where I completed various acquisitions, to Vice President of Web Hosting, where I had operational and profit/loss responsibility for a $25 million

business unit. From 2002 to 2004, I consulted various organizations on operational efficiency matters. From 2004 to present, I have worked with the Service Company.

Q. What are your job responsibilities?

A. My responsibilities as Finance Manager involve providing the following services to American's water utility subsidiaries in the Central Region, including Illinois-American Water Company, Inc. ("IAWC" or "Company"):

- Leading the preparation of capital requirements budgets and analyses;
- Preparing financial analysis of proposed acquisitions and expansion of service territory, including the preparation of applicable regulatory commission filings;
- Providing support for the preparation and presentation of all rate increase applications and supporting documents and exhibits as prescribed by regulatory commission requirements;
- Providing support for preparation of rate analyses and studies to evaluate the effect of proposed rates on the revenues, rate of return and tariff structures;
- Providing support for the implementation of rate orders, including development of the revised tariff pricing necessary to produce the proposed revenue level; and
- Providing support for the preparation of revenue budgets and analyses.

Q. Have you testified before any regulatory agencies with respect to accounting and other matters?

A. Yes. I have testified before this Commission, the Public Utilities Commission of Ohio, and the Indiana Utility Regulatory Commission.

Q. Are you generally familiar with the financial condition, business, and properties of IAWC?

A. Yes, I am.

Q. Please describe the business of IAWC.

A. The Company is a corporation organized and existing under and by virtue of the laws of the State of Illinois with its principal office in the City of Belleville, Illinois. 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 districts. IAWC's districts include Alton, Cairo, Champaign, Chicago Metro, Interurban, Lincoln, Pekin, Peoria, Pontiac, South Beloit, Sterling, and Streator. Overall, IAWC serves approximately 302,000 customers in 129 communities in Illinois. IAWC is a wholly-owned subsidiary of AWW, a holding company that owns the stock of water and sewer utility subsidiaries operating in 23 states. The principal office of AWW is in Voorhees, New Jersey. AWW is a wholly-owned subsidiary of RWE AG ("RWE"). RWE is a publicly-traded German holding company operating within the global utilities market.

Q. Is the relationship with RWE expected to change?

A. Yes. In November, 2005, RWE announced plans to divest AWW. In March, 2006, RWE announced that the divestiture would be accomplished through an initial public offering ("IPO") in the United States for the shares of AWW. The IPO will result in AWW again being a publicly-traded company.

Requested Relief

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to discuss IAWC's financing program for 2007 through 2009 (the "Financing Program"), which includes the issuance of up to $28,500,000 in long-term debt primarily to finance a portion of the capital costs of a new surface water treatment facility planned for the Champaign District (the "Champaign Plant"). The balance of the approximately $51,000,000 total cost of the Champaign Plant will be funded through receipt of additional paid-in capital from the Company's parent, AWW.

Q. Are you familiar with the Petition filed by IAWC in this proceeding?

A. Yes, I am.

Q. What authorizations does IAWC seek in this proceeding?

A. In the Petition, IAWC seeks approval of the Commission under Sections 6-102, 7-101 and 7-102 of the Illinois Public Utilities Act (the "Act") to issue and sell or incur in one or more transactions indebtedness in the form of (i) promissory notes ("Notes") issued to its affiliate American Water Capital Corporation ("AWCC") pursuant to the approval for such transactions given by the Commission in the Order entered May 16, 2000 in Docket 00-0306 and reaffirmed in Docket 04-0582 and/or (ii) one or more series of General

Mortgage Bonds ("Taxable Bonds") and/or (iii) loan obligations to one or more governmental bodies or political subdivisions of the State of Illinois ("Governmental Issuer") in connection with the issuance by the Governmental Issuer of one or more series of tax-exempt bonds ("Tax-Exempt Bonds") and/or (iv) one or more borrowings from the State of Illinois Public Water Supply Loan Program ("Revolving Fund Loans") created under the Illinois Environmental Protection Act (415 ILCS 5/19/1 et seq.) and pursuant to the rules and regulations thereunder (the "Revolving Fund Program"). The Revolving Fund Loans, together with the Notes, Taxable Bonds, and Tax-Exempt Bonds, are referred to collectively as the "New Indebtedness."

The Company provides that the aggregate amount of New Indebtedness issued under the authority sought herein will not exceed $28,500,000 outstanding at any time and that immediately following each issuance approved herein, the Company's ratio of common equity to total capitalization shall be not less than 40%.

