American Water Capital Corp.
Form 424B3
May 12, 2008
Table of Contents

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-148284
Registration No. 333-148284-01

Prospectus

American Water Capital Corp.

American Water Works Company, Inc.

Offer to Exchange

6.085% Senior Notes due 2017	**6.593% Senior Notes due 2037**
For a Like Principal Amount of New	**For a Like Principal Amount of New**
6.085% Senior Notes due 2017	**6.593% Senior Notes due 2037**

We are offering to exchange up to (i) $750,000,000 aggregate principal amount of new 6.085% Senior Notes due 2017, which we refer to as the new 2017 notes, for a like principal amount of the outstanding 6.085% Senior Notes due 2017, which have certain transfer restrictions, which we refer to as the original 2017 notes and (ii) $750,000,000 aggregate principal amount of new 6.593% Senior Notes due 2037, which we refer to as the new 2037 notes and, together with the new 2017 notes, as the new notes, for a like principal amount of the outstanding 6.593% Senior Notes due 2037, which have certain transfer restrictions, which we refer to as the original 2037 notes and, together with the original 2017 notes, as the original notes. The original notes and the new notes are collectively referred to in this prospectus as the notes. The new notes will be free of the transfer restrictions that apply to the original notes that you currently hold, but will otherwise have substantially the same terms as the outstanding original notes and will be issued under the same indenture. The new notes will not trade on any established exchange.

This offer will expire at 5:00 p.m., New York City time, on June 11, 2008, unless we extend it.

Each broker-dealer that receives new notes for its own account pursuant to this exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of such new notes. The letter of transmittal accompanying this prospectus states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act of 1933, as amended. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of new notes received in exchange for outstanding original notes where such outstanding original notes were acquired by such broker-dealer as a result of market-making activities or other trading activities. We have agreed that, starting on the expiration date and for a period ending upon the earlier of the 180th day after the expiration of this exchange offer or such time as such broker-dealers no longer own any original notes, we will make this prospectus available to any broker-dealer for use in connection with any such resale. See Plan of Distribution.

SEE RISK FACTORS BEGINNING ON PAGE 11 TO READ ABOUT IMPORTANT FACTORS YOU SHOULD CONSIDER IN CONNECTION WITH THIS EXCHANGE OFFER.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY OTHER REGULATORY BODY HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED ON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

Prospectus dated May 12, 2008.

Table of Contents

You should rely only on the information contained in this prospectus prepared by or on behalf of us. We have not authorized anyone to provide you with information that is different. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front cover of this prospectus.

TABLE OF CONTENTS

	Page
Where You Can Find More Information	ii
Industry and Market Data	ii
Forward-Looking Statements	iii
Summary	1
Risk Factors	11
Use of Proceeds	25
Ratio of Earnings to Fixed Charges	26
The Exchange Offer	27
Unaudited Pro Forma Condensed Consolidated Financial Information	35
Selected Historical Consolidated Financial Data	41
Management_s Discussion and Analysis of Financial Condition and Results of Operations	43
Business	77
Management	105
Certain Relationships and Related Transactions	144
Principal Stockholders	148
Description of Other Indebtedness	150
Description of the Notes	154
United States Federal Income Tax Considerations	170
Plan of Distribution	171
Legal Matters	172
Experts	172
Glossary	G-1
Index to Consolidated Financial Statements	F-1

Table of Contents

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the Securities and Exchange Commission, which we refer to as the SEC, a registration statement on Form S-4 under the Securities Act of 1933, as amended, which we refer to as the Securities Act, with respect to the this exchange offer. This prospectus, which constitutes part of the registration statement, does not contain all of the information set forth in the registration statement. For further information about us and the securities we propose to exchange in this exchange offer, we refer you to the registration statement and the exhibits and schedules filed as a part of the registration statement. Statements contained in this prospectus as to the contents of any contract or other document filed as an exhibit to the registration statement are not necessarily complete. If a contract or document has been filed as an exhibit to the registration statement, we refer you to the copy of the contract or document that has been filed. The registration statement may be inspected without charge at the principal office of the SEC in Washington, D.C. and copies of all or any part of the registration statement may be inspected and copied at the SEC s Public Reference Room at 100 F Street, N.E. Washington, D.C. 20549. The SEC s toll-free number is 1-800-SEC-0330. In addition, the SEC maintains a website (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC.

We are subject to the information and periodic reporting requirements of the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act, and are required to file periodic reports, proxy statements and other information with the SEC. The periodic reports and other information that we file with the SEC will be available for inspection and copying at the SEC s public reference facilities and on the website of the SEC referred to above.

INDUSTRY AND MARKET DATA

Unless otherwise indicated, information contained in this prospectus concerning the water and wastewater industry, its segments and related markets and our general expectations concerning such industry and its segments and related markets are based on management estimates. Such estimates are derived from publicly available information released by third-party sources, as well as data from our internal research and on assumptions made by us based on such data and our knowledge of such industry and markets, which we believe to be reasonable. We have estimated the number of people served by our water and wastewater systems (i) by multiplying the number of residential water and wastewater connections by average people per household based on 2000 United States Census data by state (average people per household varies by state but is generally between 2.4 to 3.0 individuals per household); (ii) by adjusting for weather fluctuations, for some other customer classes, including commercial customers, and for bulk water sales and (iii) by reconciling drinking water and wastewater connections to avoid double counting population served where the same user has both drinking water and wastewater service. In some instances, population estimates for our Non-Regulated Businesses are based on either (i) specific population estimates from the client or (ii) population estimates based on the average volume of water processed by the applicable facilities. While we are not aware of any misstatements regarding the industry or similar data presented herein, such data involve risks and uncertainties and are subject to change based on various factors, including those discussed under the heading Risk Factors in this prospectus.

Table of Contents

FORWARD-LOOKING STATEMENTS

We have made statements under the captions Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business and in other sections of this prospectus that are forward-looking statements. In some cases, these forward-looking statements can be identified by words with prospective meanings such as intend, plan, estimate, believe, anticipate, expect, predict, p forecast, outlook, future, potential, continue, may, can, should and could and similar expressions. Forward-looking statements m among other things, our future financial performance, our growth strategies, our ability to repay debt, our ability to finance current operations and growth initiatives, trends in our industry, regulatory or legal developments or rate adjustments.

Forward-looking statements are predictions based on our current expectations and assumptions regarding future events. They are not guarantees of any outcomes, financial results or levels of performance, and you are cautioned not to place undue reliance upon them. These forward-looking statements are subject to a number of risks and uncertainties, and new risks and uncertainties of which we are not currently aware or which we do not currently perceive may arise in the future from time to time. Should any of these risks or uncertainties materialize, or should any of our expectations or assumptions prove incorrect, then our results may vary materially from those discussed in the forward-looking statements herein. Factors that could cause actual results to differ from those discussed in forward-looking statements include, but are not limited to, the factors discussed under the caption Risk Factors and the following factors:

- weather conditions, patterns or events, including drought or abnormally high rainfall;
- changes in general economic, business and financial market conditions;
- changes in laws, governmental regulations and policies, including environmental, health and water quality and public utility regulations and policies;
- the decisions of governmental and regulatory bodies, including decisions to raise or lower rates;
- the timeliness of regulatory commissions actions concerning rates;
- migration into or out of our service territories;
- our ability to obtain permits for expansion projects;
- changes in customer demand for, and patterns of use of, water, such as may result from conservation efforts;
- the availability of adequate and cost-effective supplies of chemicals, electricity, fuel, water and other raw materials that are needed for our operations;
- our ability to successfully acquire and integrate water and wastewater systems that are complementary to our operations and the growth of our business;
- our ability to manage the expansion of our business;

our ability to control operating expenses and to achieve efficiencies in our operations;

access to sufficient capital on satisfactory terms;

fluctuations in interest rates;

restrictive covenants in or changes to the credit ratings on our current or future debt that could increase our financing costs or affect our ability to borrow, make payments on debt or pay dividends;

changes in our credit rating;

changes in capital requirements;

the incurrence of impairment charges;

difficulty in obtaining insurance at acceptable rates and on acceptable terms and conditions;

Table of Contents

ability to retain and attract qualified employees;

cost overruns relating to improvements or the expansion of our operations; and

civil disturbance or terrorist threats or acts or public apprehension about future disturbances or terrorist threats or acts.

Any forward-looking statements we make speak only as of the date of this prospectus. Except as required by law, we do not have any obligation, and we specifically disclaim any undertaking or intention, to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. It may not contain all the information that is important to you. You should carefully read this entire prospectus, including the section captioned Risk Factors and the consolidated financial statements and notes to the consolidated financial statements, before making an investment decision. For the definition of certain terms used in this prospectus, please refer to the definitions set forth in the Glossary.

Our Company

Founded in 1886, American Water Works Company, Inc., which we refer to, together with its subsidiaries, as American Water or the Company, is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our nearly 7,000 employees provide approximately 15.6 million people with drinking water, wastewater and other water-related services in 32 states and Ontario, Canada.

Our primary business involves the ownership of regulated water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers, treating and delivering over one billion gallons of water per day. Our subsidiaries that provide these services are generally subject to economic regulation by state Public Utility Commissions, which we refer to as state PUCs, in the states in which they operate. In 2007, we generated $2,214.2 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, $15.1 million in operating income, which includes $509.3 million of impairment charges relating to continuing operations, and a net loss of $342.8 million. Our Regulated Businesses, operating in 20 states in the United States, generated 89.8% of our total operating revenue in 2007.

We also provide services that are not subject to economic regulation by state PUCs. Our Non-Regulated Businesses include our Contract Operations Group, our Applied Water Management Group and our Homeowner Services Group. In 2007, our Non-Regulated Businesses generated $242.7 million in operating revenue, prior to inter-segment eliminations.

Our Industry

The United States water and wastewater industry has two main segments: (i) utility, which involves supplying water and wastewater services to customers, and (ii) general services, which involves providing water and wastewater-related services, including engineering, consulting and sales of water infrastructure and distribution products, such as pipes, to water and wastewater utilities and other consumers on a fee-for-service contract basis.

The utility segment includes municipal systems, which are owned and operated by local governments, and investor-owned systems. Government-owned systems make up the vast majority of the United States water and wastewater utility segment, accounting for approximately 84% of all United States community water systems and approximately 98% of all United States community wastewater systems.

The utility segment is characterized by high barriers to entry, including high capital spending requirements. Investor-owned water and wastewater utilities also face regulatory approval processes in order to do business, which may involve obtaining relevant operating approvals, including certificates of public convenience and necessity (or similar authorizations), pursuant to which state PUCs grant investor-owned utilities the right to provide service within an authorized service area. The utility segment of the United States water and wastewater

Table of Contents

industry is highly fragmented, with approximately 53,000 community water systems and approximately 16,000 community wastewater facilities, according to the United States Environmental Protection Agency, or EPA, and therefore presents opportunities for consolidation. Larger utilities, such as ours, that have greater access to capital are generally more capable of making mandated and other necessary infrastructure upgrades to water and wastewater systems.

Our Strengths

We believe that we are distinguished by the following key competitive strengths:

Market leader with broad national footprint and strong local presence. We are the largest and most geographically diversified investor-owned water and wastewater utility company in the United States. Our scale provides us with a competitive advantage in procuring goods and services reliably and economically. Our geographic scope enables us to capitalize effectively on growth opportunities across our service areas, while helping to insulate us from adverse conditions relating to regulatory environments, weather and economic conditions in any one geographic area. Also, our active community involvement supports customer satisfaction.

Regulated Businesses provide financial stability. Our Regulated Businesses provide a high degree of financial stability because (i) high barriers to entry insulate us from competitive pressures, (ii) economic regulation promotes predictability in financial planning and long-term performance through the rate-setting process and (iii) our largely residential customer base promotes consistent operating results.

Experience in securing appropriate rates of return and promoting constructive regulatory frameworks. We seek appropriate rates of return on our investment and a return of our investment and recovery of prudently incurred operating expenses from state PUCs in the form of rate increases, which we refer to as rate relief. We have a strong track record of providing reliable service at cost-effective rates, which has generally allowed us to maintain positive relations with regulators. We have generally been granted rate relief in a timely manner after application.

Significant growth opportunities with a low risk business profile. We believe we are well positioned to benefit from favorable industry dynamics in the water and wastewater sectors, which provide significant opportunities for future growth in both our Regulated Businesses and complementary Non-Regulated Businesses.

We intend to invest capital prudently to enable us to continue to provide essential services to our customers in the water and wastewater utility industry and to municipalities in meeting the capital challenges of making substantial required infrastructure upgrades.

Our Regulated Businesses provide a large platform on which to grow both organically and through consolidation from among the numerous water and wastewater systems in the United States.

Our national footprint increases our ability to make opportunistic investments in non-regulated businesses that are complementary to our Regulated Businesses.

Experienced senior management team. Our three senior managers have an average of 27 years of experience in the utilities industry. Our 14 state presidents have an average of 25 years of experience in the utilities industry.

Industry leader in water quality, testing and research. We are experts in water quality testing, compliance and treatment and have established and own industry-leading water testing facilities. Our technologically advanced quality control and testing laboratory in Belleville, Illinois is certified in 23 states and Puerto Rico.

Table of Contents

Our Strategy

Our goal is to consistently provide customers with safe, high quality drinking water and reliable water and wastewater services. Our business strategies include:

- continuing to prudently invest in regulated water and wastewater infrastructure projects;
- earning an appropriate rate of return on our investments from state PUCs;
- growing our Regulated Businesses through acquisitions; and
- continuing to pursue public/private partnerships, including O&M and military contracts and services, and other non-regulated businesses that are complementary to our Regulated Businesses.

The Transactions

American Water is currently an indirect majority-owned subsidiary of RWE Aktiengesellschaft, a stock corporation incorporated in the Federal Republic of Germany whose shares are publicly listed on the Frankfurt and Düsseldorf stock exchanges and other German stock exchanges as well as on the Zurich stock exchange, which we refer to as RWE. RWE is one of Europe s leading electricity and gas companies and supplies 20 million customers with electricity and 10 million customers with gas in Germany, the United Kingdom and Central and Eastern Europe. On November 4, 2005, RWE announced its intention to exit its water activities in the United States and the United Kingdom to focus on its core European electricity and gas business and has since then completed the divestiture of its water business in the United Kingdom. As a part of this strategy, RWE intends to fully divest its ownership of American Water through the consummation of one or more public offerings of common stock of American Water as soon as reasonably practicable, subject to market conditions, which we refer to as the RWE Divestiture. On April 28, 2008, our initial public offering was consummated pursuant to which RWE Aqua Holdings, GmbH, a direct wholly-owned subsidiary of RWE, sold approximately 36% of our outstanding common stock. On September 28, 2007, Thames Water Aqua US Holdings, Inc., at the time an indirect wholly owned subsidiary of RWE, which we refer to as Thames US Holdings, was merged with and into American Water with American Water being the surviving entity, which we refer to as the Merger.

On September 20, 2007, American Water Capital Corp., our wholly owned financing subsidiary, which we refer to as AWCC or the issuer, issued $1,750.0 million of debt to RWE, which we refer to as the RWE redemption notes, which was used to fund the early redemption of $1,750.0 million of preferred stock held by RWE. In addition, on October 22, 2007 we used the net proceeds from the issuance of the original notes, to fund the repayment of $1,286.0 million aggregate principal amount of RWE redemption notes and $206.0 million (including after tax gains of $2.2 million, net of $1.4 million of tax) aggregate principal amount of other debt owed to RWE, which we refer to as the RWE notes.

On November 7, 2007, we effected a 160,000-for-1 stock split.

In December 2007 we used the net proceeds from the issuance of approximately $415.0 million of commercial paper and $49.0 million of excess cash to fund the repayment of approximately $464.0 million of RWE redemption notes.

These transactions, together with the non-cash equity contribution to the Company by RWE of $100.0 million of debt of our subsidiaries held by RWE on March 29, 2007, the $550.0 million cash equity contribution to the Company by RWE on March 29, 2007, which was used to pay down $232.5 million of short-term debt and the remainder used for general working capital purposes, and the cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007, which was used to pay down $266.0 million of commercial paper, are collectively referred to as the Refinancing. The Refinancing, the Merger and the 160,000-for-1 split of common stock are collectively referred to in this prospectus as the Transactions.

Table of Contents

Organizational Structure

American Water is currently a direct majority-owned subsidiary of RWE Aqua Holdings GmbH, a limited liability company organized under the laws of the Federal Republic of Germany and a direct wholly owned subsidiary of RWE. The following chart sets forth our organizational structure:

Our Executive Offices

We are a corporation incorporated under the laws of Delaware. Our principal executive offices are located at 1025 Laurel Oak Road, Voorhees, NJ 08043. Our telephone number is (856) 346-8200. Our internet address is www.amwater.com. **The information contained on or accessible from our website does not constitute a part of this prospectus and is not incorporated by reference herein.**

American Water and its logos are our trademarks. Other service marks, trademarks and trade names referred to in this prospectus are the property of their respective owners.

Recent Developments

On December 21, 2007, our subsidiary, New Jersey American Water, signed an agreement with the city of Trenton, New Jersey to purchase the assets of the city s water system located in Ewing, Hamilton, Hopewell and Lawrence townships, which will add approximately 39,000 customers to our Regulated Businesses. The purchase price is $100 million, and the agreement was approved by the Trenton City Council. The agreement requires approval by various regulatory agencies, including the New Jersey Board of Public Utilities. We can provide no assurances that the agreement will be approved.

On April 11, 2008, the Company entered into an agreement to issue through AWCC $110 million of 6.25% senior notes due 2018 and $90 million of 6.55% senior notes due 2023 in a private placement to be consummated on May 15, 2008, the proceeds of which will be used to refinance outstanding short term indebtedness of AWCC and for general corporate purposes.

In April and May 2008, the Company redeemed an aggregate of $144.7 million of long-term auction rate debt of its subsidiaries with interest rates ranging from 6.48% to 10% per annum and maturities ranging from 2021 to 2032.

