

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

**ILLINOIS-AMERICAN WATER COMPANY, )  
and THAMES WATER AQUA HOLDINGS, )  
GmbH )**

**Docket No. 01-0832**

**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. )**

**SUPPLEMENTAL TESTIMONY**

**OF**

**STEPHEN SMITH**



23 **Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?**

24 A. As indicated in the Verified Application (p. 12) and Direct Testimony of Michael  
25 Carmedy (Exhibit G), Joint Applicants propose in this proceeding that control of  
26 Illinois-American Water Company (“Illinois-American”) and American Water Works  
27 Company, Inc. (“American”) be acquired by RWE Aktiengesellschaft (“RWE”), Thames  
28 Water Aqua Holdings GmbH (“Thames Holdings”), “and any other entity owned or  
29 controlled, directly or indirectly, by Thames Holdings and managed by Thames [Thames  
30 Water Plc.]” The purpose of my supplemental testimony is to provide additional  
31 information relating to the specific intermediate holding company which Thames  
32 Holdings proposes to establish for use in the post-transaction corporate structure. The  
33 intermediate holding company will be formed in Delaware and is expected to be called  
34 Thames Water Aqua US Holdings, Inc. (“TWUS”). TWUS’ business address, in the  
35 U.S., will be 1101 Laurel Oak Rd., Suite 120 Voorhees, NJ 08043.

36 **Q. PLEASE DESCRIBE THE CORPORATE STRUCTURE FOR THE**  
37 **ACQUISITION OF AMERICAN, PARTICULARLY AS IT RELATES TO USE**  
38 **OF THE INTERMEDIATE HOLDING COMPANY.**

39 A. The proposed corporate structure is shown on Exhibit I.

40 **Q. WHAT IS THE REASON FOR PROPOSING TO ESTABLISH AN**  
41 **INTERMEDIATE HOLDING COMPANY AND WHY WASN’T SPECIFIC**  
42 **INFORMATION REGARDING THE INTERMEDIATE COMPANY**  
43 **PREVIOUSLY PROVIDED?**

44 A. TWUS would be established solely to make it possible to file a consolidated U.S. tax  
45 return. TWUS was not specifically identified earlier because German law in effect at the

46 time the transaction was entered into imposed a tax at each level within the corporate  
47 structure, making a relatively flat corporate structure desirable. That law has now  
48 changed, making it financially desirable to add TWUS to the corporate structure so that a  
49 U.S. consolidated tax return can be filed. In addition, as more fully described below,  
50 other than allowing the filing of a consolidated tax return, TWUS will have no  
51 detrimental impact on Illinois-American from an operating, financial or management  
52 perspective.

53 **Q. WILL THE ADDITION OF TWUS TO THE CORPORATE STRUCTURE**  
54 **AFFECT ILLINOIS-AMERICAN'S ABILITY TO ATTRACT CAPITAL?**

55 A. No. As a subsidiary of RWE, the financial strength of TWUS will come from its ultimate  
56 corporate parent, RWE. RWE is the ultimate source of capital for its subsidiaries and  
57 should continue to be the entity considered in evaluating the transaction's financial effect  
58 on Illinois-American.

59 **Q. FROM AN OVERALL MANAGEMENT PERSPECTIVE, WOULD ANY**  
60 **CHANGE RESULT FROM USE OF THE DELAWARE COMPANY?**

61 A. No. As Mr. Carmedy indicates (Jt. App. Ex. G), Thames Water Plc ("Thames") operates  
62 (through its officers and employees) all of the water businesses of Thames Holdings.  
63 Thames will be responsible for the management of TWUS. I would further note that  
64 establishment of the intermediate holding company would not affect the post-transaction  
65 operation or management of Illinois-American in any way, as the intermediate holding  
66 company's board of directors will be identical to American's post-acquisition board of  
67 directors.

68 **Q. WOULD FILING OF A CONSOLIDATED TAX RETURN ADVERSELY**  
69 **AFFECT ILLINOIS-AMERICAN AND ITS CUSTOMERS?**

70 A. No. As is the case from an overall management perspective, there would be no change at  
71 all from the present situation. This is because American has historically filed a  
72 consolidated tax return, as Thames proposes to do, while Illinois-American's income tax  
73 calculation for ratemaking purposes has historically been computed on a "stand alone"  
74 basis

75 **Q. WILL ILLINOIS-AMERICAN HAVE ANY TRANSACTIONS WITH TWUS OR**  
76 **OTHERWISE TRANSFER FUNDS DIRECTLY TO TWUS?**

77 A. No. Illinois-American's income tax payments will be sent to its corporate parent,  
78 American, as they have been in the past. Any transaction or transfer of funds to cover tax  
79 liabilities would be between American and TWUS. Illinois-American will continue to  
80 make its stand-alone tax payments to American, as it has done for many years.

81 **Q. WOULD ESTABLISHMENT OF THE INTERMEDIATE COMPANY**  
82 **ADVERSELY AFFECT ILLINOIS-AMERICAN OR ITS CUSTOMERS IN ANY**  
83 **WAY?**

84 A. No. No costs will be passed down to regulated entities by or as a result of formation of  
85 the intermediate holding company, and the proposed corporate structure would have  
86 absolutely no adverse impact on Illinois-American's ability to provide adequate, reliable,  
87 efficient and least cost service, nor any impact on Illinois-American's ability to attract  
88 capital or maintain a reasonable capital structure. RWE would continue to provide the  
89 organization's underlying financial strength, while Thames and American (with its  
90 operating utility subsidiaries) would continue to provide the water expertise.