The Financing Program

Q. Please describe IAWC's proposed Financing Program.

A. As noted above, IAWC is seeking authority to issue up to $28,500,000 in one or more issuances of New Indebtedness during the period 2007 through 2009. The purposes of the proposed issuances are (i) reimbursement to the Company for expenditures made for construction or improvements of or additions to its facilities in the Champaign district, (ii) to refinance short-term debt incurred to temporarily fund construction expenditures expected to be incurred for the construction or improvements of or additions to its

facilities needed to provide adequate and reliable water service, including the new Champaign Plant, and (iii) for other corporate purposes, including paying the debt issuance expenses associated with the proposed New Indebtedness.

Q. Please explain in more detail how expenditures made for construction, improvements, or additions to its facilities in the Champaign district will impact the Financing Program.

A. The primary driver of expenditures in the Champaign district is the Champaign Plant. As discussed in the direct testimony of Company witness Barry Suits, this is a significant construction program that will require the investment of approximately $51,000,000. Construction of the Champaign Plant will begin in 2007 and is scheduled to be completed in late 2008. Although short-term debt will be issued periodically to finance construction during this period, short-term debt is a temporary source of capital and must be refinanced. To permanently finance the Champaign Plant, including pre-construction costs and other purposes as described above, the Company plans to issue up to $28,500,000 of long-term debt and receive up to $22,500,000 in additional paid-in capital during the period 2007 through 2009. Prior to the commencement of construction of the Champaign Plant, the Company believes that it should have in place the approvals necessary to permanently finance the costs of this project. Thus, in this proceeding, the Company is seeking an order granting approval for the New Indebtedness planned for the years 2007 through 2009.

Q. Does IAWC plan to use internally generated funds to finance any of the capital costs associated with the Champaign Plant?

A. To the extent internally generated funds are available to finance the capital costs associated with the Champaign Plant, IAWC will use those funds to offset the amount of New Indebtedness and additional paid-in capital that would otherwise have been required.

Q. Why is IAWC seeking approval to engage in a multi-year Financing Program?

A. The Company is seeking that approval to obtain the flexibility to respond to favorable capital market conditions when they arise, and to finance the capital expenditures for the Champaign Plant in an efficient and cost-effective manner. None of the New Indebtedness proposed in this proceeding will be issued after December 31, 2009. The precise timing of the issuances will depend on capital market conditions, as well as the timing of the capital expenditures during the construction of the Champaign Plant. The Company will have the flexibility to obtain the additional equity as needed through receipt of additional paid-in capital from AWW. The Company will not issue any new shares of IAWC common stock ("Common Stock").

Q. Will IAWC report to the Commission when it issues securities pursuant to the financing authority requested in this proceeding?

A. Yes. IAWC will file with the Commission a written report on the terms of each issue of New Indebtedness within thirty days after it occurs and thereafter as specified in 83 Ill. Adm. Code Section 240.

Q. Please discuss the various types of financing for which the Company is seeking approval in this proceeding.

A. The Company is seeking Commission approval to issue Notes, Taxable Bonds, Tax-Exempt Bonds, and/or enter into Revolving Fund Loans.

Q. How will the Company determine which of these options to use?

A. The Company will seek to match its financing needs with the types of financing that are available at the time and that will produce the lowest overall cost of debt available to IAWC.

Q. How will the terms be set for any Notes?

A. The Notes will be sold to AWCC pursuant to the Financial Services Agreement between IAWC and AWCC that has been reviewed and approved by the Illinois Commerce Commission. To give the Company flexibility to complete its Financing Program, it is seeking authority to issue Notes, as long as the interest rate, determined at the time of sale, does not exceed a rate equal to the then-current yield on 30-year U.S. Treasury Bonds ("U.S. Treasuries"), as published in the *Wall Street Journal*, plus 200 basis points.

Q. Please explain why using the yield on U.S. Treasuries as the base rate for the Notes is appropriate.

A. U. S. Treasury Bond yields are widely followed as a benchmark for many interest rate calculations and are most often used by the market to price utility bond offerings.

Q. What is the reason for the 200 basis point spread over the index?

A. The index is based on the highest available credit quality (AAA) of the U.S. government. Investors require a greater return on obligations of lesser credit quality and higher risk. Since IAWC is not rated (and its credit quality metrics are not in the AAA category), its securities will be priced at an interest rate in excess of U.S. Treasuries. I believe that the 200 basis point spread is sufficient to give the Company the needed flexibility to obtain financing and accommodate the spread on the return investors require for an unsecured note over that of a natural AAA offering. The Commission authorized a maximum rate for IAWC as 275 basis points over U.S. Treasuries in ICC Docket Nos. 06-0650 / 06-0651 (consolidated).