Table of Contents

SUMMARY OF THE TERMS OF THE EXCHANGE OFFER

Background	On October 22, 2007, we completed a private placement of (i) $750,000,000 aggregate principal amount of the original 2017 notes and (ii) $750,000,000 aggregate principal amount of the original 2037 notes. In connection with that private placement, we entered into an exchange and registration rights agreement in which we agreed to, among other things, complete an exchange offer for the original notes.
The Exchange Offer	We are offering to exchange our new notes for a like principal amount of our outstanding original notes. Original notes may only be tendered in principal amounts of $2,000 or in integral multiples of $1,000 principal amount in excess thereof. See The Exchange Offer Terms of the Exchange.
Resale of New Notes	Based upon the position of the staff of the SEC as described in previous no-action letters, we believe that each series of new notes issued pursuant to the exchange offer in exchange for original notes may be offered for resale, resold and otherwise transferred by you without compliance with the registration and prospectus delivery provisions of the Securities Act, *provided* that: you are acquiring the new notes in the ordinary course of your business; you have not engaged in, do not intend to engage in, and have no arrangement or understanding with any person to participate in a distribution of the new notes; and you are not our affiliate as defined under Rule 405 of the Securities Act. We do not intend to apply for listing of the new notes on any securities exchange or to seek approval for quotation through an automated quotation system. Accordingly, there can be no assurance that an active market will develop upon completion of the exchange offer or, if developed, that such market will be sustained or as to the liquidity of any market. Each participating broker-dealer that receives new notes for its own account pursuant to the exchange offer in exchange for original notes that were acquired as a result of market-making or other trading activity, may be a statutory underwriter and must acknowledge that it will deliver a prospectus meeting the requirements of the Securities Act, which may be the prospectus for the exchange offer so long as it contains a plan of distribution with respect to the resale transactions, in connection with any resale of new notes. See Plan of Distribution.

Table of Contents

Consequences If You Do Not Exchange Your Original Notes	Original notes that are not tendered in the exchange offer or are not accepted for exchange will continue to bear legends restricting their transfer. You will not be able to offer or sell such original notes: except pursuant to an exemption from the requirements of the Securities Act; or unless the original notes are registered under the Securities Act. After the exchange offer is closed, we will no longer have an obligation to register the original notes, except for some limited exceptions. See Risk Factors Risks Relating to the Notes and the Exchange Offer If you fail to exchange your original notes, they will continue to be restricted securities and may become less liquid.
Expiration Date	The exchange offer will expire at 5:00 p.m., New York City time, on June 11, 2008, unless we extend the exchange offer. See The Exchange Offer Expiration Date; Extensions; Amendments.
Exchange Date; Issuance of New Notes	The date of acceptance for exchange of each series of original notes is the exchange date, which will be the first business day following the expiration date of the exchange offer. We will issue new notes in exchange for original notes tendered and accepted in the exchange offer promptly following the exchange date. See The Exchange Offer Terms of the Exchange.
Certain Conditions to the Exchange Offer	The exchange offer is subject to certain customary conditions, which we may waive. See The Exchange Offer Conditions to the Exchange Offer.
Special Procedures for Beneficial Holders	If you beneficially own original notes that are registered in the name of a broker, dealer, commercial bank, trust company or other nominee and you wish to tender in the exchange offer, you should contact such registered holder promptly and instruct such person to tender on your behalf. If you wish to tender in the exchange offer on your own behalf, you must, prior to completing and executing the letter of transmittal and delivering your original notes, either arrange to have the original notes registered in your name or obtain a properly completed bond power from the registered holder. The transfer of registered ownership may take a considerable time. See The Exchange Offer Procedures for Tendering.
Withdrawal Rights	You may withdraw your tender of original notes at any time before the exchange offer expires. See The Exchange Offer Withdrawal of Tenders.

Table of Contents

Accounting Treatment	We will not recognize any gain or loss for accounting purposes upon the completion of the exchange offer. The expenses of the exchange offer that we pay will increase our deferred financing costs in accordance with generally accepted accounting principles. See The Exchange Offer Accounting Treatment.
Certain Tax Consequences	The exchange pursuant to the exchange offer generally will not be a taxable event for U.S. Federal income tax purposes. See United States Federal Income Tax Considerations.
Use of Proceeds	We will not receive any proceeds from the exchange or the issuance of new notes in connection with the exchange offer. See Use of Proceeds.
Exchange Agent	Wells Fargo Bank, National Association is serving as exchange agent in connection with the exchange offer. See The Exchange Offer Exchange Agent.

Table of Contents

SUMMARY OF THE TERMS OF THE NOTES

Other than the obligation to conduct an exchange offer, the new notes will have the same financial terms and covenants as the original notes, which are as follows:

Issuer	American Water Capital Corp.
Securities Offered	$750,000,000 aggregate principal amount of 6.085% Senior Notes due 2017, which we refer to as the new 2017 notes; and $750,000,000 aggregate principal amount of 6.593% Senior Notes due 2037, which we refer to as the new 2037 notes, collectively referred to as the new notes.
Maturity Date	The new 2017 notes will mature on October 15, 2017; and the new 2037 notes will mature on October 15, 2037.
Interest Payment Dates	April 15 and October 15 of each year, beginning April 15, 2008.
Support Agreement	The new notes will have the benefit of a support agreement from American Water, pursuant to which American Water has agreed to pay to any debt investor or lender any principal or interest owed by the issuer to such debt investor or lender that the issuer fails to pay on a timely basis, referred to herein as the support agreement.
Ranking	The new notes will be the issuer s unsecured senior obligations and will:

- rank equal in right of payment to all of the issuer s existing and future unsecured obligations that are not, by their terms, expressly subordinated in right of payment to the notes;
- rank senior in right of payment to all of the issuer s future obligations that are, by their terms, expressly subordinated in right of payment to the notes; and
- rank effectively junior in right of payment to all of our future secured indebtedness to the extent of the value of the assets securing such indebtedness.

Similarly, the obligations of American Water under the support agreement will be unsecured senior obligations of the support provider and will:

- rank equal in right of payment to all existing and future unsecured obligations of American Water that are not, by their terms, expressly subordinated in right of payment to such obligations;

rank senior in right of payment to any future obligations of American Water that are, by their terms, expressly subordinated in right of payment to such obligations; and

Table of Contents

	rank (i) effectively junior in right of payment to any secured indebtedness of American Water to the extent of the value of the assets securing such indebtedness and (ii) structurally junior in right of payment to any liabilities of the applicable American Water subsidiaries.
	As of December 31, 2007, on a pro forma basis after giving effect to the Transactions (other than the non-cash equity contributions to the Company by RWE, which are each reflected in the historical balance sheet, and excluding the effect of the initial public offering):
	The issuer would have had $3,019.4 million of senior indebtedness, including (i) $1,212.0 million of currently outstanding senior notes, other than the notes, (ii) $1,500.0 million of the notes, (iii) $86.9 million of other senior indebtedness and (iv) $220.5 million of commercial paper and no subordinated indebtedness;
	the support provider would have had no indebtedness other than its obligations under the support agreement with respect to the issuer s indebtedness; and
	the subsidiaries of the support provider (other than the issuer) would have had approximately $5,016.1 million of indebtedness and other liabilities.
Optional Redemption	We may redeem the new notes, in whole or in part, at any time at a redemption price equal to the greater of the principal amount of the notes and the make-whole price described under the heading Description of the Notes Optional Redemption by the Issuer.
Repurchase Right of Holders Upon a Change in Control	Upon the occurrence of both (i) a change of control of American Water and (ii) a downgrade of the notes below an investment grade rating by each of Moody s Investors Service, Inc. and Standard & Poor s Ratings Services within a specified period, you will have the right to require us to repurchase the new notes of each series at a price equal to 101% of the aggregate principal amount of notes repurchased plus accrued and unpaid interest, if any, on the notes repurchased, to the date of purchase. See Description of the Notes Change of Control.
Certain Covenants	The indenture governing the new notes contains certain covenants that, among other things, limit our ability to:
	create or assume liens; and
	enter into sale and leaseback transactions.
	These limitations are subject to a number of significant exceptions. See Description of the Notes Certain Covenants.

9

Table of Contents

Absence of a Public Market	The new notes will generally be freely transferable but will be issues of securities for which there is currently no established market. Accordingly, there can be no assurance as to the development or liquidity of any market for the new notes.
Risk Factors	See the section entitled Risk Factors in this prospectus for a description of certain of the risks you should consider before deciding to participate in the exchange offer.
Governing Law	The indenture and the new notes are governed by, and construed in accordance with, the laws of the State of New York.

Table of Contents

RISK FACTORS

In considering whether to participate in this exchange offer, you should carefully consider these risk factors together with all of the other information included in this prospectus, including the information contained in the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements included elsewhere in this prospectus and the notes thereto. If any of the following risks actually occurs, our business, financial condition, operating results and prospects could be adversely affected, which in turn could adversely affect your investment in the notes.

Risks Related to Our Industry and Business

Our utility operations are heavily regulated. Decisions by state PUCs and other regulatory agencies can significantly affect our business and results of operations.

Our Regulated Businesses provide water and wastewater services to our customers through subsidiaries economically regulated by state PUCs. Economic regulation affects the rates we charge our customers and has a significant effect on our business and results of operations. Generally, the state PUCs authorize us to charge rates that they determine are sufficient to recover our prudently incurred operating expenses, to enable us to finance the addition of new, or the replacement of existing, water and wastewater infrastructure and to allow us the opportunity to earn what they determine to be an appropriate rate of return on our invested capital and a return of our invested capital.

Our ability to meet our financial objectives depends upon the rates authorized by the various state PUCs. We periodically file rate increase applications with state PUCs. The ensuing administrative process may be lengthy and costly. We can provide no assurances that our rate increase requests will be granted. Even if approved, there is no guarantee that approval will be given in a timely manner or at a sufficient level to cover our expenses, the recovery of our investment and/or provide us an opportunity to earn an appropriate rate of return on our investment and a return of our investment. If the authorized rates are insufficient to cover operating expenses, to allow for the recovery of our investment and to provide an appropriate return on invested capital, or if the rate increase decisions are delayed, our financial condition, results of operations, cash flow and liquidity may be adversely affected. Even if rates are sufficient, we face the risk that we will not achieve the rates of return on our invested capital and a return of our invested capital that are permitted by the state PUC.

Our operations and the quality of water we supply are subject to extensive environmental laws and regulations. Our operating costs have increased, and are expected to continue to increase, as a result of complying with environmental laws and regulations. We also could incur substantial costs as a result of violations of or liabilities under such laws and regulations.

Our water and wastewater operations are subject to extensive United States federal, state and local and, in the case of our Canadian operations, Canadian laws and regulations, that govern the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat and discharge wastewater. These requirements include the United States Clean Water Act of 1972, which we refer to as the Clean Water Act, and the United States Safe Drinking Water Act of 1974, which we refer to as the Safe Drinking Water Act, and similar state and Canadian laws and regulations. We are also required to obtain various environmental permits from regulatory agencies for our operations. State PUCs also set conditions and standards for the water and wastewater services we deliver. If we deliver water or wastewater services to our customers that do not comply with regulatory standards, or otherwise violate environmental laws, regulations or permits, or other health and safety and water quality regulations, we could incur substantial fines, penalties or other sanctions or costs or damage to our reputation. In the most serious cases, regulators could force us to discontinue operations and sell our operating assets to another utility or municipality. Given the nature of our business which, in part, involves supplying water for human consumption, any potential non-compliance with, or violation of, environmental laws or regulations would likely pose a more significant risk to us than to an issuer not similarly involved in the water and wastewater industry.

Table of Contents

We incur substantial operating and capital costs on an ongoing basis to comply with environmental laws and regulations and other health and safety and water quality regulations. These laws and regulations, and their enforcement, have tended to become more stringent over time, and new or stricter requirements could increase our costs. Although we may seek to recover ongoing compliance costs in our rates, there can be no guarantee that the various state PUCs or similar regulatory bodies that govern our Regulated Businesses would approve rate increases to recover such costs or that such costs will not adversely and materially affect our financial condition, results of operations, cash flow and liquidity.

We may also incur liabilities under environmental laws and regulations requiring us to investigate and clean up environmental contamination at our properties or at off-site locations where we have disposed of waste or caused adverse environmental impacts. The discovery of previously unknown conditions, or the imposition of cleanup obligations in the future, could result in significant costs, and could adversely affect our financial condition, results of operations, cash flow and liquidity. Such remediation losses may not be covered by our insurance policies and may make it difficult for us to secure insurance in the future at acceptable rates.

Changes in laws and regulations over which we have no control can significantly affect our business and results of operations.

Any governmental entity that regulates our operations may enact new legislation or adopt new regulations or policies at any time, and new judicial decisions may change the interpretation of existing legislation or regulations at any time. The individuals who serve as regulators are elected or are political appointees. Therefore, elections which result in a change of political administration or new appointments may also result in changes in the individuals who serve as regulators and the policies of the regulatory agencies that they serve. New laws or regulations, new interpretations of existing laws or regulations, or changes in agency policy, including as a response to shifts in public opinion, or conditions imposed during the regulatory hearing process may affect our business in a number of ways, including the following:

- making it more difficult for us to raise our rates and, as a consequence, to recover our costs or earn our expected rates of return;
- changing the determination of the costs, or the amount of costs, that would be considered recoverable in rate cases;
- changing water quality or delivery service standards or wastewater collection, treatment and discharge standards with which we must comply;
- restricting our ability to terminate our services to customers who owe us money for services previously provided;
- requiring us to provide water services at reduced rates to certain customers;
- restricting our ability to sell assets or issue securities;
- changing regulatory benefits that we expected to receive when we began offering services in a particular area;
- changing or placing additional limitations on change in control requirements relating to any concentration of ownership of our common stock;
- making it easier for governmental entities to convert our assets to public ownership via eminent domain;
- restricting or prohibiting our extraction of water from rivers, streams, reservoirs or aquifers; and

revoking or altering the terms of the certificates of public convenience and necessity (or similar authorizations) issued to us by state PUCs.

Any of these changes or any other changes in laws, regulations, judicial decisions or agency policies applicable to us may have an adverse effect on our business, financial condition, results of operations, cash flow and liquidity.

Table of Contents

Weather conditions, natural hazards, availability of water supplies and competing uses may interfere with our sources of water, demand for water services and our ability to supply water to customers.

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. As a general rule, sources of public water supply, including rivers, lakes, streams and groundwater aquifers are held in the public trust and are not owned by private interests. As such, we typically do not own the water that we use in our operations, and the availability of our water supply is established through allocation rights and passing-flow requirements set by governmental entities. Passing-flow requirements set minimum volumes of water that must pass through specified water sources, such as rivers and streams, in order to maintain environmental habitats and meet water allocation rights of downstream users. Allocation rights are imposed to ensure sustainability of major water sources and passing flow requirements are most often imposed on source waters from smaller rivers, lakes and streams. These requirements can change from time to time and adversely impact our water supply. Drought, overuse of sources of water, the protection of threatened species or habitats or other factors may limit the availability of ground and surface water.

Governmental restrictions on water use may also result in decreased use of water services, even if our water supplies are sufficient to serve our customers, which may adversely affect our financial condition and results of operations. Seasonal drought conditions that would impact our water services are possible across all of our service areas, and drought conditions currently exist in several areas of the United States. However, these conditions are more prevalent in the Northeast and West where supply capacity is limited and per capita water demand is high. If a regional drought were to occur affecting our service areas and adjacent systems, governmental restrictions may be imposed on all systems within a region independent of the supply adequacy of any individual system. Voluntary restrictions were implemented during certain periods of 2007 in certain parts of the states of Illinois, New Jersey, Pennsylvania and Indiana and a mandatory restriction was implemented, and subsequently rescinded, in Kentucky. Following drought conditions, water demand may not return to pre-drought levels even after restrictions are lifted. Cool and wet weather may also reduce demand for water, thereby adversely affecting our financial condition, results of operations, cash flow and liquidity.

Service interruptions due to severe weather events are possible across all our service areas. These include winter storms and freezing conditions in our colder climate service areas, high wind conditions in our service areas known to experience tornados, earthquakes in our service areas known to experience seismic activity, high water conditions for our facilities located in or near designated flood plains, hurricanes in our coastal service areas and severe electrical storms which are possible across all of our service areas. These weather events may affect the condition or operability of our facilities, limiting or preventing us from delivering water or wastewater services to our customers, or requiring us to make substantial capital expenditures to repair any damage. Any interruption in our ability to supply water or to collect, treat and properly dispose of wastewater, or any costs associated with restoring service, could adversely affect our financial condition and results of operations. Furthermore, losses from business interruptions or damage to our facilities might not be covered by our insurance policies and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

Declining residential per customer water usage may reduce our long-term revenues, financial condition and results of operations.

Increased water conservation, including through the use of more efficient household fixtures and appliances among residential consumers, combined with declining household sizes in the United States, has contributed to a trend of declining residential per customer water usage. Our Regulated Businesses are heavily dependent upon revenue generated from rates we charge to our residential customers for the volume of water they use. The rate we charge for our water is regulated by state PUCs and we may not unilaterally adjust our rates to reflect demand. Declining usage will have a negative impact on our long-term operating revenues if we are unable to secure rate increases or to grow our residential customer base to the extent necessary to offset the residential usage decline.

Table of Contents

Risks associated with the collection, treatment and disposal of wastewater may impose significant costs.

The wastewater collection, treatment and disposal operations of our subsidiaries are subject to substantial regulation and involve significant environmental risks. If collection or sewage systems fail, overflow or do not operate properly, untreated wastewater or other contaminants could spill onto nearby properties or into nearby streams and rivers, causing damage to persons or property, injury to aquatic life and economic damages, which may not be recoverable in rates. This risk is most acute during periods of substantial rainfall or flooding, which are the main causes of sewer overflow and system failure. Liabilities resulting from such damage could adversely and materially affect our business, results of operations and financial condition. Moreover, in the event that we are deemed liable for any damage caused by overflow, our losses might not be covered by insurance policies, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

Our Regulated Businesses require significant capital expenditures to maintain infrastructure and expand our rate base and may suffer if we fail to secure appropriate funding to make investments, or if we suffer delays in completing major capital expenditure projects.

The water and wastewater utility business is capital intensive. In addition to our acquisition strategy, we invest significant amounts of capital to add, replace and maintain property, plant and equipment. In 2007, we invested $758.6 million in net Company-funded capital improvements. We expect the level of capital expenditures necessary to maintain the integrity of our systems to increase in the future. We fund these projects from cash generated from operations, borrowings under our revolving credit facility and commercial paper programs and the issuance of long-term debt and equity securities. We can provide no assurances that we will be able to access the debt and equity capital markets or do so on favorable terms.

RWE has certain registration rights with respect to future issuances of our equity securities and, subject to lock-up provisions, intends to fully divest its ownership of American Water as soon as reasonably practicable, subject to market conditions. The registration rights agreement to be entered into with RWE will impose certain restrictions on our ability to issue equity securities in amounts beyond specified thresholds without RWE s consent. Future sales of our common stock by RWE, as well as the restrictions in the registration rights agreement, may make it more difficult or costly for us to raise additional equity in the future. Furthermore, if we are unable to raise sufficient equity, we can provide no assurances that we will be able to access the debt capital markets, or do so on favorable terms.