91 **Q. WILL TWUS BE IN PLACE BY THE TIME THE TRANSACTION CLOSES?**

92 A. Yes.

93 **Q. IN YOUR OPINION, WOULD INCLUSION OF TWUS IN THE CORPORATE**  
94 **STRUCTURE BE TRANSPARENT TO THE ILLINOIS COMMERCE**  
95 **COMMISSION AND ILLINOIS-AMERICAN'S CUSTOMERS?**

96 A. Yes. Inclusion of TWUS as part of the corporate structure would not change anything  
97 that could impact either the Commission's ability to regulate Illinois-American or that  
98 could in any way adversely impact rates or service for Illinois-American's ratepayers.  
99 More specifically, I cannot conceive of any way in which use of the proposed  
100 intermediate holding company could have any impact whatsoever on the analysis and  
101 conclusions already contained in the record with respect to the findings required under  
102 Section 7-204 of the Public Utilities Act. This is because, as I have previously explained,  
103 TWUS, which will also own other existing Thames Holdings U.S. subsidiaries, would be  
104 included in the corporate structure only to make it possible to file a consolidated U.S. tax  
105 return for all of Thames Holdings' U.S. businesses. It would serve no other purpose with  
106 respect to Illinois-American.

107 **Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL TESTIMONY?**

108 A. Yes.

## CURRICULUM VITAE

NAME **STEPHEN SMITH**

DATE OF BIRTH 16 October 1958

STATUS Married

NATIONALITY British

EDUCATION Bristol Grammar School (1977)  
9 O'Levels  
3 A'Levels: Chemistry B  
Physics B  
Mathematics B  
2 S'Levels: Chemistry 1  
Mathematics 2

Birmingham University (1980)  
B Comm (Accounting), 2:i

PROFESSIONAL QUALIFICATIONS ACA (1983)  
ATII (1984)  
All examinations passed at first attempt

### CAREER HISTORY

Jan 93 to date **THAMES WATER PLC**

Thames Water Plc was acquired by RWE AG, a German multi utility company, in November 2000 and thus ceased to be a UK quoted company.

#### **Corporate Finance and Tax Director**

Appointed in February 2001 to a new role within Thames Water (TW). Reporting to the TW Group Finance Director and working closely with the TW Divisional Board.

Responsibilities include:

- Supporting the development and implementation of the division's business strategy.
- Advising on the financial and commercial implications of major projects and opportunities.

- Ensuring consistent and appropriate financial evaluation policies and procedures are used across the division.
- Representing the Group Finance Director in the Commercial Development and Contract Performance Review processes.
- Liaison with RWE corporate staff and external advisors.
- All the responsibilities previously undertaken in the tax manager role outlined below.

It is envisaged that a team of 4 will be required to carry out the 'corporate finance' element of this role.

**Tax and accounting manager**, reporting to Group Finance Director

The tax department now consists of 6 professional staff and a secretary. Certain technical accounting responsibilities were acquired from January 1999.

**Responsible for the tax affairs of the group including:**

- UK corporate tax compliance.
- Tax implications and structuring of major contracts, acquisitions and disposals.
- Tax accounting for the group including statutory accounts, budgets, forecasts and business planning.
- Technical support to the personnel and payroll departments re PAYE issues including P11D dispensations and the management of a PAYE audit.
- UK VAT matters.
- Liaison with local management of overseas entities and external tax advisors in respect of overseas compliance and planning.

**Specific activities include:**

- Leading the financial due diligence of the RWE proposed \$7.6b acquisition of American Water Works. The transaction is subject to regulatory approval.
- Tax and financial review of the acquisition of a water concession contract in Chile for \$171m by TW.

- Due diligence work in connection with the RWE acquisition of TW.
- Restructuring of the TW group to minimise the exposure to German CFC legislation.
- ACT planning around surplus ACT of £159m.
- Tax structuring for \$1bn US acquisition.
- Tax implications and structuring of contracts for water and waste water infrastructure projects and long term concession contracts around the world and for PFI contracts in the UK.
- Chairman of a working party of the Water UK practitioners group set up to negotiate with the West Midlands LBO of the Inland Revenue on two major issues affecting the water industry.
- Appeal to the Special Commissioners.
- Creation of capital allowance data base covering expenditure of £350m p.a.
- Tailoring tax software to meet the specific accounting and Inland Revenue reporting needs of the group.
- Liaison with treasury manager regarding tax based treasury products.
- Dealing with the Inspector of Foreign Dividends and International Division to obtain clearance to pay interest to overseas companies without withholding tax.
- Obtaining Treasury Consent as required for investments overseas.
- Tax issues and negotiations in respect of share buy backs.
- Negotiations with International division regarding the Thames Water captive insurance company.

**In addition to the tax responsibilities set out above other responsibilities from January 1999 include:**

- Technical accounting issues, new standards etc.
- Accounting implications of new projects, acquisitions and disposals.
- Other one off accounting issues.

- Member of the TW foreign exchange committee.

Jun 87 - Dec 92      **ARTHUR ANDERSEN, Bristol**

**Tax Manager**

The final 6 months were spent on secondment to Thames Water Plc.

Responsibility for the day to day tax affairs of nominated clients. A significant part of the work load related to 'one off' consultancy projects.

Jul 86 - May 87      **MERVYN ANDREWS & CO, Bristol**

**Tax Manager**

Sole responsibility for the tax department of a small local firm with several good quality clients.

Oct 83 - Jun 86      **ARTHUR ANDERSEN, Birmingham**

**Tax Manager**

Joined Arthur Andersen's tax division immediately after qualifying. Promoted to Manager in January 1986.

Oct 80 - Sep 83      **PEAT MARWICK MITCHELL & CO, Birmingham**

Qualified as a Chartered Accountant, mainly working on audit assignments with some experience of insolvency work.