Q. What have been the rates for U.S. Treasuries over the past 12 months?

A. Examining the weekly-published rates over the June 2, 2006 to May 25, 2007 time period, the maximum rate was 5.25%, the minimum rate was 4.58%, and the average rate was 4.88%. Thus, using the 200 basis point cap, the highest rate at which the Notes would have been issued over that period is 7.25% (i.e. maximum rate of 5.25% plus 200 basis points or 2.00%).

Q. What have been the rates for U.S. Treasuries for the months of March, April, and May, 2007?

A. The weekly-published rates for those months can be seen in the following table:

March 2, 2007	4.67%	April 20, 2007	4.85%
March 9, 2007	4.66%	April 27, 2007	4.84%
March 16, 2007	4.69%	May 4, 2007	4.82%
March 23, 2007	4.74%	May 11, 2007	4.82%

March 30, 2007	4.82%	May 18, 2007	4.90%
April 6, 2007	4.87%	May 25, 2007	4.99%
April 13, 2007	4.92%		

Q. Why would the Company issue the Notes to AWCC rather than do a separate financing with an unrelated lender?

A. AWCC will fund the Notes to IAWC through long-term senior unsecured debt instruments ("AWCC Securities") issued in a public offering or private placement by AWCC. The AWCC Securities will not be issued to or guaranteed by any person that constitutes an "affiliated interest" of AWCC or IAWC. IAWC does not have as ready access to capital markets as does AWCC. In addition, the AWCC Securities will be issued in a transaction of a sufficient size to ensure that AWCC is able to obtain the most favorable market rate possible given the circumstances. IAWC expects that the interest rate or rates it will pay in connection with the Notes issued to AWCC, which are in turn funded by AWCC through the AWCC Securities, will be no greater, and may be lower, than it could obtain if it issued its own securities. Further, IAWC expects that the total transaction costs incurred by IAWC in a transaction through AWCC will be lower than the total transaction costs incurred by IAWC in a transaction where IAWC issued its own securities. IAWC will not issue Notes to AWCC unless it can determine that, based on market conditions applicable at the time, such issuance will result in the lowest overall cost available to IAWC for the securities of comparable type, maturity, and terms.

Q. How will interest rates be set for the Taxable Bonds.

A. The interest rate will be set at the time of issuance through negotiation with one or more underwriting firms (each an "Underwriter") and consistent with then-current market conditions. The interest rate on fixed-rate Taxable Bonds, determined at the time of sale, will not exceed a rate equal to the then-current yield on U.S. Treasuries, as published in the *Wall Street Journal*, plus 200 basis points.

Q. Please explain why using the yield on U.S. Treasuries as the base rate for the Taxable Bonds is appropriate.

A. As I explained with respect to the Notes above, the yields on U. S. Treasuries are widely followed as a benchmark for many interest rate calculations and are most often used by the market to price utility bond offerings.

Q. What is the reason for the 200 basis point spread over the yield on U.S. Treasuries?

A. The 200 basis point spread is required for the same reason as I mentioned above regarding the interest rates on the Notes.

Q. Will the Taxable Bonds be issued on an insured basis?

A. If IAWC can obtain a bond insurance policy (the "Policy") at a cost that will result in an all-in cost of debt on a series of bonds being less (taking into account the insurance premium) than the all-in cost of debt of such bonds without a Policy, then the Company will purchase such a Policy. The bond insurer may require the Company to enter into an Insurance Agreement providing for reimbursement to the insurer if the insurer pays on a claim under the Policy.

Q. How will the interest rate and other business terms be determined for the Tax-Exempt Bonds?

A. The Tax-Exempt Bonds would most likely be sold in a public offering pursuant to a contract of purchase among the Governmental Issuer, if applicable, one or more Underwriters, and IAWC. The Tax-Exempt Bonds will be secured through a Loan Agreement between IAWC and the Governmental Issuer and may also be secured by General Mortgage Bonds issued under IAWC's Indenture of Mortgage (the "Indenture"). The interest rate will be a fixed rate negotiated with the Underwriter, or floating rate determined in accordance with market conditions at the time of issuance. To give IAWC flexibility to implement its Financing Program, we are seeking authority to issue Tax-Exempt Bonds provided that the fixed interest rate, determined at the time of sale, does not exceed a rate equal to the most currently available Municipal Market Data ("MMD") Index, plus 100 basis points.