In addition, we believe that our dividend policy with respect to our common stock could limit, but not preclude, our ability to pursue growth. In particular, this limitation could be significant, for example, with respect to large acquisitions and growth opportunities that require cash investments in amounts greater than our operating subsidiaries available cash or external financing resources. In order to fund construction expenditures, acquisitions (including tuck-in acquisitions) and principal and interest payments on our indebtedness, and pay dividends at the level currently anticipated under our dividend policy, we expect that we will need additional financing. However, we intend to retain sufficient cash from operating activities after the distribution of dividends to fund a portion of our capital expenditures. For further discussion of our acquisition strategy, see Business Our Regulated Businesses Acquisitions.

If we are unable to obtain sufficient capital, we may fail to maintain our existing property, plant and equipment, realize our capital investment strategies, meet our growth targets and successfully expand the rate base upon which we are able to earn future returns on our investment and a return of our investment. Even if we have adequate resources to make required capital expenditures, we face the additional risk that we will not complete our major capital expenditures on time, as a result of construction delays or other obstacles. Each of these outcomes could adversely affect our financial condition and results of operations. We also face the risk that after we make substantial capital expenditures, the rate increases granted to us by state PUCs may not be sufficient to recover our prudently incurred operating expenses and to allow us the opportunity to earn an appropriate rate of return on our invested capital and a return of our invested capital.

Table of Contents

The failure of, or the requirement to repair, upgrade or dismantle, any of our dams may adversely affect our financial condition and results of operations.

We own a total of 99 dams. A failure of any of those dams could result in injuries and property damage downstream for which we may be liable. The failure of a dam would also adversely affect our ability to supply water in sufficient quantities to our customers and could adversely affect our financial condition and results of operations. Any losses or liabilities incurred due to a failure of one of our dams might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

We also are required from time to time to repair or upgrade the dams that we own. The cost of such repairs can be and has been material. We might not be able to recover such costs through rates. The inability to recover these higher costs or regulatory lag in the recovery of such costs can affect our financial condition, results of operations, cash flow and liquidity.

The federal and state agencies that regulate our operations may adopt rules and regulations requiring us to dismantle our dams. Federal and state agencies are currently considering rules and regulations that could require us to strengthen or dismantle one of our dams on the Carmel River in California due to safety concerns related to seismic activity. Any requirement to strengthen or dismantle this dam could result in substantial costs that may adversely affect our financial condition and results of operations. We are currently engaged in negotiations with federal and state agencies and local stakeholders on a plan to maintain our existing Carmel River dams or to share the costs of dismantling one of them with those federal and state agencies and local stakeholders. These negotiations could be delayed or abandoned.

Any failure of our network of water and wastewater pipes and water reservoirs could result in losses and damages that may affect our financial condition and reputation.

Our operating subsidiaries distribute water and wastewater through an extensive network of pipes and store water in reservoirs located across the United States. A failure of major pipes or reservoirs could result in injuries and property damage for which we may be liable. The failure of major pipes and reservoirs may also result in the need to shut down some facilities or parts of our network in order to conduct repairs. Such failures and shutdowns may limit our ability to supply water in sufficient quantities to our customers and to meet the water and wastewater delivery requirements prescribed by governmental regulators, including state PUCs with jurisdiction over our operations, and adversely affect our financial condition, results of operations, cash flow, liquidity and reputation. Any business interruption or other losses might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance in the future at acceptable rates.

Contamination of our sources of water could result in service interruptions and human exposure to hazardous substances and subject our subsidiaries to civil or criminal enforcement actions, private litigation and clean-up obligations.

Our water supplies are subject to contamination, including contamination from naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources, such as perchlorate and methyl tertiary butyl ether (MTBE), and possible terrorist attacks. In the event that our water supply is contaminated, we may have to interrupt the use of that water supply until we are able to substitute the supply of water from another water source, including, in some cases, through the purchase of water from a third-party supplier. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities, or development of new treatment methods. If we are unable to substitute water supply in a cost-effective manner, our financial condition, results of operations, cash flow, liquidity and reputation may be adversely affected. We might not be able to recover costs associated with treating or decontaminating water supplies through rates, or such recovery may not occur in a timely manner. Moreover, we could be held liable for environmental damage as well as damages arising from toxic tort or other lawsuits or

Table of Contents

criminal enforcement actions or other consequences arising out of human exposure to hazardous substances in our drinking water supplies.

Our liquidity and earnings could be adversely affected by increases in our production costs, including the cost of chemicals, electricity, fuel or other significant materials used in the water and wastewater treatment process.

We incur significant production costs in connection with the delivery of our water and wastewater services. Our production costs are driven by inputs such as chemicals used to treat water and wastewater as well as electricity and fuel, which are used to operate pumps and other equipment used in water treatment and delivery and wastewater collection, treatment and disposal. We also incur production costs for waste disposal. For 2007, production costs accounted for 12.8% of our total operating costs. These costs can and do increase unexpectedly and in substantial amounts, as occurred in California during 2001 and Illinois during 2007 when the cost of electricity rose substantially.

Our Regulated Businesses might not be able to recover increases in the costs of chemicals, electricity, fuel, other significant inputs or waste disposal through rates, or such recovery may not occur in a timely manner. Our Non-Regulated Businesses may not be able to recover these costs in contract prices or other terms. The inability to recover these higher costs can affect our financial condition, results of operations, cash flow and liquidity.

Our reliance on third-party suppliers poses significant risks to our business and prospects.

We contract with third parties for goods and services that are essential to our operations, such as maintenance services, pipes, chemicals, electricity, water, gasoline, diesel and other materials. We are subject to substantial risks because of our reliance on these suppliers. For example:

- our suppliers may not provide raw materials that meet our specifications in sufficient quantities;
- our suppliers may provide us with water that does not meet applicable quality standards or is contaminated;
- our suppliers may face production delays due to natural disasters or strikes, lock-outs or other such actions;
- one or more suppliers could make strategic changes in the lines of products and services they offer; and
- some of our suppliers are small companies which are more likely to experience financial and operational difficulties than larger, well-established companies, because of their limited financial and other resources.

As a result of any of these factors, we may be required to find alternative suppliers for the raw materials and services on which we rely. Accordingly, we may experience delays in obtaining appropriate raw materials and services on a timely basis and in sufficient quantities from such alternative suppliers at a reasonable price, which could interrupt services to our customers and adversely affect our revenues, financial condition, results of operations, cash flow and liquidity.

Risks associated with potential acquisitions or investments may adversely affect us.

We will continue to seek to acquire or invest in additional regulated water or wastewater systems, including by acquiring systems in markets in the United States, where we do not currently operate our Regulated Businesses, and through tuck-ins. We will also continue to seek to enter into public/private partnerships, including O&M, military and design, build and operate, which we refer to as DBO, contracts and services that complement our businesses. These transactions may result in:

- incurrence of debt and contingent liabilities;

failure to have or to maintain effective internal control over financial reporting;

Table of Contents

fluctuations in quarterly results;

exposure to unknown risk and liabilities, such as environmental liabilities; and

other acquisition-related expenses.

We may also experience difficulty in obtaining required regulatory approvals for acquisitions, and any regulatory approvals we obtain may require us to agree to costly and restrictive conditions imposed by regulators. Future sales of our common stock by RWE, as well as the restrictions in the registration rights agreement to be entered into with RWE, may make it more difficult or costly for us to raise additional equity to fund an acquisition or to issue shares as consideration in connection with an acquisition. We may not identify all significant risks when conducting due diligence for the transaction, and we could be exposed to potential liabilities for which we will not be indemnified. There may be difficulties integrating new businesses, including bringing newly acquired businesses up to the necessary level of regulatory compliance. The demands of identifying and transitioning newly acquired businesses or pursuing investment opportunities may also divert management s attention from other business concerns and otherwise disrupt our business. Any of these risks may adversely affect our financial condition, results of operations and cash flows.

We have recorded a significant amount of goodwill, and we may never realize the full value of our intangible assets causing us to record impairments that may negatively affect our results of operations.

Our total assets include substantial goodwill. At December 31, 2007, our goodwill totaled $2,457.0 million. The goodwill is associated primarily with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E Town Corporation in 2001, representing the excess of the purchase price the purchaser paid over the fair value of the net tangible and intangible assets acquired. Goodwill is recorded at fair value on the date of an acquisition and, in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, or SFAS No. 142, is reviewed annually or more frequently if changes in circumstances indicate the carrying value may not be recoverable. Annual impairment reviews are performed in the fourth quarter. We have been required to reflect, as required by SFAS No. 142 and other applicable accounting rules, a non-cash charge to operating results for goodwill impairment in the amounts of $396.3 million in 2005, $227.8 million in 2006 and $509.3 million in 2007. These amounts include impairments relating to discontinued operations.

Our annual goodwill impairment test is conducted during the fourth quarter. We have processes to monitor for interim triggering events. During the third quarter of 2007, as a result of our debt being placed on review for a possible downgrade and the anticipated sale of a portion of the Company in the initial public offering, management determined at that time that it was appropriate to update its valuation analysis before the next scheduled annual test.

Based on this assessment, we performed an interim impairment test and recorded an impairment charge to goodwill of our Regulated Businesses in the amount of $243.3 million in the third quarter of 2007. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

We completed our annual goodwill impairment test for 2007 and recorded an additional goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007. We determined that an impairment had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, an additional impairment to our carrying value was recorded.

We may be required to recognize additional impairments in the future, depending on, among other factors, the market value of our common stock and its value relative to our book equity at the consummation of the initial public offering or the level over a period of time of the trading price of our stock since our initial public offering.

Table of Contents

Other factors that could necessitate an impairment would include a decline over a period of time in valuation multiples of comparable water utilities and a decline in our forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates. Further recognition of impairments of a significant portion of goodwill would negatively affect our results of operations and total capitalization, the effect of which could be material and could make it more difficult for us to secure financing on attractive terms and maintain compliance with our debt covenants.

Based on the initial public offering price, we have determined that it is probable we will record an impairment to goodwill when we report results for the quarter ended March 31, 2008. Whether such an impairment to goodwill is recognized will depend on an analysis of the factors described above. The size of any such impairment to goodwill, if any, cannot be determined at this time.

Our Regulated Businesses compete with other regulated utilities, as well as strategic and financial buyers, for acquisition opportunities, which may hinder our ability to grow our business.

We compete with other regulated utilities, as well as strategic and financial buyers, for acquisition opportunities, including tuck-ins. Our competitors may impede our growth by purchasing water utilities near our existing operations, thereby preventing us from acquiring them. Competing utilities and strategic and financial buyers have challenged, and may in the future challenge, our applications for new service territories. Our growth could be hindered if we are not able to compete effectively for new territories with other companies or strategic and financial buyers that have lower costs of operations or that can submit more attractive bids.

The assets of our Regulated Businesses are subject to condemnation through eminent domain.

Municipalities and other government subdivisions have historically been involved in the provision of water and wastewater services in the United States, and organized movements may arise from time to time in one or more of the service areas in which our Regulated Businesses operate to convert our assets to public ownership and operation through the governmental power of eminent domain. Should a municipality or other government subdivision seek to acquire our assets through eminent domain, we may resist the acquisition. Contesting an exercise of condemnation through eminent domain may result in costly legal proceedings and may divert the attention of the affected Regulated Business s management from the operation of its business.

The last sale of one of our water and wastewater systems under threat of condemnation occurred in 2003 in California. On March 1, 2007, our subsidiary, California American Water Company, was served by the San Lorenzo Valley Water District with court papers seeking to condemn our water and wastewater system in Felton, California, which serves approximately 1,300 customers. If a municipality or other government subdivision succeeds in acquiring the assets of one or more of our Regulated Businesses through eminent domain, there is a risk that we will not receive adequate compensation for the business, that we will not be able to keep the compensation, or that we will not be able to divest the business without incurring significant one-time charges.

In order to consummate the proposed RWE Divestiture, we and RWE were required to obtain approvals from thirteen state PUCs. There can be no guarantee that some state PUC approvals already granted to us will not be appealed, withdrawn, modified or stayed.

To consummate the proposed RWE Divestiture, we and RWE obtained regulatory approvals from state PUCs in 13 states. The state PUC approval in Illinois has been appealed, and there can be no guarantee that the state PUC approval in Illinois will not be overturned. Moreover, some of our existing state PUC approvals may be withdrawn or altered in the future by the state PUCs since they retain authority to withdraw or modify their prior decisions. There also can be no guarantee that, in conjunction with an appeal or otherwise, a stay or other form of injunctive relief will not be granted by a state PUC or reviewing court.

In addition, two of the regulatory approvals that we and RWE obtained expire 24 months from April 22, 2008, the date of effectiveness of the registration statement for the initial public offering, and another approval

Table of Contents

expires 36 months from that date. If RWE does not fully divest its ownership of American Water within 24 or 36 months of the effectiveness of the registration statement for the initial public offering, then we and RWE may be required to seek an extension of such approvals, as applicable, which process may result in delays, costs and the imposition of additional conditions on us or on RWE.

In order to obtain the state PUC approvals to consummate the proposed RWE Divestiture we were required to accept certain conditions and restrictions that could increase our costs.

Some of the regulatory approvals contain conditions and restrictions, including reporting obligations; obligations to maintain appropriate credit worthiness; restrictions on changes of control; prohibitions on the pass-through of our initial Sarbanes-Oxley Act compliance costs; prohibitions on the pass-through of costs of the Transactions; service quality and staffing level requirements; and the maintenance of specific collective bargaining agreements and retirement and certain other post employment benefit programs. These conditions and restrictions could increase our costs and adversely affect our business.

Our Non-Regulated Businesses, through American Water (excluding its regulated subsidiaries), provide performance guarantees and other forms of financial security to our public-sector clients that could be claimed by our clients or potential clients if we do not meet certain obligations.

Under the terms of some of our indebtedness and some of our agreements with the municipalities and other governmental entities, which we serve pursuant to O&M contracts, American Water (excluding its regulated subsidiaries) provides guarantees of the performance of our Non-Regulated Businesses, including financial guarantees or deposits to ensure performance of certain obligations. At December 31, 2007, we had guarantees and deposits totaling approximately $475.3 million, and this amount is likely to increase if our Non-Regulated Businesses grow. The presence of these contingent liabilities may adversely affect our financial condition and make it more difficult for us to secure financing on attractive terms. In addition, if the obligor on the guaranteed instrument fails to perform certain obligations to the satisfaction of the party that holds the guarantee, that party may seek to enforce the guarantee against us or proceed against the deposit. In that event, our financial condition, results of operations, cash flow and liquidity could be adversely affected.

We operate a number of water and wastewater systems under O&M contracts and face the risk that the owners of those systems may fail to maintain those systems, which will negatively affect us as the operators of the systems.

We operate a number of water and wastewater systems under O&M contracts. Pursuant to these contracts, we operate the system according to the standards set forth in the applicable contract, where it is generally the responsibility of the owner to undertake capital improvements. In some cases, we may not be able to convince the owner to make needed improvements in order to maintain compliance with applicable regulations. Although violations and fines incurred by water and wastewater systems may be the responsibility of the owner of the system under these contracts, those non-compliance events may reflect poorly on us as the operator of the system and damage our reputation, and in some cases, may result in liability to the same extent as if we were the owner.

Our Non-Regulated Businesses are party to long-term contracts to operate and maintain water and wastewater systems under which we may incur costs in excess of payments received.

Some of our Non-Regulated Businesses enter into long-term contracts pursuant to which they agree to operate and maintain a municipality s or other party s water or wastewater treatment and delivery facilities in exchange for an annual fee. Our Non-Regulated Businesses are generally subject to the risk that costs associated with operating and maintaining the facilities may exceed the fees received from the municipality or other contracting party. In addition, directly or through our non-regulated subsidiaries, we often guarantee our Non-Regulated Businesses obligations under those contracts. Losses under these contracts or guarantees may adversely affect our financial condition, results of operations, cash flow and liquidity.

Table of Contents

We rely on our IT systems to assist with the management of our business and customer and supplier relationships, and a disruption of these systems could adversely affect our business.

Our IT systems are an integral part of our business, and a serious disruption of our IT systems could significantly limit our ability to manage and operate our business efficiently, which in turn could cause our business and competitive position to suffer and cause our results of operations to be reduced. We depend on our IT systems to bill customers, process orders, provide customer service, manage construction projects, manage our financial records, track assets, remotely monitor certain of our plants and facilities and manage human resources, inventory and accounts receivable collections. Our IT systems also allow us to purchase products from our suppliers and bill customers on a timely basis, maintain cost-effective operations and provide service to our customers. Our IT systems are vulnerable to damage or interruption from:

- power loss, computer systems failures and internet, telecommunications or data network failures;
- operator negligence or improper operation by, or supervision of, employees;
- physical and electronic loss of customer data or security breaches, misappropriation and similar events;
- computer viruses;
- intentional acts of vandalism and similar events; and
- hurricanes, fires, floods, earthquakes and other natural disasters.

Such damages or interruptions may result in physical and electronic loss of customer or financial data, security breaches, misappropriation and similar events. In addition, the lack of redundancy for certain of our IT systems, including billing systems, could exacerbate the impact on the Company of any of the foregoing events.

In addition, we may not be successful in developing or acquiring technology that is competitive and responsive to the needs of our business and we might lack sufficient resources to make the necessary investments in technology to allow us to continue to operate at our current level of efficiency.

Our indebtedness could affect our business adversely and limit our ability to plan for or respond to changes in our business, and we may be unable to generate sufficient cash flow to satisfy our liquidity needs.

As of December 31, 2007, after giving effect to the Transactions, our pro forma indebtedness (including preferred stock with mandatory redemption requirements) was $5,016.1 million, and our working capital, defined as current assets less current liabilities, was in a deficit position. Our indebtedness could have important consequences, including:

- limiting our ability to obtain additional financing to fund future working capital or capital expenditures;
- exposing us to interest rate risk with respect to the portion of our indebtedness that bears interest at a variable rate, including $169.6 million of our auction-rate debt that resets to higher interest rates in the event of a failed auction;
- limiting our ability to pay dividends on our common stock or make payments in connection with our other obligations;

likely requiring that a portion of our cash flow from operations be dedicated to the payment of the principal of and interest on our debt, thereby reducing funds available for future operations, acquisitions, dividends on our common stock or capital expenditures;

limiting our ability to take advantage of significant business opportunities, such as acquisition opportunities, and to react to changes in market or industry conditions; and

placing us at a competitive disadvantage compared to those of our competitors that have less debt.