Q. Please describe the MMD Index and why it is relevant.

A. The MMD Index is a widely followed and generally recognized generic index used as a benchmark for rates on long-term tax-exempt bonds similar to the Tax-Exempt Bonds for which IAWC is seeking approval to issue in this proceeding. It is reflective of interest rates for AAA-rated municipal general obligation bonds, which are the highest quality debt a state can issue. There is a separate rate for bonds maturing in one year through bonds maturing in 30 years.

Q. What have been the rates for the MMD Index during the past 12 months?

A. The MMD Index is published every business day, Monday through Friday. Examining the daily-published 30-year MMD rates over the May 30, 2006 to May 30, 2007 time period, the maximum rate was 4.67%, the minimum rate was 3.89%, and the average rate was 4.21%. Thus, using the 100 basis point cap, the highest rate at which the Tax-Exempt Bonds would have been issued over that period is 5.67% (i.e. maximum rate of 4.67% plus 100 basis points or 1.00%).

Q. What have been the rates for the MMD for the month of May 2007?

A. Those rates for 30-year MMD can be seen in the following table:

May 1, 2007	4.10%	May 16, 2007	4.13%
May 2, 2007	4.10%	May 17, 2007	4.16%
May 3, 2007	4.12%	May 18, 2007	4.19%
May 4, 2007	4.09%	May 21, 2007	4.19%
May 7, 2007	4.09%	May 22, 2007	4.21%
May 8, 2007	4.26%	May 23, 2007	4.23%
May 9, 2007	4.10%	May 24, 2007	4.23%
May 10, 2007	4.10%	May 25, 2007	4.23%
May 11, 2007	4.10%	May 29, 2007	4.24%
May 14, 2007	4.12%	May 30, 2007	4.24%
May 15, 2007	4.13%		

Q. What is the reason for the 100 basis point spread over the index?

A. Similar to the use of U.S. Treasuries as a basis for the interest rate for the Notes and Taxable Bonds, the MMD index is based on AAA credit quality and thus the rate that IAWC could obtain would in all cases be higher than the index. This 100 basis point

spread will give IAWC flexibility to price its obligations to offer the spread on the return investors require for an insured tax-exempt bond over that of a natural AAA offering, and giving consideration to the alternative minimum tax imposed on corporate-backed tax-exempt bonds.

Q. Will the Tax-Exempt Bonds be issued on an insured basis?

A. If IAWC can obtain a Policy at a cost that will result in an all-in cost of debt on a series of bonds being less (taking into account the insurance premium) than the all-in cost of debt of such bonds without a Policy, then the Company will purchase such a Policy. The bond insurer may require the Company to enter into an Insurance Agreement providing for reimbursement to the insurer if the insurer pays on a claim under the Policy.

Q. Do you anticipate that Tax-Exempt Bonds will be available for all or a substantial portion of the New Indebtedness?

A. I do not anticipate that Tax-Exempt Bonds will be available for a substantial portion of the New Indebtedness. The amount of available Tax-Exempt Bonds is limited by federal tax law. The Champaign Plant is a project that would be eligible to use tax-exempt financing, but only a limited amount of bonds can be issued in the State for this and similar projects so the Company will have to secure “volume cap” for the project, which may not be available or only be available in a limited amount.

Q. Please discuss the Revolving Loan Program.

A. The Revolving Loan Program provides low interest loans to units of local government for the construction of community water supply facilities. This loan program is capitalized at

an annual amount of $30 - $40 million with federal and state funds. The loans are awarded with a maximum term of 20 years at one-half the market interest rate. These funds are awarded on a competitive basis with an annual pre-application deadline of March 31. Priority consideration is given to projects with compliance problems, financial hardship, and small community water supplies. The amount that is available to the Company under the Revolving Fund Program is limited and likely will not be sufficient for all our financing needs for the Champaign Plant and other projects.

Q. How will interest rates be set on the Revolving Fund Loans?

A. The interest rate on the Revolving Fund Loans, will be below market rates for securities of similar risk, as discussed above.

Q. Are you proposing an interest rate cap be imposed on any Revolving Fund Loans the Company obtains through the Revolving Loan Program?

A. No, I am not. As noted previously, the interest rate on Revolving Fund Loans will be lower than market rates for securities of similar risk, rendering a cap unnecessary.