In order to meet our capital expenditure needs, we may be required to make additional borrowings under our credit facilities or be required to issue new debt securities in the capital markets. We can provide no assurances

Table of Contents

that we will be able to access the debt capital markets or do so on favorable terms. If new debt is added to our current debt levels, the related risks we now face could intensify limiting our ability to refinance existing debt on favorable terms.

We will depend primarily on operations to fund our expenses and to pay the principal and interest on our outstanding debt. Our ability to meet our expenses thus depends on our future performance, which will be affected by financial, business, economic, competitive, legislative, regulatory and other factors beyond our control. If we do not have enough money to pay the principal and interest on our outstanding debt, we may be required to refinance all or part of our existing debt, sell assets, borrow additional funds or sell additional equity. If our business does not generate sufficient cash flow from operations or if we are unable to incur indebtedness sufficient to enable us to fund our liquidity needs, we may be unable to plan for or respond to changes in our business that would prevent us from maintaining or increasing our business and cause our operating results and prospects to be affected adversely.

Our failure to comply with restrictive covenants under our credit facilities could trigger prepayment obligations.

Our failure to comply with the restrictive covenants under our credit facilities could result in an event of default, which, if not cured or waived, could result in us being required to repay or refinance (on less favorable terms) these borrowings before their due date. If we are forced to repay or refinance (on less favorable terms) these borrowings, our results of operations and financial condition could be adversely affected by increased costs and rates. In 2007, we were not in compliance with reporting covenants contained in some of the debt agreements of our subsidiaries. Such defaults under the reporting covenants were caused by our delay in producing our quarterly and audited annual consolidated financial statements. We have obtained all necessary waivers under the agreements. We can provide no assurance that we will comply in the future with all our reporting covenants and will not face an event of default under our debt agreements, or that such default will be cured or waived.

Work stoppages and other labor relations matters could adversely affect our results of operations.

Currently, approximately 3,600 employees, or approximately 51% of our total workforce, are unionized and represented by 18 different unions. Approximately one-third of our 75 union collective bargaining agreements expire annually, with 18 agreements covering 759 employees scheduled to expire before the end of 2008. We might not be able to renegotiate labor contracts on terms that are favorable to us and negotiations or dispute resolutions undertaken in connection with our labor contracts could be delayed or become subject to the risk of labor actions or work stoppages. Labor actions, work stoppages or the threat of work stoppages and our failure to obtain favorable labor contract terms during renegotiations may all adversely affect our financial condition, results of operations, cash flow and liquidity.

We currently have material weaknesses in internal control over financial reporting. If we fail to remedy our material weaknesses or otherwise maintain effective internal control over financial reporting, we may not be able to report our financial results accurately or on a timely basis. Any inability to report and file our financial results in an accurate and timely manner could harm our business and adversely impact your investment in the notes.

As a public company, we are required to comply with the Sarbanes-Oxley Act and other rules and regulations that govern public companies. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which requires us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our registered public accounting firm to report on the effectiveness of our internal control over financial reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable

Table of Contents

assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, from 2003 to April 28, 2008, we were an indirect wholly owned subsidiary of RWE, a stock corporation incorporated in the Federal Republic of Germany, and were not required to maintain a system of internal control consistent with the requirements of the SEC and the Sarbanes-Oxley Act, nor to prepare our own financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company s annual or interim financial statements will not be prevented or detected on a timely basis. In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants have identified the following material weaknesses in our internal control over financial reporting:

Inadequate internal staffing and skills;

Inadequate controls over financial reporting processes;

Inadequate controls over month-end closing processes, including account reconciliations;

Inadequate controls over maintenance of contracts and agreements;

Inadequate controls over segregation of duties and restriction of access to key accounting applications; and

Inadequate controls over tax accounting and accruals.

We have initiated a remediation plan with respect to our material weaknesses, but there can be no assurances that our remediation plan will be effective. For further discussion, see Management s Discussion and Analysis of Financial Condition and Results of Operations Our Internal Control and Remediation Initiatives.

Each of these weaknesses could result in a material misstatement of our annual or interim consolidated financial statements. Moreover, we cannot assure you that we have identified all, or that we will not in the future have additional, material weaknesses, any of which may subject us to additional regulatory scrutiny, and cause future delays in filing our financial statements and periodic reports with the SEC. Any such delays in the filing of our financial statements and periodic reports may result in a loss of public confidence in the reliability of our financial statements and sanctions imposed on us by the SEC. We believe that such misstatements or delays could negatively impact our liquidity, access to capital markets, financial condition and the market value of our common stock or cause a downgrade in the credit ratings of American Water or the issuer. These material weaknesses contributed to our inability to comply with reporting covenants in our debt agreements and those of our subsidiaries, and could hinder our ability to comply with such covenants in the future if we are not successful in remediating such weaknesses.

Risks Related to the Notes and the Exchange Offer

The notes are structurally subordinated to all the obligations of our subsidiaries other than the issuer. The issuer s ability to service its debt is dependent on the performance of our other subsidiaries.

The notes have been issued by American Water Capital Corp., our finance subsidiary. American Water has signed a support agreement with the issuer. The notes are not guaranteed by any of our subsidiaries and are the obligations only of the issuer and American Water, by virtue of the support agreement. Accordingly, the notes are structurally subordinated to the liabilities, including trade payables, lease commitments and moneys

22

Table of Contents

borrowed, of American Water s subsidiaries other than the issuer. American Water has no material assets or operations other than equity interests in its subsidiaries, and the issuer has no material assets or operations except for its limited operations as a finance vehicle for our businesses. We expect that payments of interest and principal that the issuer makes on the notes (or that American Water makes pursuant to the support agreement) will be made only to the extent that our operating subsidiaries can distribute cash or other property to American Water and, through American Water, to the issuer.

Although the terms of the notes restrict our ability and the ability of our subsidiaries to incur certain liens and to enter into certain sale and leaseback transactions, the incurrence of other indebtedness or other liabilities by any of our subsidiaries is not prohibited in connection with the notes and could adversely affect our ability to pay our obligations on the notes. As of December 31, 2007, total liabilities of our subsidiaries other than the issuer were $5,146.7 million. As of December 31, 2007, the indebtedness of our subsidiaries other than the issuer, excluding intercompany liabilities and obligations of a type not required to be reflected on a balance sheet in accordance with generally accepted accounting principles, that would effectively have been senior to the notes, was approximately $1,926.0 million. We anticipate that from time to time our subsidiaries will incur additional debt and other liabilities. Any debt incurred by our subsidiaries other than the issuer will be structurally senior to the notes.

We have not agreed to any financial covenants in connection with the notes. Consequently, we are not required in connection with the notes to meet any financial tests, such as those that measure our working capital, interest coverage, fixed charge or net worth, in order to maintain compliance with the terms of the notes.

Our ability to service our obligations under the notes depends on our ability to receive cash distributions from our operating subsidiaries. There can be no assurance that we will continue to receive such distributions or, if they are received, that they will be in amounts similar to past distributions.

The issuer is our finance subsidiary and has no substantial assets. We have entered into a support agreement with the issuer pursuant to which we have agreed to pay to any debt investor or lenders of the issuer any principal or interest amounts owed by the issuer to such debt investor or lender that the issuer fails to pay on a timely basis. Because substantially all of our operations are conducted through our subsidiaries other than the issuer, the issuer will not be able to make interest and principal payments on the notes (and we will not be able to fulfill our obligations under the support agreement) unless we receive sufficient cash distributions from our operating subsidiaries and contribute such distributions to the issuer. The distributions received from our operating subsidiaries might not permit the issuer or us to make required payments of interest and principal under the notes or pursuant to the support agreement, as applicable, on a timely basis, or at all.

If an active trading market does not develop for the new notes you may not be able to resell them.

Currently, there is no public market for the new notes. If no active trading market develops, you may not be able to resell the new notes at their fair market value or at all. We do not intend to apply for listing of the new notes on any securities exchange or for quotation on any automated quotation system.

The liquidity of any market for the new notes will depend upon various factors, including:

- the number of holders of the new notes;
- the interest of securities dealers in making a market for the new notes;
- our financial performance or prospects; and
- the prospects for companies in our industry generally.

Accordingly, we cannot assure you that a market or liquidity will develop for the new notes.

23

Table of Contents

If you fail to exchange your original notes, they will continue to be restricted securities and may become less liquid.

Original notes that you do not tender or we do not accept will, following the exchange offer, continue to be restricted securities, and you may not offer to sell them except pursuant to an exemption from, or in a transaction not subject to, the Securities Act and applicable state securities laws. We will issue new notes in exchange for the original notes pursuant to the exchange offer only following the satisfaction of the procedures and conditions set forth in The Exchange Offer Procedures for Tendering . Such procedures and conditions include timely receipt by the exchange agent of such original notes and of a properly completed and duly executed letter of transmittal. Because we anticipate that most holders of original notes will elect to exchange such original notes, we expect that the liquidity of the market for each series of the original notes remaining after the completion of the exchange offer will be substantially limited. Any original notes of a series tendered and exchanged in the exchange offer will reduce the aggregate principal amount at maturity of the original notes of that series outstanding. Following the exchange offer, if you did not tender your original notes you generally will not have any further registration rights, and such original notes will continue to be subject to certain transfer restrictions. Accordingly, the liquidity of the market for each series of original notes could be adversely affected.

Our principal stockholder is in a position to affect our ongoing operations, corporate transactions and other matters, and its interests may conflict with or differ from your interests as a noteholder.

RWE owns approximately 64% of our common stock. As a result, RWE is able to control the outcome on virtually all matters submitted to a vote of our stockholders, including the election of directors. So long as RWE continues to own a significant portion of the outstanding shares of our common stock, it will continue to be able to significantly influence the election of our directors, subject to compliance with applicable NYSE requirements, our decisions, policies, management and affairs and corporate actions requiring stockholder approval, including the approval of transactions involving a change in control. The interests of RWE and its affiliates may not coincide with the interests of our other stockholders or with your interests as a noteholder.

We may not be able to repurchase the notes upon a change of control.

Upon the occurrence of a change of control triggering event, the issuer will be required to offer to repurchase all outstanding notes at 101% of their principal amount plus accrued and unpaid interest. The source of funds for any such purchase of the notes will be available cash, cash generated from our operating subsidiaries (other than the issuer) or other sources, including borrowings, sales of assets or sales of equity. The sources of cash may not be adequate to permit the issuer (or us, pursuant to our obligations under the support agreement) to repurchase the notes upon a change of control triggering event. The issuer s failure to offer to repurchase the notes, or to repurchase notes tendered following a change of control triggering event, will result in a default under the indenture governing the notes, which could lead to a cross-default under the terms of our existing and future indebtedness. For further information, see Description of the Notes.

Table of Contents

USE OF PROCEEDS

This exchange offer is intended to satisfy our obligations under the exchange and registration rights agreement entered into in connection with the issuance of the original notes. We will not receive any cash proceeds from the issuance of the new notes in the exchange offer. In consideration for issuing the new notes as contemplated by this prospectus, we will receive the original notes in like principal amount. The original notes surrendered and exchanged for the new notes will be retired and canceled and cannot be reissued. Accordingly, the issuance of the new notes will not result in any increase in our indebtedness or capital stock. We used the net proceeds from the issuance of the original notes to fund the repayment of $1,286.0 million aggregate principal amount of RWE redemption notes and $206.0 million (including after tax gains of $2.2 million, net of $1.4 million of tax) aggregate principal amount of RWE notes.

Table of Contents

RATIO OF EARNINGS TO FIXED CHARGES

American Water s and the issuer s ratio of earnings to fixed charges for each of the periods indicated is as follows:

For purposes of calculating the ratio of earnings to fixed charges, earnings consists of income (loss) from continuing operations before income taxes including the effect of allowance for funds used during construction, which we refer to as AFUDC, plus fixed charges. Fixed charges consist of interest expense, amortization of debt issuance costs, and a portion of rent expense that management believes is representative of the interest component of rental expense. Fixed charges have not been reduced for the effect of AFUDC.

The ratio of earnings to fixed charges was less than 1.00x for the periods indicated in the table below.

	For the Year Ended December 31,				
	2003	2004	2005	2006	2007
American Water					
Ratio of Earnings to Fixed Charges (1)	1.35	1.38			
Pro Forma Ratio of Earnings to Fixed Charges (2)					
American Water Capital Corp.					
Ratio of Earnings to Fixed Charges	1.00	1.00	1.00	1.00	1.00
Pro Forma Ratio of Earnings to Fixed Charges					1.00

(1) For the years ended December 31, 2005, 2006 and 2007, earnings were insufficient to cover fixed charges and there were deficiencies of $224.3 million, $109.1 million and $255.7 million, respectively.

(2) On a pro forma basis after giving effect to the offering of notes, earnings would have been insufficient to cover fixed charges and there would have been a deficiency of $256.8 million for the year ended December 31, 2007.

Table of Contents

THE EXCHANGE OFFER

Purpose of the Exchange Offer

In connection with the sale of the original notes, we entered into an exchange and registration rights agreement with the initial purchasers of the original notes, under which we agreed to file and to use our reasonable efforts to have declared effective an exchange offer registration statement under the Securities Act and to consummate an exchange offer.

We are making the exchange offer in reliance on the position of the SEC as set forth in certain no-action letters. However, we have not sought our own no-action letter. Based upon these interpretations by the SEC, we believe that a holder of new notes, but not a holder who is our affiliate within the meaning of Rule 405 of the Securities Act, who exchanges original notes for new notes in the exchange offer, generally may offer the new notes for resale, sell the new notes and otherwise transfer the new notes without further registration under the Securities Act and without delivery of a prospectus that satisfies the requirements of Section 10 of the Securities Act. This does not apply, however, to a holder who is our affiliate within the meaning of Rule 405 of the Securities Act. We also believe that a holder may offer, sell or transfer the new notes only if the holder acquires the new notes in the ordinary course of its business and is not participating, does not intend to participate and has no arrangement or understanding with any person to participate in a distribution of the new notes.

Any holder of the original notes using the exchange offer to participate in a distribution of new notes cannot rely on the no-action letters referred to above. A broker-dealer that acquired original notes directly from us, but not as a result of market-making activities or other trading activities, must comply with the registration and prospectus delivery requirements of the Securities Act in the absence of an exemption from such requirements.

Each broker-dealer that receives new notes for its own account in exchange for original notes, as a result of market-making activities or other trading activities, must acknowledge that it will deliver a prospectus in connection with any resale of such new notes. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of new notes received in exchange for original notes where such original notes were acquired by such broker-dealer as a result of market-making activities or other trading activities. The letter of transmittal states that by so acknowledging and delivering a prospectus, a broker-dealer will not be considered to admit that it is an underwriter within the meaning of the Securities Act. We have agreed that starting on the expiration date and for a period ending upon the earlier of the 180th day after the expiration of this exchange offer or such time as such broker-dealers no longer own any original notes, we will make this prospectus available to broker-dealers for use in connection with any such resale. See Plan of Distribution .

Except as described above, this prospectus may not be used for an offer to resell, resale or other transfer of new notes.

The exchange offer is not being made to, nor will we accept tenders for exchange from, holders of original notes in any jurisdiction in which the exchange offer or the acceptance of tenders would not be in compliance with the securities or blue sky laws of such jurisdiction.

Terms of the Exchange

Upon the terms and subject to the conditions of the exchange offer, we will accept any and all original notes validly tendered prior to 5:00 p.m., New York City time, on the expiration date for the exchange offer. The date of acceptance for exchange of the original notes, and completion of the exchange offer, is the exchange date, which will be the first business day following the expiration date (unless extended as described in this prospectus). We will issue, on or promptly after the exchange date, an aggregate principal amount of (i) up to $750,000,000 of the new 2017 notes for a like principal amount of the outstanding original 2017 notes tendered and accepted in connection with the exchange offer and (ii) up to $750,000,000 of the new 2037 notes for a like principal amount of the outstanding original 2037 notes tendered and accepted in connection with the exchange offer. The new notes issued in connection with the exchange offer will be delivered on the earliest practicable

Table of Contents

date following the exchange date. Holders may tender some or all of their original notes in connection with the exchange offer, but only in principal amounts of $2,000 or in integral multiples of $1,000 principal amount in excess thereof.

The terms of the new notes will be identical in all material respects to the terms of the respective original notes, except that the new notes will have been registered under the Securities Act and are issued free from any covenant regarding registration, including the payment of additional interest upon a failure to file or have declared effective an exchange offer registration statement or to complete the exchange offer by certain dates. The new notes will evidence the same debt as the original notes and will be issued under the same indenture and entitled to the same benefits under that indenture as the original notes being exchanged. As of the date of this prospectus, $1,500.0 million in aggregate principal amount of the original notes are outstanding, consisting of (i) $750,000,000 aggregate principal amount of the original 2017 notes and (ii) $750,000,000 aggregate principal amount of the original 2037 notes.

In connection with the issuance of the original notes, we have arranged for the original notes originally purchased by qualified institutional buyers and those sold in reliance on Regulation S under the Securities Act to be issued and transferable in book-entry form through the facilities of The Depository Trust Company, which we refer to as DTC, acting as depositary. The new notes will be issued in the form of global notes registered in the name of DTC or its nominee and each beneficial owner s interest in it will be transferable in book-entry form through DTC.

Holders of original notes do not have any appraisal or dissenters rights in connection with the exchange offer. Original notes that are not tendered for exchange or are tendered but not accepted in connection with the exchange offer will remain outstanding and be entitled to the benefits of the indenture under which they were issued, but, subject to certain limited exceptions, will not be entitled to any registration rights under the exchange and registration rights agreement. See Consequences of Failures to Properly Tender Original Notes in the Exchange Offer .

We shall be considered to have accepted validly tendered original notes if and when we have given oral or written notice to the exchange agent. The exchange agent will act as agent for the tendering holders for the purposes of receiving the new notes from us.

If any tendered original notes are not accepted for exchange because of an invalid tender, the occurrence of certain other events described in this prospectus or otherwise, we will return the original notes, without expense, to the tendering holder as quickly as possible after the expiration date.

Holders who tender original notes will not be required to pay brokerage commissions or fees or, subject to the instructions in the letter of transmittal, transfer taxes on exchange of original notes in connection with the exchange offer. We will pay all charges and expenses, other than certain applicable taxes described below, in connection with the exchange offer. See Fees and Expenses .