Q. Are the maximum interest rates for the New Indebtedness determined as you describe above consistent with market conditions?

A. In my opinion, the maximum rates compare favorably with the rates for the new issues of the securities of the quality comparable to that of IAWC's debt while giving the Company the flexibility to respond to changing market conditions.

Q. Do you expect that the actual interest rate on the various series of the New Indebtedness to be less than the maximum permitted rate?

A. Yes, I do. Also, the Company will inform the Commission of the actual rates in its filings.

Q. Will the New Indebtedness be subject to redemption?

A. The Tax-Exempt Bonds and Taxable Bonds may be redeemable in whole or in part at the option of IAWC, with a pre-payment premium, if any, determined in accordance with market conditions at the time of issuance. Further, these bonds may be subject to mandatory sinking fund requirements. The Notes will be prepayable as provided in the Financial Services Agreement. The Revolving Fund Loans will be prepayable as allowed or required by the Revolving Fund Program.

Q. Will the Company issue Taxable Bonds, Tax-Exempt Bonds or Revolving Fund Loans to AWCC?

A. No.

Q. Please describe Exhibits 1.1 and 1.2 attached to your testimony.

A. Exhibit 1.1 shows the capital structure of the Company as of March 31, 2007, per books and pro forma, giving effect as of that date to both the issuance of $28,500,000 of New Indebtedness and additional paid-in capital of $22,500,000, and giving effect to the financings recently approved in ICC Docket Nos. 06-0650 / 06-0651 (consolidated). Exhibit 1.2 shows the Company's Long-Term Debt as of March 31, 2007.

Q. Why do you include pro forma information related to ICC Docket Nos. 06-0650 / 06-0651 (consolidated)?

A. The Order in ICC Docket Nos. 06-0650 / 06-0651 (consolidated) was issued in May 2007. Since the per books data in the exhibits attached to my testimony is actual unaudited data as of March 31, 2007, the per books data does not reflect the expected debt issuances authorized in ICC Docket Nos. 06-0650 / 06-0651 (consolidated). Thus, it is reasonable to include pro forma information related to the debt issuances approved in these dockets in the exhibits.

Q. Please describe Exhibits 1.3 and 1.4.

A. Exhibit 1.3 is a Balance Sheet as of March 31, 2007 and Exhibit 1.4 is a Statement of Income for the twelve months ended March 31, 2007. The data is shown per books and pro forma giving effect to the Financing Program in this proceeding, and the financings recently approved in ICC Docket Nos. 06-0650 / 06-0651 (consolidated).

Q. Please describe Exhibit 1.5.

A. Page 1 of Exhibit 1.5 provides narratives describing the adjustments in the adjustment column on the Statement of Income resulting from the financings approved in 06-0650/06-0651 (consolidated). Page 2 of this Exhibit provides narratives describing the adjustments in the adjustments column on the Statement of Income resulting from the Financing Program in this proceeding. Page 3 of this Exhibit provides narratives describing the adjustments recorded on the Statement of Income resulting from annualizing the increased Qualified Infrastructure Plant (QIP) revenue.

Q. Please describe Exhibit 1.6.

A. Exhibit 1.6 is a schedule that shows the estimated expenses of the financings. Page 1 shows the estimated expenses for the issuances approved in Docket Nos. 06-0650 / 06-0651 (consolidated) and page 2 shows the estimated expenses for the Financing Program.

Q. What is the total estimated cost the Company expects to incur in connection with the Financing Program?

A. As reflected on page 2 of Exhibit 1.6, the total cost is estimated to be $161,266. In connection with this Exhibit, I would note that the amount of the statutory issuance fee of $68,400 associated with the New Indebtedness was calculated pursuant to Sections 6-108 and 6-108(2) of the Act, on the maximum amount of the New Indebtedness ($28,500,000) to be issued pursuant to the Financing Program. No fee is due under Section 6-108 with respect to the $22,500,000 of additional paid-in capital.

Q. How does IAWC propose to treat, for purposes of its books of account, the expenses of approximately $161,266 expected to be incurred in connection with the Financing Program?

A. The Company proposes to treat the expenses of approximately $161,266 related to the issuance of the New Indebtedness as a deferred charge and amortize that deferred charge over the life of the New Indebtedness.