Expiration Date; Extensions; Amendments

The expiration date for the exchange offer is 5:00 p.m., New York City time, on June 11, 2008, unless extended by us in our sole discretion (but in no event to a date later than June 26, 2008), in which case the term expiration date shall mean the latest date and time to which the exchange offer is extended.

We reserve the right, in our sole discretion:

- to delay accepting any original notes, to extend the offer or to terminate the exchange offer if, in our reasonable judgment, any of the conditions described below shall not have been satisfied, by giving oral or written notice of the delay, extension or termination to the exchange agent; or

- to amend the terms of the exchange offer in any manner.

Table of Contents

If we amend the exchange offer in a manner that we consider material, we will disclose such amendment by means of a prospectus supplement, and, if necessary, we will extend the exchange offer for a period of five to ten business days after disclosure of such a material change.

If we determine to make a public announcement of any delay, extension, amendment or termination of the exchange offer, we will do so by making a timely release through an appropriate news agency.

If we delay accepting any original notes or terminate the exchange offer, we promptly will pay the consideration offered, or return any original notes deposited, pursuant to the exchange offer as required by Rule 14e-1(c) under the Exchange Act.

Interest on the New Notes

Interest on the new 2017 notes will accrue at a per annum rate of 6.085% from the most recent date to which interest on the original 2017 notes has been paid or, if no interest has been paid, from October 22, 2007. Interest on the new 2037 notes will accrue at a per annum rate of 6.593% from the most recent date to which interest on the original 2037 notes has been paid or, if no interest has been paid, from October 22, 2007.

Interest on the new notes will be paid semiannually to holders of record at the close of business on April 1 and October 1 immediately preceding the interest payment date on April 15 and October 15 of each year, commencing on April 15, 2008 or, if the exchange offer is not consummated by such date, October 15, 2008.

Conditions to the Exchange Offer

Notwithstanding any other term of the exchange offer, we will not be required to accept for exchange, or exchange new notes for, any original notes and may terminate the exchange offer as provided in this prospectus before the acceptance of the original notes, if prior to the expiration date:

- any action or proceeding is instituted or threatened in any court or by or before any governmental agency relating to the exchange offer which, in our reasonable judgment, might materially impair our ability to proceed with the exchange offer or materially impair the contemplated benefits of the exchange offer to us, or any material adverse development has occurred in any existing action or proceeding relating to us or any of our subsidiaries;

- any change, or any development involving a prospective change, in our business or financial affairs or any of our subsidiaries has occurred which, in our reasonable judgment, might materially impair our ability to proceed with the exchange offer or materially impair the contemplated benefits of the exchange offer to us;

- any law, statute, rule or regulation is proposed, adopted or enacted, which in our reasonable judgment, might materially impair our ability to proceed with the exchange offer or materially impair the contemplated benefits of the exchange offer to us; or

- any governmental or regulatory approval has not been obtained, which approval we, in our reasonable discretion, consider necessary for the completion of the exchange offer as contemplated by this prospectus.

The conditions listed above are for our sole benefit and may be asserted by us regardless of the circumstances giving rise to any of these conditions. We may waive these conditions in our reasonable discretion in whole or in part at any time and from time to time prior to the expiration date. The failure by us at any time to exercise any of the above rights shall not be considered a waiver of such right, and such right shall be considered an ongoing right which may be asserted at any time and from time to time.

Table of Contents

If we determine in our reasonable discretion that any of the conditions are not satisfied, we may:

- refuse to accept any original notes and return all tendered original notes to the tendering holders;
- extend the exchange offer and retain all original notes tendered before the expiration of the exchange offer, subject, however, to the rights of holders to withdraw these original notes (see Withdrawal of Tenders below); or
- waive unsatisfied conditions relating to the exchange offer and accept all properly tendered original notes which have not been withdrawn.

Procedures for Tendering

Unless the tender is being made in book-entry form, to tender in the exchange offer, a holder must:

- complete, sign and date the letter of transmittal, or a facsimile of it;
- have the signatures guaranteed if required by the letter of transmittal; and
- mail or otherwise deliver the letter of transmittal or the facsimile, the original notes and any other required documents to the exchange agent prior to 5:00 p.m., New York City time, on the expiration date.

Any financial institution that is a participant in DTC s Book-Entry Transfer Facility system may make book-entry delivery of the original notes by causing DTC to transfer the original notes into the exchange agent s account. To validly tender original notes through DTC, the financial institution that is a participant in DTC will electronically transmit its acceptance through the Automated Tender Offer Program. DTC will then verify the acceptance, execute a book-entry transfer of the tendered original notes into the applicable account of the exchange agent at DTC and then send to the exchange agent confirmation of such book-entry transfer. The confirmation of such book-entry transfer will include an agent s message stating that DTC has received an express acknowledgment from the participant in DTC tendering the original notes that the participant has received and agrees to be bound by the terms of the letter of transmittal and that we may enforce the terms of the letter of transmittal against the participant. A tender of original notes through a book-entry transfer into the exchange agent s account will only be effective if an agent s message or letter of transmittal (or facsimile), with any required signature guarantees and any other required documents are transmitted to and received or confirmed by the exchange agent at its address set forth under the caption Exchange Agent below, prior to 5:00 p.m., New York City time, on the expiration date. Delivery of documents to DTC in accordance with its procedures does not constitute delivery to the exchange agent.

The tender by a holder of original notes will constitute an agreement between us and the holder in accordance with the terms and subject to the conditions set forth in this prospectus and in the letter of transmittal.

The method of delivery of original notes and the letter of transmittal and all other required documents to the exchange agent is at the election and risk of the holders. Instead of delivery by mail, we recommend that holders use an overnight or hand delivery service. In all cases, holders should allow sufficient time to assure delivery to the exchange agent before the expiration date. No letter of transmittal of original notes should be sent to us. Holders may request their respective brokers, dealers, commercial banks, trust companies or nominees to effect the tenders for such holders.

Any beneficial owner whose original notes are registered in the name of a broker, dealer, commercial bank, trust company or other nominee and who wishes to tender should contact the registered holder promptly and instruct such registered holder to tender on behalf of the beneficial owner. If the beneficial owner wishes to tender on that owner s own behalf, the beneficial owner must, prior to completing and executing the letter of transmittal and delivering such beneficial owner s original notes, either make appropriate arrangements to register ownership of the original notes in such beneficial owner s name or obtain a properly completed bond power from the registered holder. The transfer of registered ownership may take considerable time.

30

Table of Contents

Signatures on letters of transmittal or notices of withdrawal must be guaranteed by an eligible guarantor institution within the meaning of Rule 17Ad-15 under the Exchange Act, unless the original notes tendered pursuant thereto are tendered:

- by a registered holder who has not completed the box entitled Special Issuance Instructions or Special Delivery Instructions on the letter of transmittal; or
- for the account of an eligible guarantor institution.

In the event that a signature on a letter or transmittal or a notice of withdrawal is required to be guaranteed, such guarantee must be by:

- a member firm of a registered national securities exchange or of the Financial Industry Regulatory Authority;
- a commercial bank or trust company having an office or correspondent in the United States; or
- an eligible guarantor institution .

If the letter of transmittal is signed by a person other than the registered holder of any original notes, the original notes must be endorsed by the registered holder or accompanied by a properly completed bond power, in each case signed or endorsed in blank by the registered holder.

If the letter of transmittal or any original notes or bond powers are signed or endorsed by trustees, executors, administrators, guardians, attorneys-in-fact, officers of corporations or others acting in a fiduciary or representative capacity, such persons should so indicate when signing and, unless waived by us, submit evidence satisfactory to us of their authority to act in that capacity with the letter of transmittal.

We will determine all questions as to the validity, form, eligibility (including time of receipt) and acceptance and withdrawal of tendered original notes in our sole discretion. We reserve the absolute right to reject any and all original notes not properly tendered or any original notes whose acceptance by us would, in the opinion of our counsel, be unlawful. We also reserve the right to waive any defects, irregularities or conditions of tender as to any particular original notes either before or after the expiration date. Our interpretation of the terms and conditions of the exchange offer (including the instructions in the letter of transmittal) will be final and binding on all parties. Unless waived, any defects or irregularities in connection with tenders of original notes must be cured within a time period we will determine. Although we intend to request the exchange agent to notify holders of defects or irregularities relating to tenders of original notes, neither we, the exchange agent nor any other person will have any duty or incur any liability for failure to give such notification. Tenders of original notes will not be considered to have been made until such defects or irregularities have been cured or waived. Any original notes received by the exchange agent that are not properly tendered and as to which the defects or irregularities have not been cured or waived will be returned by the exchange agent to the tendering holders, unless otherwise provided in the letter of transmittal, as soon as practicable following the expiration date.

In addition, we reserve the right, as set forth above under the caption Conditions to the Exchange Offer , to terminate the exchange offer.

By tendering, each holder represents to us, among other things, that:

- the new notes acquired in connection with the exchange offer are being obtained in the ordinary course of business of the person receiving the new notes, whether or not such person is the holder;
- neither the holder nor any such other person has an arrangement or understanding with any person to participate in the distribution of such new notes; and

neither the holder nor any such other person is our affiliate (as defined in Rule 405 under the Securities Act).

Table of Contents

If the holder is a broker-dealer which will receive new notes for its own account in exchange for original notes, it will acknowledge that it acquired such original notes as the result of market-making activities or other trading activities and it will deliver a prospectus in connection with any resale of such new notes. See Plan of Distribution .

Guaranteed Delivery Procedures

A holder who wishes to tender its original notes and:

whose original notes are not immediately available;

who cannot deliver the holder s original notes, the letter of transmittal or any other required documents to the exchange agent prior to the expiration date; or

who cannot complete the procedures for book-entry transfer before the expiration date;

may effect a tender if

the tender is made through an eligible guarantor institution;

before the expiration date, the exchange agent receives from the eligible guarantor institution:

(i) a properly completed and duly executed notice of guaranteed delivery by facsimile transmission, mail or hand delivery,

(ii) the name and address of the holder, and

(iii) the certificate number(s) of the original notes and the principal amount of original notes tendered, stating that the tender is being made and guaranteeing that, within three New York Stock Exchange trading days after the expiration date, the letter of transmittal and the certificate(s) representing the original notes (or a confirmation of book-entry transfer), and any other documents required by the letter of transmittal will be deposited by the eligible guarantor institution with the exchange agent; and

the exchange agent receives, within three New York Stock Exchange trading days after the expiration date, a properly completed and executed letter of transmittal or facsimile, as well as the certificate(s) representing all tendered original notes in proper form for transfer or a confirmation of book-entry transfer, and all other documents required by the letter of transmittal.

Withdrawal of Tenders

Except as otherwise provided herein, tenders of original notes may be withdrawn at any time prior to 5:00 p.m., New York City time, on the expiration date.

To withdraw a tender of original notes in connection with the exchange offer, a written or facsimile transmission notice of withdrawal must be received by the exchange agent at its address set forth herein prior to 5:00 p.m., New York City time, on the expiration date. Any such notice of withdrawal must:

specify the name of the person who deposited the original notes to be withdrawn;

identify the original notes to be withdrawn (including the certificate number(s) and principal amount of such original notes);

be signed by the depositor in the same manner as the original signature on the letter of transmittal by which such original notes were tendered (including any required signature guarantees) or be accompanied by documents of transfer sufficient to have the Trustee register the transfer of such original notes into the name of the person withdrawing the tender; and

specify the name in which any such original notes are to be registered, if different from that of the depositor.

Table of Contents

We will determine all questions as to the validity, form and eligibility (including time of receipt) of such notices of withdrawal. Any original notes so withdrawn will be considered not to have been validly tendered for purposes of the exchange offer, and no new notes will be issued unless the original notes withdrawn are validly re-tendered. Any original notes which have been tendered but which are not accepted for exchange or which are withdrawn will be returned to the holder without cost to such holder as soon as practicable after withdrawal, rejection of tender or termination of the exchange offer. Properly withdrawn original notes may be re-tendered by following one of the procedures described above under the caption Procedures for Tendering at any time prior to the expiration date.

Exchange Agent

Wells Fargo Bank, National Association has been appointed as exchange agent in connection with the exchange offer. Questions and requests for assistance, requests for additional copies of this prospectus or of the letter of transmittal should be directed to the exchange agent by registered or certified mail to Wells Fargo Bank, N.A., Corporate Trust Operations, MAC N9303-121, P.O. Box 1517, Minneapolis, MN 55480, by overnight courier or regular mail to Wells Fargo Bank, N.A., Corporate Trust Operations, MAC N9303-121, 6th & Marquette Avenue, Minneapolis, MN 55479 or by hand delivery to Wells Fargo Bank, N.A., Corporate Trust Services, 608 2nd Avenue South, Northstar East Building-12th Floor, Minneapolis, MN 55402. The exchange agent s telephone number is (800) 344-5128 and facsimile number is (612) 667-6282.

Fees and Expenses

We will not make any payment to brokers, dealers or others soliciting acceptances of the exchange offer. We will pay certain other expenses to be incurred in connection with the exchange offer, including the fees and expenses of the exchange agent and certain accounting and legal fees.

Holders who tender their original notes for exchange will not be obligated to pay transfer taxes. However, if:

- new notes are to be delivered to, or issued in the name of, any person other than the registered holder of the original notes tendered; or
- tendered original notes are registered in the name of any person other than the person signing the letter of transmittal; or
- a transfer tax is imposed for any reason other than the exchange of original notes in connection with the exchange offer;

then the amount of any such transfer taxes (whether imposed on the registered holder or any other person) will be payable by the tendering holder. If satisfactory evidence of payment of such taxes or exemption from them is not submitted with the letter of transmittal, the amount of such transfer taxes will be billed directly to the tendering holder.

Accounting Treatment

The new notes will be recorded at the same carrying value as the original notes as reflected in our accounting records on the date of the exchange. Accordingly, we will not recognize any gain or loss for accounting purposes upon the completion of the exchange offer. The expenses of the exchange offer that we pay will increase our deferred financing costs in accordance with generally accepted accounting principles.

Consequences of Failures to Properly Tender Original Notes in the Exchange Offer

Issuance of the new notes in exchange for the original notes in the exchange offer will be made only after timely receipt by the exchange agent of such original notes, a properly completed and duly executed letter of transmittal and all other required documents. Therefore, holders of the original notes desiring to tender such

Table of Contents

original notes in exchange for new notes should allow sufficient time to ensure timely delivery. We are under no duty to give notification of defects or irregularities of tenders of original notes for exchange. Original notes that are not tendered or that are tendered but not accepted by us will, following completion of the exchange offer, continue to be subject to the existing restrictions upon transfer thereof under the Securities Act, and, upon completion of the exchange offer, certain registration rights under the exchange and registration rights agreement will terminate. In the event the exchange offer is completed, other than in limited circumstances, we will not be required to register the remaining original notes. Remaining original notes will continue to be subject to the following restrictions on transfer:

- the remaining original notes may be resold only (i) if registered pursuant to the Securities Act, (ii) if an exemption from registration is available, or (iii) if neither such registration nor such exemption is required by law; and

- the remaining original notes will bear a legend restricting transfer in the absence of registration or an exemption.

We do not currently anticipate that we will register the remaining original notes under the Securities Act. To the extent that original notes are tendered and accepted in connection with the exchange offer, any trading market for remaining original notes could be adversely affected. See Risk Factors Risks Relating to the Notes and the Exchange Offer If you fail to exchange your original notes, they will continue to be restricted securities and may become less liquid .

Table of Contents

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The following unaudited pro forma condensed consolidated financial information have been developed by applying pro forma adjustments to the historical audited consolidated financial statements of American Water appearing elsewhere in this prospectus. See the explanatory note to the unaudited pro forma condensed consolidated financial statements. The unaudited pro forma condensed consolidated statements of operations give effect to the Transactions as if they had occurred on January 1, 2007. The unaudited pro forma condensed consolidated balance sheet gives effect to the adjustment of restricted stock units from liability classified awards to equity classified awards as a result of the initial public offering as if it had occurred on December 31, 2007. The Transactions consist of the following:

The Merger, comprising:

The merger of Thames US Holdings into American Water with American Water being the surviving entity.

The Refinancing, comprising:

The non-cash equity contribution to the Company by RWE of $100.0 million of debt of our subsidiaries held by RWE on March 29, 2007 and the $550.0 million cash equity contribution to the Company by RWE on March 29, 2007, which was used to pay down $232.5 million of short-term debt and the remainder used for general working capital purposes;

The $1,750.0 million issuance of RWE redemption notes on September 20, 2007, which was used to fund the early redemption of $1,750.0 million of preferred stock held by RWE;

The issuance of $1,500.0 million aggregate principal amount of new senior notes, less issuance costs of $11.7 million on October 22, 2007, which resulted in the repayment of $1,286.0 million aggregate principal amount of RWE redemption notes and $206.0 million of RWE notes;

The $8.6 million gain (after tax gains of $5.2 million, net of $3.4 million of tax) on early repayment of RWE notes;

The issuance of $415.0 million of commercial paper to fund the partial repayment of $464.0 million of RWE redemption notes with the balance of $49.0 million of the RWE redemption notes repaid with excess cash; and

The cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007, which was used to pay down commercial paper.

The 160,000-for-1 split of common stock effected on November 7, 2007.

The initial public offering of 58,000,000 shares of our common stock, consummated on April 28, 2008.

The unaudited pro forma condensed consolidated statement of operations adjustments and financial information do not include the $150.0 million equity contribution from RWE on September 27, 2007.

The Company paid approximately $3.0 million in completion bonuses related to the initial public offering to various key members of management. As of December 31, 2007, approximately $2.6 million has been accrued as a portion of the completion bonuses are not contingent on the successful completion of the initial public offering and may be paid as cash bonuses. The unaccrued portion of the completion bonuses has not been reflected in the unaudited pro forma condensed consolidated financial information.

Assumptions underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with these unaudited pro forma condensed consolidated financial statements.

The unaudited pro forma adjustments and financial information:

- are based upon available information and certain assumptions that we believe are reasonable under the circumstances;

- are presented for informational purposes only;

Table of Contents

do not purport to represent what our results of operations or financial condition would have been had the Transactions actually occurred on the dates indicated; and

do not purport to project our results of operations or financial condition for any future period or as of any future date.

The unaudited pro forma condensed consolidated financial statements should be read in conjunction with the information contained in Use of Proceeds, Selected Historical Consolidated Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes thereto appearing elsewhere in this prospectus. All pro forma adjustments and their underlying assumptions are described more fully in the notes to our unaudited pro forma condensed consolidated financial statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

Unaudited Pro Forma Condensed Consolidated Statement of Operations

For the Year Ended December 31, 2007

	Historical	Pro forma adjustments	Pro forma
	(In thousands except per share data)		
Operating revenues	$ 2,214,215	$	$ 2,214,215
Operating expenses			
Operation and maintenance	1,246,479	2,540(A)	1,249,019
Depreciation and amortization	267,335		267,335
General taxes	183,253		183,253
Loss (gain) on sale of assets	(7,326)		(7,326)
Impairment charges	509,345		509,345
Total operating expenses, net	2,199,086	2,540	2,201,626
Operating income (loss)	15,129	(2,540)	12,589
Other income (deductions)			
Interest	(283,165)	(1,705)(B)	(281,232)
		4,116 (C)	
		(478)(D)	
Amortization of debt expense	(4,867)	(544)(B)	(5,411)
Other, net	17,384		17,384
Total other income (deductions)	(270,648)	1,389	(269,259)
Income (loss) from continuing operations before income taxes	(255,519)	(1,151)	(256,670)
Provision for income taxes	86,756	(455)(E)	86,301
Income (loss) from continuing operations	$ (342,275)	$ (696)	$ (342,971)
Unaudited pro forma earnings per share:			
Basic	$ (2.14)		$ (2.14)
Diluted	$ (2.14)		$ (2.14)
Weighted average shares used in calculating earnings per share:			
Basic	160,000	(F)	160,000
Diluted	160,000	(G)	160,000

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

Unaudited Pro Forma Condensed Consolidated Balance Sheet

December 31, 2007

	Historical	Pro forma adjustments	Pro forma
	(in thousands, except per share data)		
ASSETS			
Property, plant and equipment			
Utility plant at original cost, net of accumulated depreciation	$ 9,199,909	$	$ 9,199,909
Nonutility property, net of accumulated depreciation	118,052		118,052
Total property, plant and equipment	9,317,961		9,317,961
Current assets			
Cash and cash equivalents	13,481		13,481
Other current assets	416,873		416,873
Total current assets	430,354		430,354
Regulatory and other long-term assets			
Goodwill	2,456,952		2,456,952
Other regulatory and other long-term assets	728,805		728,805
Total regulatory and other long-term assets	3,185,757		3,185,757
TOTAL ASSETS	$ 12,934,072	$	$ 12,934,072
CAPITALIZATION & LIABILITIES			
Capitalization			
Common stockholders equity	$ 4,542,046	$ 680(H)	$ 4,542,726
Preferred stock without mandatory redemption requirements	4,568		4,568
Long-term debt			
Long-term debt	4,674,837		4,674,837
Redeemable preferred stock at redemption value	24,296		24,296
Total capitalization	9,245,747	680	9,246,427
Current liabilities			
Short-term debt and current portion of long-term debt	316,969		316,969
Other current liabilities	457,520		457,520
Total current liabilities	774,489		774,489
Total regulatory and other long-term liabilities	2,095,449	(680)(H)	2,094,769
Contributions in aid of construction	818,387		818,387
TOTAL CAPITALIZATION AND LIABILITIES	$ 12,934,072	$	$ 12,934,072

See accompanying notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

Notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements

Explanatory Note: On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. American Water is an indirect majority-owned subsidiary of RWE. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.

(A) Reflects the granting of 843,869 unvested stock options, 107,025 restricted stock units and 89,921 restricted stock awards to our employees in connection with the initial public offering. The awards were issued under the American Water 2007 Omnibus Equity Compensation Plan and will be recorded as equity awards. The restricted stock units and stock options vest over a 3-year period commencing January 1, 2007 and 566,562 unvested stock options and 71,852 restricted stock units are expected to vest over the three-year period based on our assessment of the probability of achieving performance conditions. The 89,921 restricted stock awards vest over a 3-month period commencing with the pricing of the initial public offering and 89,921 of the awards are expected to vest over the 3-month period. The grant date value of the stock options at issuance was $4.09 using the following assumptions in a Black-Scholes model: $21.50 Exercise Price, 52 1/2 month Expected Term, 2.87% Discount Rate, 29% Volatility, 3.72% Dividend Yield.

(B) The sources and uses of funds in connection with the Refinancing and the related impact on interest expense related to the Transactions are summarized below, which are defined and further discussed elsewhere in this prospectus.

	Principal	Rate	Interest expense 12 months	Debt expense amortization 12 months
			(In thousands)	
SOURCES:				
RWE redemption notes(1)	$ 1,750,000	5.72%	100,122	
Original notes(1)	1,500,000	6.34%	77,124	
Commercial paper(1)	415,000	5.31%	22,036	
RWE cash equity contribution(1)	266,000			
Excess cash	49,026			
Total	$ 3,980,026		$ 199,282	
USES:				
Redeemable preferred stock(1)	$ 1,750,000		$ (74,569)	
RWE redemption notes(1)	1,750,000		(100,122)	
RWE notes(1)	202,370		(9,154)	
Commercial paper(1)	266,000		(13,732)	
Financing costs	11,656			$ 544
Total	$ 3,980,026		(197,577)	544
Net increase (decrease)			$ (1,705)	$ 544

(1) The issuance of $1,750.0 million of RWE redemption notes on September 20, 2007 was used to fund the early redemption of $1,750.0 million of preferred stock held by RWE. The RWE redemption notes were repaid early with $1,286.0 million of the proceeds of the original notes, $415.0 million of commercial paper and $49.0 million of excess cash. $202.4 million of the proceeds of the original notes were used to fund the repayment of $206.0 million (including after tax gains of $2.2 million, net of $1.4 million of tax) of RWE notes. The cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007 was used to

pay down commercial paper.

(C) Reflects the non-cash equity contribution to the Company by RWE of $100.0 million of debt of our subsidiaries held by RWE and the $550.0 million of cash equity contribution to the Company by RWE on March 29, 2007. The cash was used to pay down $232.5 million of short-term debt with the remainder used for general working capital purposes.

Table of Contents

The resulting reduction in interest expense is computed as follows:

	RWE Notes	Commercial Paper	Total
		(In thousands)	
Principal redemption	$ 100,000	$ 232,500	
Calculated effective rate	4.00%	5.44%	
Reduction in interest expense for the year ended December 31, 2007	$ 989	$ 3,127(1)	$ 4,116

(1) Reflects actual interest accrued from January 1, 2007 to March 27, 2007.

(D) Reflects the amortization of the $8.6 million gain on the early extinguishment of RWE notes, which was recorded as a long term regulatory liability, over the lives of the debt tranches that were repaid.

(E) Represents the reduction in income tax expense resulting from the Transactions at the estimated blended tax rate of 39.6%.

(F) The number of common shares used to compute pro forma basic earnings per common share is 160.0 million, which is the number of shares of our common stock assumed to be outstanding upon the consummation of the initial public offering.

(G) The number of shares used to compute pro forma diluted earnings per share is based on the number of shares of our common stock described in (F) above, plus the potential dilution that could occur if options and restricted stock units granted under the American Water 2007 Omnibus Equity Compensation Plan were exercised or converted into common stock. There are no dilutive incremental common shares included in the calculation of pro forma diluted earnings per share as the potentially dilutive instruments would be antidilutive.

(H) Reflects the adjustment of the restricted stock units from liability-classified awards to equity-classified awards as of the completion of the initial public offering resulting in a reclassification of $0.7 million of current liabilities to additional paid-in capital.

Table of Contents

SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

The following table presents our selected historical consolidated financial data at the dates and for the periods indicated. The statements of operations data for the years ended December 31, 2005, 2006 and 2007 and the balance sheet data as of December 31, 2006 and 2007 have been derived from our audited consolidated financial statements included elsewhere in this prospectus. The historical financial data as of December 31, 2005 have been derived from our audited consolidated financial statements not included in this prospectus. The statement of operations for the years ended December 31, 2003 and 2004, and the financial data as of December 31, 2003 and 2004 have been derived from our historical financial statements, in each case, which are not included in this prospectus.

Our historical consolidated financial data are not necessarily indicative of our future performance or what our financial position and results of operations would have been if we had operated as a separate, stand-alone entity during the periods shown. This financial data should be read in conjunction with, and is qualified in its entirety by reference to, the information in the section in this prospectus entitled Use of Proceeds , Unaudited Pro Forma Condensed Consolidated Financial Information , Management s Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the notes thereto included elsewhere in this prospectus.

	For the years ended December 31,				
	2003 (unaudited)	2004	2005	2006	2007
	(in thousands, except per share data)				
Statement of operations data(1):					
Operating revenues	$ 1,890,291	$ 2,017,871	$ 2,136,746	$ 2,093,067	$ 2,214,215
Operating expenses					
Operation and maintenance	1,089,071	1,121,970	1,201,566	1,174,544	1,246,479
Depreciation and amortization	210,588	225,260	261,364	259,181	267,335
General taxes	164,677	170,165	183,324	185,065	183,253
Loss (gain) on sale of assets(2)	(16,771)	(8,611)	(6,517)	79	(7,326)
Impairment charges	3,555	78,688	385,434	221,685	509,345
Total operating expenses, net	1,451,120	1,587,472	2,025,171	1,840,554	2,199,086
Operating income (loss)	439,171	430,399	111,575	252,513	15,129
Other income (deductions)					
Interest	(280,501)	(315,944)	(345,257)	(365,970)	(283,165)
Amortization of debt expense	(3,872)	(3,377)	(4,367)	(5,062)	(4,867)
Other, net(3)	(52,387)	14,350	13,898	9,581	17,384
Total other income (deductions)	(336,760)	(304,971)	(335,726)	(361,451)	(270,648)
Income (loss) from continuing operations before income taxes	102,411	125,428	(224,151)	(108,938)	(255,519)
Provision for income taxes	60,271	66,328	50,979	46,912	86,756
Income (loss) from continuing operations	$ 42,140	$ 59,100	$ (275,130)	$ (155,850)	$ (342,275)
Income (loss) from continuing operations per basic common share(4)	$ 0.26	$ 0.37	$ (1.72)	$ (0.97)	$ (2.14)
Income (loss) from continuing operations per common diluted share(4)	$ 0.26	$ 0.37	$ (1.72)	$ (0.97)	$ (2.14)
Basic weighted average common shares(4)	160,000	160,000	160,000	160,000	160,000
Diluted weighted average common shares(4)	160,000	160,000	160,000	160,000	160,000

41

Table of Contents

	For the years ended December 31,		
	2005	2006	2007
		(in thousands)	
Other data:			
Cash flows provided by (used in):			
Operating activities	$ 525,435	$ 323,748	$ 473,712
Investing activities	(530,165)	(691,438)	(746,578)
Financing activities	(9,049)	332,367	256,593
Construction expenditures	(558,446)	(688,843)	(758,569)

	As of December 31,				
	2003	2004	2005	2006	2007
	(unaudited)		(in thousands)		
Balance sheet data:					
Cash and cash equivalents	$ 71,097	$ 78,856	$ 65,077	$ 29,754	$ 13,481
Utility plant and property, net of depreciation	7,377,195	7,754,434	8,101,769	8,605,341	9,199,909
Total assets	12,629,354	12,728,410	12,542,029	12,783,059	12,934,072
Other short term and long term debt	5,063,344	5,101,891	5,030,078	4,103,532	4,991,806
Redeemable preferred stock	1,787,777	1,775,224	1,774,691	1,774,475	24,296
Total debt	6,851,121	6,877,115	6,804,769	5,878,007	5,016,102
Common stockholder equity	3,198,144	3,129,555	2,804,716	3,817,397	4,542,046
Preferred stock without mandatory redemption requirements	5,687	4,651	4,571	4,568	4,568

(1) On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. American Water is an indirect majority-owned subsidiary of RWE. The historical consolidated financial statements of American Water represent the consolidated results of the Company, formerly issued under the name Thames Water Aqua US Holdings, Inc. and Subsidiary Companies.

(2) Represents primarily losses (gains) on sales of publicly traded securities and dispositions of assets not needed in utility operations.

(3) Includes allowance for other funds used during construction, allowance for borrowed funds used during construction and preferred dividends of subsidiaries.

(4) The number of shares used to compute income (loss) from continuing operations per basic share and income (loss) from continuing operations per diluted common share for the fiscal years ended December 31, 2005, 2006 and 2007 is 160.0 million after giving effect to the 160,000-for-1 stock split on November 7, 2007. For the year ended December 31, 2007, there are no dilutive incremental common shares included in diluted earnings per share as all potentially dilutive instruments would be antidilutive.

Table of Contents

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations covers periods prior to the consummation of the Transactions. Accordingly, the discussion and analysis of historical periods does not reflect the significant impact that the Transactions will have on us. You should read the following discussion together with the financial statements and the notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements that are based on management s current expectations, estimates and projections about our business and operations. The cautionary statements made in this prospectus should be read as applying to all related forward-looking statements whenever they appear in this prospectus. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss under Risk Factors and elsewhere in this prospectus. You should read Risk Factors and Forward-Looking Statements.

Overview

Founded in 1886, American Water is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our nearly 7,000 employees provide approximately 15.6 million people with drinking water, wastewater and other water-related services in 32 states and Ontario, Canada. In 2007, we generated $2,214.2 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, and $15.1 million in operating income, which includes $509.3 million of impairment charges relating to continuing operations, and a net loss of $342.8 million.

Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state PUCs in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters. Our Regulated Businesses currently provide services in 20 states and in 2007 served approximately 3.3 million customers, or connections to our water and wastewater networks. We report the results of this business in our Regulated Businesses segment. In 2007, our Regulated Businesses generated $1,987.6 million in operating revenue, prior to inter-segment eliminations, representing 89.8% of our consolidated operating revenue.

We also provide services that are not subject to economic regulation by state PUCs. Our Non-Regulated Businesses include our:

- Contracts Operations Group, which enters into public/private partnerships, including O&M and DBO contracts for the provision of services to water and wastewater facilities for municipalities, the United States military and other customers;
- Applied Water Management Group, which works with customers to design, build and operate small water and wastewater treatment plants; and
- Homeowner Services Group, which provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes.

We report the results of this business in our Non-Regulated Businesses segment. In 2007, our Non-Regulated Businesses generated $242.7 million in operating revenue, prior to inter-segment eliminations.

History

Prior to being acquired by RWE in 2003, we were the largest publicly traded water utility company in the United States. In 2003, we were acquired by RWE and became a private company. Prior to the Merger, Thames US Holdings, formerly an indirect wholly owned subsidiary of RWE, was the holding company for us and our regulated and unregulated subsidiaries throughout the United States and Ontario, Canada.

43

Table of Contents

Our consolidated statements of operations for the years ended December 31, 2005 and 2006 reflect expense allocations for some central corporate functions historically provided to us by Thames Water Plc, a former subsidiary of RWE, which we refer to as Thames Water, including information systems, human resources, accounting and treasury activities and legal services. These allocations reflected expenses specifically identifiable as relating to our business as well as our share of expenses allocated to us based on capital employed, capital expenditures, headcount, revenues, production volumes, fixed costs, environmental accruals or other methods management considers to be reasonable. During our transition to a separate, stand-alone company, we have developed or obtained additional in-house capabilities related to these functions, and therefore there were no such expense allocations in 2007 from RWE or its affiliates. We and RWE consider these allocations to be a reasonable reflection of our utilization of the services provided by Thames Water. However, our expenses as a separate, stand-alone company may be higher or lower than the amounts reflected in our consolidated statements of operations.

The RWE acquisition resulted in certain changes in our business. For example, our operations and management were managed through Thames Water. Also, we agreed not to file rate cases with some state PUCs for specified periods of time as a condition of the acquisition. As of December 31, 2007, all rate stay-out provisions associated with the RWE acquisition had expired.

As a result of significantly increased costs, our inability to file rate cases and impairment charges, we recorded net losses in the amount of $325.0 million, $162.2 million and $342.8 million for the years ended December 31, 2005, 2006, and 2007 respectively.

In 2005, RWE decided to divest American Water. In March 2006, RWE decided to divest American Water through the sale of shares in one or more public offerings. In order to become a public company once again, we have had to incur substantial initial costs, including costs associated with ensuring adequate internal control over financial reporting in order to achieve compliance with the Sarbanes-Oxley Act. These substantial initial costs will not be recovered in rates charged to our customers. See Our Internal Control and Remediation Initiatives.

We performed valuations of our long-lived assets, investments and goodwill, as of December 31, 2005, 2006 and 2007. As a result of the valuation analyses, we recorded pre-tax charges of $420.4 million and $227.8 million, including impairment charges from discontinued operations, for the years ended December 31, 2005 and 2006, respectively. During the third quarter of 2007, as a result of our debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, an interim impairment test was performed, and a pre-tax impairment charge to goodwill of $243.3 million was recorded in the third quarter of 2007. We completed our annual impairment test for 2007 and recorded an additional pre-tax goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007. We determined that an impairment had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, an additional pre-tax impairment to our carrying value was recorded. As a result of these impairments, net income was reduced by $388.6 million, $223.6 million and $501.5 million in 2005, 2006 and 2007, respectively.

The Company estimates the fair value of our long-lived assets, investments and goodwill using available market values, discounted cash flow models from our business plan or a combination of market and discounted cash flow values. Annual impairment reviews are performed in the fourth quarter. There are a number of significant assumptions reflected in our valuation analyses. These include market interest rates used for discounting future cash flows, market value assumptions using market valuation multiples of comparable water utilities, information regarding the Company s market value in connection with the initial public offering and revenue and operating income growth assumptions in our business plan. We base these assumptions on our best estimates of the Company s future performance and available market information at the time. Any decline over a period of time in the valuation multiples of comparable water utilities, a decline in the market value of our

Table of Contents

common stock and its value relative to our book equity or a decline over a period of time of our stock price could result in additional impairments. A decline in our forecasted results in our business plan, such as changes in rate case results or capital investment budgets or an increase in interest rates, may also result in an incremental impairment charge. In accordance with GAAP, the Company reviews goodwill annually, or more frequently, if changes in circumstances indicate the carrying value may not be recoverable. See Critical Accounting Policies and Estimates. Based on the price of our shares in the initial public offering, we have determined that it is probable that we will record an impairment to goodwill when we report results for the quarter ended March 31, 2008. The size of such impairment to goodwill, if any, cannot be determined at this time.

Our Internal Control and Remediation Initiatives

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, since 2003 and prior to our initial public offering, we were an indirect wholly owned subsidiary of RWE and, as a privately owned company, were not required to maintain a system of internal control consistent with the requirements of the SEC and the Sarbanes-Oxley Act, nor to prepare our own financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which requires us to perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting.