Q. Upon what basis does IAWC propose to issue the Tax-Exempt Bonds and/or Taxable Bonds?

A. The Company proposes to issue the Taxable Bonds and, if they are to be secured by the mortgage, the Tax-Exempt Bonds under the Indenture. IAWC must be in compliance with the terms of the Indenture and any Supplemental Indentures and receive authorization from the Board of Directors of IAWC and this Commission in order to issue additional bonds under the Indenture.

Q. What are the terms of the Indenture and the Supplemental Indentures with which IAWC must comply in order to issue additional bonds under the Indenture?

A. Under the terms of the Indenture, IAWC may issue additional bonds as long as all outstanding "Long Term Debt", including the bonds to be issued, does not exceed 65 percent of the "Total Capitalization" of IAWC, as those terms are therein defined (the "Total Capitalization Test"). Under the terms of certain Supplemental Indentures, IAWC may issue additional bonds as long as the before-tax income of IAWC covers aggregate annual interest charges on all Long Term Debt to be afterwards outstanding at least one and one-half times, as defined in the applicable prior Supplemental Indentures (the "Required Net Income for Debt Test"). If bonds are to be issued under the Indenture, the tests would be based on recently available financial results (a current 12-month period as permitted under the Indenture) at the time of issuance.

Q. Please explain the factors the Company considers when establishing its capital structure objectives.

A. The Company's goal is to minimize the overall cost of capital. It is also necessary, however, to maintain financial ratios that allow the Company to attract new capital on reasonable terms, and that provide the flexibility to enable the Company to issue various

types of securities (e.g., tax-exempt debt, long-term taxable debt, preferred or common equity) under varying market conditions. Pursuant to a Stipulation entered into by the Company in Docket 06-0336, the Company has committed, for three years following the date of the final order in that case, to maintain its equity-to-capital ratio between 40% and 50%. The Company's present objective is to maintain its common equity ratio within a target range of approximately 43% to 48%. As outlined above, the major construction program of the Champaign Plant will be financed with a mix of New Indebtedness and additional paid-in capital obtained from the Company's parent.

Q. What is the estimated capitalization that would result from IAWC's Financing Program?

A. In this proceeding, the Company proposes to issue Tax-Exempt Debt and/or Revolving Fund Loans to the extent possible. However, given the limits on availability of those sources as I mentioned above, the remaining funds, which may be up to 100% of the New Indebtedness, will be Taxable Bonds or Notes. As shown on Exhibit 1.1, the pro forma capitalization, assuming issuance of $28,500,000 of New Indebtedness and receipt of $22,500,000 of additional paid-in capital, will consist of 43.6% common equity and 56.4% long-term debt.

Q. Do you believe that is a reasonable capital structure?

A. Yes, this capital structure is reasonable for the Company, and the ratios shown on Exhibit 1.1 are consistent with the Company's commitment of maintaining an equity ratio of at least 40%. In addition, the pro forma equity ratio of 43.6% is consistent with the Company's long-term target equity range of 43% to 48%. Finally, the equity ratio may increase over the term of the Financing Program assuming increases in retained earnings.

Q. Is IAWC seeking approval in this proceeding to issue any additional shares of its Common Stock?

A. No. IAWC will periodically receive additional paid-in capital from AWW necessary to maintain its equity ratio within the desired range. This process does not require the issuance of any additional shares of Common Stock or other securities by IAWC. If the Company were to determine that the appropriate form of equity investment is through the sale of additional shares of Common Stock, the Company would seek to obtain approval from the Commission at that time for such issuance.

Q. Did the Company consider alternatives in developing the Financing Program presented in this docket?

A. Yes. As I mentioned above, the Company will use internally generated funds to the extent available rather than obtaining financing. In conjunction with all financings, the Company considers the appropriate mix of debt, preferred stock and common equity. In this instance, the Company concluded that the resulting debt and equity ratios would be at the target ranges if the financing was made up of the New Indebtedness and receipt, as needed, of approximately $22,500,000 of additional paid-in capital. Thus, no preferred stock, which is more costly than debt due to higher risk exposure, was included in the proposed Financing Program. The Company is seeking flexibility in this docket regarding the exact type and mix of New Indebtedness to issue to give it the ability to take advantage of any available tax-exempt financing and of future market conditions to obtain favorable financing terms.

Q. Is the Financing Program proposed in this proceeding in the best interests of IAWC and its customers?

A. Yes, it is. By implementing the Financing Program, the Company can meet its capital structure objectives and fund the 2007 through 2009 construction expenditures at an attractive cost for the benefit of its customers.

Q. Does this conclude your testimony?

A. Yes, it does.

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