In connection with the preparation of our consolidated financial statements as of December 31, 2006, we and our independent registered public accountants identified the following material weaknesses in our internal control over financial reporting:

- Inadequate internal staffing and skills;
- Inadequate controls over financial reporting processes;
- Inadequate controls over month-end closing processes, including account reconciliations;
- Inadequate controls over maintenance of contracts and agreements;
- Inadequate controls over segregation of duties and restriction of access to key accounting applications; and
- Inadequate controls over tax accounting and accruals.

Since joining the Company in 2006, Donald L. Correll, our Chief Executive Officer, and Ellen C. Wolf, our Chief Financial Officer, have assigned a high priority to the evaluation and remediation of our internal controls, and have taken numerous steps to remediate these material weaknesses and to evaluate and strengthen our other internal controls over financial reporting. Some of the actions taken include:

- Increasing our internal financial staff numbers and skill levels, and using external resources to supplement our internal staff where necessary;
- Implementing detailed processes and procedures related to our period end financial closing processes, key accounting applications and our financial reporting processes;

Implementing or enhancing systems used in the financial reporting processes and month-end close processes;

Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;

Table of Contents

- Enhancing our internal audit staff;
- Hiring a director of internal control and a director of taxes;
- Implementing a tracking mechanism and new policy and procedure for approval of all contracts and agreements; and
- Retaining a nationally recognized accounting and auditing firm to assist management in developing policies and procedures surrounding internal controls over financial reporting, to evaluate and test these internal controls and to assist in the remediation of internal control deficiencies.

With respect to the material weaknesses described above, we have initiated a process to clearly delineate our control weaknesses and formulated a remediation plan. We believe that we have made significant progress in remediating several of the identified material weaknesses; however, as our testing procedures have not yet been completed, we can make no assurances as to the success of our remediation efforts. As of December 31, 2007, the Company has incurred $48.9 million to remediate these material weaknesses and to document and test key financial reporting controls. We will need to allocate additional resources to enhance the quality of our staff and to carry out the remediation of these material weaknesses. Based upon our current assessment, we expect to complete the remediation of these material weaknesses during 2008 with an estimated additional cost of approximately $15 million. The Company cannot indicate with certainty that the material weaknesses will be remediated or whether additional costs may be incurred. The Company needs to initiate additional controls and test the effectiveness of controls prior to concluding controls are effective. As a condition to state PUC approval of the RWE Divestiture, we agreed that costs incurred in connection with our initial internal control and remediation initiatives would not be recoverable in rates charged to our customers.

Elements of our remediation activities can only be accomplished over time, and our initiatives provide no assurances that they will result in an effective internal control environment. Our board of directors, in coordination with our audit committee, will continually assess the progress and sufficiency of these initiatives and make adjustments, as necessary.

Factors Affecting Our Results of Operations

As the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served, our financial condition and results of operations are influenced by a variety of industry-wide factors, including the following:

- economic utility regulation;
- the need for infrastructure investment;
- compliance with environmental, health and safety standards;
- production costs;
- customer growth;
- an overall trend of declining water usage per customer; and
- weather and seasonality.

Since our acquisition by RWE in 2003, our results of operations have also been significantly influenced by goodwill impairments.

Factors that may affect the results of operations of our Regulated Businesses operating performance are mitigated by state PUCs granting us appropriate rate relief that is designed to allow us to recover prudently incurred expenses and to earn an appropriate rate of return on our investment.

Table of Contents

Economic Utility Regulation

Our subsidiaries in the states in which we operate our Regulated Businesses are generally subject to extensive economic regulation by their respective state PUCs. Although specific authority might differ from state to state, in most states, these state PUCs must approve rates, accounting treatments, long-term financing programs, significant capital expenditures and plant additions, transactions between the regulated subsidiary and affiliated entities, reorganizations and mergers and acquisitions, in many instances prior to their completion. Regulatory policies not only vary from state to state, they may change over time. These policies will affect the timing as well as the extent of recovery of expenses and the realized return on invested capital.

Our operating revenue is typically determined by reference to the volume of water supplied to a customer multiplied by a price-per-gallon set by a tariff approved by the relevant state PUC. The process to obtain approval for a change in rates, or rate case, involves filing a petition with the state PUC on a periodic basis as determined by our capital expenditures needs and our operating costs. Rate cases and other rate-related proceedings can take several months to a year or more to complete. Therefore, there is frequently a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating expense increase and when those costs are reflected in rates. The management team at each of our regulated subsidiaries works to minimize regulatory lag.

Our results of operations are significantly affected by rates authorized by the state PUCs in the states in which we operate, and we are subject to risks and uncertainties associated with rate stay-outs and delayed or inadequate rate recovery. In addition to general rate case filings, we generate revenues through other cost recovery procedures. For example, some states in which we operate allow utility subsidiaries to recover system infrastructure replacement costs without the necessity of filing a full rate proceeding. Since infrastructure replacement is a significant element of capital expenditures made by our subsidiaries, such programs can reduce regulatory lag.

Currently, Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio have allowed the use of these infrastructure surcharges. These surcharges adjust periodically based on qualified capital expenditures being completed or anticipated in a future period. These surcharges are typically reset to zero when new base rates are effective and incorporate the costs of these infrastructure expenditures. We anticipate an increase in revenues of approximately $6.9 million in 2008, assuming constant sales volumes, as a result of these infrastructure surcharges.

Also, some of the states in which we operate permit pass-through provisions that allow for an increase in certain operating costs, such as purchased power and property taxes to be passed on to and recovered from the customers outside of a general rate proceeding.

Some states have permitted use of some form of forecast or forward looking test year instead of historical data to set rates. Examples of these states include Hawaii, Illinois, Kentucky, Ohio, Pennsylvania, New York and California. In addition, a number of states in which we operate have allowed the utility to update historical data for some changes that occur for some limited period of time subsequent to the historical test year. This allows the utility to take account of some more current costs or capital investments in the rate-setting process. Examples of these states include New Mexico, Texas, Missouri, Iowa, Virginia, Maryland, Tennessee, West Virginia, New Jersey and Arizona.

Another regulatory mechanism to address issues of regulatory lag includes the ability, in some circumstances, to recover in rates a return on utility plant before it is actually in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Texas, Pennsylvania, Ohio, Kentucky and California.

The infrastructure surcharge, pass-through provisions, the forward looking test year and the allowance of a return on utility plant before it is actually in service, are examples of mechanisms that present an opportunity to

Table of Contents

limit the risks associated with regulatory lag. We employ each of these mechanisms as part of our rate case management program to ensure efficient recovery of our costs and investment and to ensure positive short-term liquidity and long-term profitability.

In addition, some states have permitted us to seek pre-approval of certain capital projects and/or associated costs. In this pre-approval process, the PUCs assess the prudency of the project and/or the project financing.

As a condition to our acquisition by RWE in 2003, we agreed not to file rate cases in some of the states where our Regulated Businesses operate. All rate stay-out provisions associated with the RWE acquisition have expired. As of December 31, 2007 we are awaiting final orders for two general rate cases that were filed in 2006, requesting $10.9 million in total additional annual revenues. General rate cases filed in eight states in 2007, requesting $100.8 million in additional annualized revenues, are also pending final orders as of December 31, 2007. During 2007, we received authorizations for $145.9 million of additional annualized revenues from rates, assuming constant sales volumes. In addition, we expect to continue to receive additional revenues through infrastructure replacement surcharges. There is no assurance that the complete amount, or any portion thereof, of any requested increases will be granted.

Infrastructure Investment

The water and wastewater utility industry is highly capital intensive. From 2007 to 2011, we estimate that Company-funded capital investment will total between $4,000 and $4,500 million. We anticipate spending between $770 and $950 million yearly on Company-funded capital investment for the foreseeable future, depending upon the timing of major capital projects. Our capital investment includes both infrastructure renewal programs, where we replace existing infrastructure, as needed, and construction of facilities to meet new customer growth. From 2007 to 2011, we estimate we will invest approximately $1,700 million to replace aging infrastructure including mains, meters, and supply and treatment facilities. We estimate that we will invest approximately $1,300 million in facilities to serve new customer growth over this same period. In addition, we estimate that complying with water quality standards and other regulatory requirements will require approximately $700 million of investment. Projects to enhance system reliability, security and efficiency, or to meet other needs are projected to account for approximately an additional $500 million of investment over this same period.

These capital investments are needed on an ongoing basis to comply with existing and new regulations, renew aging treatment and network assets, provide capacity for new growth and enhance system reliability, security and quality of service. The need for continuous investment presents a challenge due to the potential for regulatory lag, or the delay in recovering our operating expenses and earning an appropriate rate of return on our invested capital and a return of our invested capital. Because the decisions of state PUCs and the timing of those decisions can have a significant impact on the operations and earnings of our Regulated Businesses, we maintain a rate case management program guided by the goals of obtaining efficient recovery of costs of capital and utility operation and maintenance costs, including costs incurred for compliance with environmental, health and safety and water quality regulation. As discussed above under Economic Utility Regulation, we pursue methods to minimize the adverse impact of regulatory lag and have worked with state PUCs and legislatures to implement a number of approaches to achieve this result, including promoting the implementation of forms of forward-looking test years and infrastructure surcharges.

Compliance with Environmental, Health and Safety Standards

Our water and wastewater operations are subject to extensive United States federal, state and local and, in the case of our Canadian operations, Canadian laws and regulations, governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat and discharge wastewater. These requirements include the Safe Drinking Water Act, the Clean Water Act and similar state and Canadian laws and regulations. We are also required to obtain various

Table of Contents

environmental permits from regulatory agencies for our operations. State PUCs also set conditions and standards for the water and wastewater services we deliver. We incur substantial costs associated with compliance with environmental, health and safety and water quality regulation to which our Regulated Businesses are subject.

Environmental, health and safety and water quality regulations are complex and change frequently, and the overall trend has been that they have become more stringent over time. We face the risk that as newer or stricter standards are introduced, they could increase our operating expenses. In the past, we have generally been able to recover expenses associated with compliance for environmental, health and safety standards, but this recovery is affected by regulatory lag and the corresponding uncertainties surrounding rate recovery.

Production Costs

Our water and wastewater services require significant production inputs and result in significant production costs. These costs include fuel and power, which is used to operate pumps and other equipment, purchased water and chemicals used to treat water and wastewater. We also incur production costs for waste disposal. For 2007, production costs accounted for approximately 12.8% of our total operating costs. Price increases associated with these inputs impact our results of operations until rate relief is granted.

Customer Growth

Customer growth in our Regulated Businesses is driven by (i) organic population growth within our authorized service areas and (ii) by adding new customers to our regulated customer base by acquiring water and wastewater utility systems through acquisitions. Generally, we add customers through tuck-ins of small water and/or wastewater systems, typically serving fewer than 10,000 customers, in close geographic proximity to where we currently operate our Regulated Businesses. We also seek large acquisitions that allow us to acquire multiple water and wastewater utility systems in our existing markets and markets where we currently do not operate our Regulated Businesses. During 2005, 2006 and 2007, we had cash outflows of $5.0 million, $12.5 million and $15.9 million, respectively, for acquisitions of water and wastewater systems which allowed us to expand our regulated customer base. Our most recent significant acquisition was the 2002 purchase of the water and wastewater assets of Citizens Communications Company, adding approximately 300,000 customers in six states in which we had existing operations. We intend to continue to expand our regulated footprint geographically by acquiring water and wastewater systems in our existing markets and some markets in the United States where we do not currently operate our Regulated Businesses. Our experienced development team evaluates potential acquisition targets across the country, particularly in higher-growth areas. Before entering new markets, we will evaluate the regulatory environment to ensure that we will have the opportunity to achieve an appropriate return on our investment while maintaining our high standards for quality, reliability and compliance with environmental, health and safety and water quality standards. These acquisitions may include large acquisitions of companies that have operations in multiple markets. For further information, see Our Business Our Regulated Businesses Acquisitions .

Declining Water Usage Per Customer

Increased water conservation, including through the use of more efficient household fixtures and appliances among residential consumers, combined with declining household sizes in the United States, has contributed to a trend of declining water usage per residential customer.

The average annual change in residential water usage per customer from January 1998 through December 2007 (as a percentage of January 1998 usage) in the larger states served by our Regulated Businesses ranged from 0.66% per year in New Jersey at the low end to as high as 1.63% per year in West Virginia.

Because the characteristics of residential water use are driven by many factors, including socio-economic and other demographic characteristics of our service areas, climate, seasonal weather patterns and water rates,

Table of Contents

these declining trends vary by state and service area and change over time. The trend of declining residential water usage per customer is higher in the predominantly rural states served by our Regulated Businesses. We do not believe that the trend in any particular state or region will have a disproportionate impact on our results of operations.

Our Regulated Businesses are heavily dependent upon operating revenue generated from rates we charge to our residential customers for the volume of water they use. Declining usage will have a negative impact on our long-term operating revenues if we are unable to secure rate increases or to grow our residential customer base to the extent necessary to offset the residential usage decline.

Water Supply

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. Drought, governmental restrictions, overuse of sources of water, the protection of threatened species or habitats or other factors may limit the availability of ground and surface water. Also, customer usage of water is affected by weather conditions, in particular during the summer. Our water systems experience higher demand in the summer due to the warmer temperatures and increased usage by customers for lawn irrigation and other outdoor uses. Summer weather that is cooler and wetter than average generally serves to suppress customer water demand, and can have a downward effect on our operating revenue and operating income. Conversely, when weather conditions are extremely dry and even if our water supplies are sufficient to serve our customers, our systems may be affected by drought-related warnings and/or water usage restrictions imposed by governmental agencies, purchase supply allocation and mandatory conservation measures. All of the above conditions serve to reduce customer demand and operating revenues. These restrictions may be imposed at a regional or state level and may affect our service areas regardless of our readiness to meet unrestricted customer demands. We employ a variety of measures to ensure that we have adequate sources of water supply, both in the short term and over the long term. For additional detail concerning these measures, see Business Our Regulated Businesses Overview of Networks, Facilities and Water Supply.

The geographic diversity of our service areas tends to mitigate some of the effect of weather extremes. In any given summer, some areas are likely to experience drier than average weather while other areas will experience wetter than average weather.

Goodwill Impairment

At December 31, 2007, our goodwill totaled $2,457.0 million. The goodwill is associated primarily with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E Town Corporation in 2001, representing the excess of the purchase price the purchaser paid over the fair value of the net tangible and intangible assets acquired. Our annual goodwill impairment test is completed during the fourth quarter of each calendar year. We also have processes to monitor for interim triggering events. As required by applicable accounting rules and principles, we were required to reflect a non-cash charge to operating results for goodwill impairment in the amounts of $396.3 million in 2005, $227.8 million in 2006 and $509.3 million in 2007. These amounts include impairments relating to discontinued operations.

During the third quarter of 2007, as a result of our debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, we performed an interim impairment test and recorded an impairment charge to goodwill to our Regulated Businesses in the amount of $243.3 million. The decline was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

Table of Contents

We completed our annual goodwill impairment test for 2007 and recorded an additional goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007. We determined that an impairment had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, an additional impairment to our carrying value was recorded.

We may be required to recognize additional impairments in the future due to, among other things, the market value of our stock, a decline in our forecasted results as compared to the business plan and, changes in interest rates or a change in rate case results. Further recognition of additional material impairments of goodwill would negatively affect our results of operations and total capitalization, the effect of which could be material and could make it more difficult for us to secure financing on effective terms and maintain compliance with our debt covenants. Based on the initial public offering price, we have determined that it is probable we will record an impairment to goodwill when we report results for the quarter ended March 31, 2008. Whether such an impairment to goodwill is recognized will depend on an analysis of the factors described above. The size of any such impairment to goodwill, if any, cannot be determined at this time.

Table of Contents

Results of Operations

The following table sets forth our consolidated statement of operations data for the years ended December 31, 2005, 2006 and 2007:

	For the years ended December 31,		
	2005	2006	2007
	(In thousands, except per share data)		
Operating revenues	$ 2,136,746	$ 2,093,067	$ 2,214,215
Operating expenses:			
Operation and maintenance	1,201,566	1,174,544	1,246,479
Depreciation and amortization	261,364	259,181	267,335
General taxes	183,324	185,065	183,253
Loss (gain) on sale of assets	(6,517)	79	(7,326)
Impairment charges	385,434	221,685	509,345
Total operating expenses, net	2,025,171	1,840,554	2,199,086
Operating income (loss)	111,575	252,513	15,129
Other income (deductions):			
Interest	(345,257)	(365,970)	(283,165)
Allowance for other funds used during construction	5,810	5,980	7,759
Allowance for borrowed funds used during construction	2,420	2,652	3,449
Amortization of debt expense	(4,367)	(5,062)	(4,867)
Preferred dividends of subsidiaries	(227)	(215)	(225)
Other, net	5,895	1,164	6,401
Total other income (deductions)	(335,726)	(361,451)	(270,648)
Income (loss) from continuing operations before income taxes	(224,151)	(108,938)	(255,519)
Provision for income taxes	50,979	46,912	86,756
Income (loss) from continuing operations	(275,130)	(155,850)	(342,275)
Income (loss) from discontinued operations, net of tax	(49,910)	(6,393)	(551)
Net income (loss)	$ (325,040)	$ (162,243)	$ (342,826)
Net income (loss) per common share:			
Basic			
Income (loss) from continuing operations	$ (1.72)	$ (0.97)	$ (2.14)
Income (loss) from discontinued operations, net of tax	$ (0.31)	$ (0.04)	(0.00)
Net income (loss)	$ (2.03)	$ (1.01)	$ (2.14)
Diluted			
Income (loss) from continuing operations	$ (1.72)	$ (0.97)	$ (2.14)
Income (loss) discontinued operations, net of tax	$ (0.31)	$ (0.04)	(0.00)

Net income (loss)	$ (2.03)	$ (1.01)	$ (2.14)
Average common shares outstanding during the period:			
Basic	160,000	160,000	160,000
Diluted	160,000	160,000	160,000

Table of Contents

The following table summarizes certain financial information for our Regulated and Non-Regulated Businesses for the periods indicated (without giving effect to inter-segment eliminations):

	For the years ended December 31,					
	2005		2006		2007	
	Regulated Businesses	Non-Regulated Businesses	Regulated Businesses	Non-Regulated Businesses	Regulated Businesses	Non-Regulated Businesses
	(In thousands)					
Operating revenues	$ 1,836,061	$ 310,771	$ 1,854,618	$ 248,451	1,987,565	242,678
Adjusted EBIT[1]	$ 469,921	$ (106)	$ 468,701	$ (4,725)	500,088	23,579

(1) Adjusted EBIT is defined as earnings before interest and income taxes from continuing operations. Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flows for periods presented and should not be considered as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state PUCs in the states in which we operate. The table below details the annualized revenue increases (assuming constant sales volumes) resulting from rate authorizations, including distribution infrastructure and other surcharges, granted in 2005, 2006 and 2007.

	Annualized Rate Increases Granted During the years		
	2005	2006	2007
State			
New Jersey	$	$	$ 56.2
Pennsylvania	5.8	8.0	40.6
Missouri		6.8	24.0
Illinois		0.9	1.7
Indiana	0.9	1.8	14.0
California	8.4	15.1	0.5
West Virginia	10.0		
Other	9.9	8.7	21.9
Total	$ 35.0	$ 41.3	$ 158.9

The change in annualized rate increases granted between 2006 and 2007 can be attributed to the removal of the stay-out provisions and increased investment in our regulated infrastructure programs.

Comparison of Results of Operations for the Years Ended December 31, 2007 and 2006

Operating revenues. Our consolidated operating revenues increased $121.1 million, or 5.8%, from $2,093.1 million for 2006 to $2,214.2 million for 2007. An increase in operating revenues for our Regulated Businesses of $132.9 million in 2007 was somewhat offset by a decrease in operating revenues for our Non-Regulated Businesses of $5.8 million. The increase in the Regulated Businesses operating revenues was primarily due to rate increases of approximately $61.9 million obtained through general rate cases in New Jersey, Ohio, Arizona, California and other states. In addition, rate increases obtained through infrastructure related provisions in Pennsylvania, Missouri, Illinois and Indiana, totaled approximately $15.5 million. Water service operating revenues also increased due to growth of 0.7% in our Regulated Businesses customer base through small acquisitions in our service areas and through growth in existing service areas. Water sales volume associated

53

Table of Contents

with existing customers increased by 1.5% in 2007 compared to the prior year due to drier weather mainly in our Mid-Atlantic states.

The following table sets forth the percentage of Regulated Businesses operating revenues and water sales volume by customer class:

	For the years ended December 31,			
	Operating Revenues		Water Sales Volume	
Customer Class	2006	2007	2006	2007
Water service:				
Residential	57.5%	57.6%	52.1%	52.8%
Commercial	19.6%	19.4%	22.0%	21.9%
Industrial	5.0%	4.8%	10.6%	10.6%
Public and other	12.4%	12.5%	15.3%	14.7%
Other water revenues	1.6%	1.9%		
Total water revenues	96.1%	96.2%	100.0%	100.0%
Wastewater service	3.9%	3.8%		
	100.0%	100.0%		

Water Services Water service operating revenues from residential customers for 2007 amounted to $1,146.1 million, a 7.3% increase over 2006, primarily due to rate increases and changes in sales volume. The volume of water sold to residential customers increased by 2.9% in 2007 to 223.4 billion gallons, from 217.2 billion gallons in 2006, largely as a result of favorable weather conditions in the Mid-Atlantic states and a 0.7% increase in the residential customer base.

Water service operating revenues from commercial water customers for 2007 amounted to $385.3 million, a 6.2% increase over 2006, primarily due to rate increases and changes in sales volume. The volume of water sold to commercial customers increased by 1.6% in 2007 to 93.0 billion gallons, from 91.6 billion gallons in 2006, driven by favorable weather conditions and partially offset by a decline in the number of commercial customers.

Water service operating revenues from industrial customers amounted to $94.7 million in 2007, a 2.9% increase over 2006, primarily due to rate increases and changes in sales volume. The volume of water sold to industrial customers increased by 0.5% in 2007 to 44.6 billion gallons, from 44.4 billion gallons in 2006.

Water service operating revenues from public and other customers increased $17.4 million for 2007 to $247.6 million from $230.2 million for 2006, mainly due to rate increases and changes in sales volume. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $99.3 million for 2007, an increase of $0.8 million over the same period of 2006. Revenues generated by sales to governmental entities and resale customers for 2007 totaled $148.3 million, an increase of $16.6 million from 2006.

Wastewater Services Our subsidiaries provide wastewater services in 11 states. Operating revenues from these services increased by 4.7% to $75.6 million for 2007. The increase reflects a growth of 0.4% in the number of wastewater customers served but is primarily due to increases in rates charged to customers in states where we have wastewater operations (principally Arizona, Hawaii, and New Jersey).

Our Non-Regulated revenues decreased by $5.8 million, or 2.3%, from $248.5 million for 2006, to $242.7 million for 2007. The net decline in revenues is primarily attributable to a $15.8 million decrease in revenues of our Contract Operations Group, partially offset by a $7.4 million increase in revenues of our Homeowner Services Group, and an increase of $3.5 million from our other Non-Regulated Businesses. The decline in revenues of our

Table of Contents

Contract Operations Group includes the effects of having substantially completed the construction of the Lake Pleasant Water Treatment plant, a large water treatment plant in Phoenix, Arizona, during 2006 ($49.5 million recognized in 2006 compared to $5.2 million in 2007). Pursuant to our DBO contract with the city of Phoenix, we served as the lead contractor in connection with the construction of the Lake Pleasant facility, which includes an 80 million gallons-per-day surface water treatment plant and granular activated carbon reactivation system. The Lake Pleasant facility is significantly larger in size and function compared to other projects with which we have been engaged. However, we do not expect the completion of this project to have a material impact on our results of operations. Revenues from that project were partially replaced by new contracts, including a DBO project in Fillmore, California generating $12.2 million of incremental revenues and new military projects generating approximately $10.0 million of revenues. The increase from our Homeowner Services Group represents expansion into new geographic markets (Virginia and Trenton, New Jersey). The increase in our other Non-Regulated Businesses revenues is due to revenues attributable to special projects in 2007.

Operation and maintenance. Our consolidated operation and maintenance expense increased $72.0 million, or 6.1%, from $1,174.5 million for 2006, to $1,246.5 million for 2007.

Operation and maintenance expense by major category was as follows:

	For the years ended December 31,	
	2006	2007
	(In thousands)	
Production costs	$ 262,450	$ 282,194
Employee-related costs	421,287	469,504
Operating supplies and services	297,008	298,398
Maintenance materials and services	96,302	112,075
Customer billing and accounting	55,260	39,003
Other	42,237	45,305
Total	$ 1,174,544	$ 1,246,479

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by 7.5% for 2007 compared to the same period in 2006. The increase was primarily attributable to higher purchased water costs mainly due to increased demand, as well as higher electricity prices as rate freezes resulting from electricity deregulation expired in some states in which we operate.

Employee-related costs including wage and salary, group insurance, and pension expense increased by 11.4% for 2007 compared to the same period in 2006. These costs represented 35.9% and 37.7% of operation and maintenance expense for 2006 and 2007, respectively. The increase in 2007 was due to higher wage, salary and group insurance expenses in our Regulated Businesses, primarily resulting from an increase in the number of employees to enable service enhancements in our Regulated Businesses as well as wage rate increases. This increase was offset by a reduction in pension expense. Pension expense in excess of the amount contributed to the pension plans is deferred by some of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. The decrease is primarily attributable to lower pension expense in 2007. In addition, pension expense for 2006 included additional pension expense due to curtailment charges and a special transaction benefit charge.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment, facilities rental charges and other miscellaneous expenses. For 2007, these costs increased by 0.5% compared to the same period in 2006. Factors contributing to this overall increase include higher accounting, legal and consulting costs. Our remediation efforts in connection with the Sarbanes-Oxley Act resulted in an increase of $15.1 million for 2007,

as compared to 2006. The Regulated Businesses transportation costs for 2007 increased by $3.2 million due to

Table of Contents

increased vehicle leasing costs and higher gasoline prices. Also costs in 2006 were lower than 2007 due to a reinstatement in 2006 by our Indiana subsidiary of $2.4 million previously disallowed in the regulatory process. Expenses related to the RWE Divestiture were $0.8 million higher for 2007 than 2006 due to higher divestiture support costs.

Offsetting the increase was approximately $48.8 million of expenses associated with the design and build of the Lake Pleasant Water Treatment Plant in Phoenix, Arizona which were included in operating supplies and services for 2006 compared to $5.1 million in 2007. The decrease also reflects Non-Regulated Businesses operating contracts that ended during 2006, and a decline in design and build activity by the Applied Water Management Group of $3.4 million due to a downturn in new home construction. Offsetting these Non-Regulated Businesses decreases was additional expense associated with several contracts, including Fillmore of $12.4 million, and increased military contract expenses of $11.4 million resulting from increased contracted services primarily due to two projects and a $5.0 million loss recorded on one project.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased by 16.4% for 2007 compared to the same period in 2006. This increase was primarily the result of a larger number of main breaks in 2007 compared to 2006 experienced by several of our operating subsidiaries due to winter weather conditions, and increased paving cost for our New Jersey, Missouri, Illinois and Pennsylvania subsidiaries.

Customer billing and accounting expenses decreased by 29.4% for 2007 compared to the same period in 2006 primarily due to lower bad debt expense of $9.2 million in our Regulated Business and $5.8 million in our Non-Regulated Businesses as a result of an increased focus on collection of past due accounts.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by 7.3% in 2007 primarily due to an increase in insurance costs for 2007 due to less favorable claims experience compared to 2006. This unfavorable variance was offset by a reduction in regulatory expenses due to the write-off of certain deferred rate case expenses in 2006 associated with our California subsidiary.

Depreciation and amortization. Our consolidated depreciation and amortization expense increased $8.1 million, or 3.1%, from $259.2 million for 2006, to $267.3 million for 2007. The increase was primarily due to property placed in service, net of retirements, of approximately $798.8 million as a result of an increased focus on infrastructure spending mainly in our Regulated Businesses.

General taxes. Our consolidated general taxes expense, which includes taxes for property, payroll, gross receipts and other miscellaneous items, decreased $1.8 million, or 1.0%, from $185.1 million for 2006, to $183.3 million for 2007. The decrease was primarily due to lower taxes for expatriates because employees seconded by Thames Water to American Water were no longer employed by American Water in 2007.

Loss (gain) on sale of assets. Our consolidated loss on sale of assets was $0.1 million for 2006, compared to a gain of $(7.3) million for 2007 due to non-recurring sales of assets not needed in our utility operations in 2007.

Impairment charges. Our consolidated impairment charges were $221.7 million for 2006 and $509.3 million for 2007. The 2006 impairment charge was primarily attributable to higher interest rates in our Regulated Businesses and a change in the potential net realizable value of our Non-Regulated Businesses. The 2007 impairment charges were primarily due to slightly lower long-term earnings caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery as well as new information regarding our market value.

Other income (deductions). Interest expense, the primary component of our consolidated other income (deductions), decreased $82.8 million, or 22.6%, from $366.0 million for 2006, to $283.2 million for 2007. The

Table of Contents

decline was primarily due to the repayment of outstanding debt with new equity contributions from RWE in order to establish a capital structure that is consistent with other regulated utilities and also to meet the capital structure expectations of various state regulatory commissions. This decrease was offset slightly by higher interest expense of our Regulated Businesses of $9.8 million mainly due to increased borrowings to fund capital programs.

Provision for income taxes. Our consolidated provision for income taxes increased $39.9 million, or 85.1%, from $46.9 million for 2006, to $86.8 million for 2007. The increase is due to higher taxable income in 2007 as compared to 2006.

Net income (loss). Our consolidated net loss including results from discontinued operations increased $180.6 million, or 111.3%, from $162.2 million for 2006, to $342.8 million for 2007. The increase is the result of the changes discussed above.

Comparison of Results of Operations for the Years Ended December 31, 2006 and 2005

Operating revenues. Our consolidated operating revenues decreased $43.6 million, or 2.0%, from $2,136.7 million for 2005 to $2,093.1 million for 2006. A decline in operating revenues associated with our Non-Regulated Businesses was partially offset by an overall increase in operating revenues from our Regulated Businesses.

Operating revenues from our Regulated Businesses increased by $18.6 million in 2006 compared to 2005, even with a 2.0% decline in water sales volume primarily due to weather fluctuations in 2006, as compared to 2005. The increase was primarily due to rate increases obtained through general rate cases in Arizona, California and New York as well as other states totaling $12.4 million. In addition, infrastructure surcharges in Pennsylvania, Missouri, Indiana, Illinois, and Ohio provided $13.7 million in additional operating revenues. Operating revenue also increased due to the addition of approximately 1.6%, or 51,000 customers, in our Regulated Businesses customer base through small acquisitions to our service areas and through growth in existing service areas.

The following table sets forth the percentage of our Regulated Businesses operating revenues and water sales volume by customer class:

	For the years ended December 31,			
	Operating Revenues		Water Sales Volume	
	2005	2006	2005	2006
Water service:				
Residential	58.2%	57.5%	52.4%	52.1%
Commercial	19.3%	19.6%	21.9%	22.0%
Industrial	5.3%	5.0%	10.6%	10.6%
Public and other	12.2%	12.4%	15.1%	15.3%
Other water revenues	1.4%	1.6%		
Total water revenues	96.4%	96.1%	100.0%	100.0%
Wastewater service	3.6%	3.9%		
	100.0%	100.0%		

Water Services Water service operating revenues from residential customers in 2006 amounted to $1,067.9 million, relatively unchanged from 2005, as rate increases offset changes in sales volume. The volume of water sold to residential customers decreased by 2.5% in 2006 to 217.2 billion gallons, from 222.8 billion gallons for 2005, primarily as a result of wetter and cooler weather conditions in some of our larger states, including New Jersey, Pennsylvania and Indiana and decreased usage related to enhanced conservation education, the installation of low-flow appliances and reduced household sizes.

Table of Contents

Water service operating revenues from commercial customers in 2006 amounted to $362.7 million, a 2.5% increase over 2005, primarily due to rate increases offset by changes in sales volume. The volume of water sold to commercial customers decreased by 1.7% in 2006 to 91.6 billion gallons, from 93.2 billion gallons for 2005, driven by a 0.4% decline in our commercial customer base due to economic conditions in our service areas with the remainder primarily attributable to weather conditions.

Water service operating revenues from industrial customers in 2006 amounted to $92.0 million, a 5.4% decrease over 2005, primarily due to changes in sales volume. The volume of water sold to industrial customers decreased by 1.8% in 2006 to 44.4 billion gallons, from 45.2 billion gallons for 2005, driven primarily by the loss of customers due to economic and business conditions in our service areas.

Water service operating revenues from public and other customers for 2006 amounted to $230.2 million, a 3.0% increase over 2005 primarily due to rate increases and changes in sales volume. Water service operating revenues from municipal governments for fire protection services and customers requiring special private fire service facilities for 2006 amounted to $98.5 million, a 9.6% increase from 2005. Water service operating revenues from governmental entities and resale customers amounted to $131.7 million in 2006, a 1.3% decrease from 2005.

Wastewater Services Our subsidiaries provide wastewater services in 11 states. Operating revenues from these services increased by 8.9% to $72.2 million for 2006, from $66.3 million for 2005. The increases were attributable to 4.4% growth in the number of wastewater customers served, with the remainder due to rate increases.

Non-Regulated Businesses operating revenues decreased by $62.3 million, or 20.0% from $310.8 million for 2005 to $248.5 million for 2006. The decrease was primarily due to a decline of approximately $63.4 million in operating revenue, representing the effects of the completion of work performed under a contract to design and build the Lake Pleasant Water Treatment Plant in Phoenix, Arizona. The decrease in operating revenues also reflects the cessation of operating contracts in Houston, Texas; Hazelton, Pennsylvania; and Dedham, Massachusetts that ended during fiscal 2006 and the non-renewal of unprofitable contracts in several smaller communities. The discontinuance of these contracts resulted in a decrease of $11.3 million in aggregate revenue in 2006 compared to 2005. Partially offsetting the decrease was $8.7 million of increased revenue related to the expansion into new markets by the Applied Water Management Group and the Homeowner Services Group, as well as $3.7 million of additional revenues from organic growth of existing O&M contracts, including capital improvement projects performed on behalf of Sioux City, Iowa and a new contract in Fillmore, California for a DBO project.

Operation and maintenance. Our consolidated operation and maintenance expense decreased $27.1 million, or 2.3%, from $1,201.6 million for 2005, to $1,174.5 million for 2006.

Operation and maintenance expense by major category was as follows:

	For the years ended December 31,	
	2005	2006
	(In thousands)	
Production costs	$ 258,609	$ 262,450
Employee-related costs	376,296	421,287
Operating supplies and services	379,878	297,008
Maintenance materials and services	97,139	96,302
Customer billing and accounting	42,793	55,260
Other	46,851	42,237
Total	$ 1,201,566	$ 1,174,544

Table of Contents

Production costs, including fuel and power, purchased water, chemicals and waste disposal, increased by 1.5% in 2006 compared to 2005. Increases in chemical prices and energy costs in our Regulated Businesses were the principal drivers of the increase, mitigated by the overall decline in water sales and decreases in costs resulting from reduced Non-Regulated Businesses activities. Energy costs increased due to higher electricity prices as rate freezes resulting from electricity deregulation expired in some states in which we operate. The unit cost of water produced was up 7.3% in 2006 compared to 2005.

Employee-related costs include wage and salary, group insurance, pension expense and expenses related to our long-term incentive plan, which we refer to as the LTIP, for certain key employees. These costs represented 35.8% of operation and maintenance expense in 2006 and increased 12.0% in 2006 as compared to 2005. Wage and salary expenses were up $29.2 million, or 10.0%, in 2006, due to salary increases and workforce additions. The LTIP accounted for $3.1 million of the increase. Group insurance expense, which includes the cost of providing current health care and life insurance benefits as well as the expected cost of providing postretirement benefits, increased 16.0% in 2006 as a result of workforce additions and higher group insurance premiums associated with our active employees. Pension expense increased by 32.9% in 2006 compared to 2005, due to lower than expected returns on plan assets and a decrease in the discount rate actuarial assumption. Additionally, our contributions to a defined contribution plan for employees increased over 2005 as the number of program participants increased.

Operating supplies and services include the day-to-day expenses of office operation, legal and other professional services, as well as information systems and other office equipment and facility rental charges. These costs decreased by 21.8% in 2006 compared to 2005. The expenses in this category include rents, general office expense, and other miscellaneous expenses. A significant factor contributing to the decrease was approximately $63.0 million of expenses associated with the timing of project activity for the design and build of the Lake Pleasant Water Treatment Plant in Phoenix, Arizona. The majority of the project activity occurred during 2005. These Non-Regulated Businesses operating expenses also decreased as a result of the aforementioned operating and maintenance contracts that ended during 2006. These cost reductions were offset by additional expenses related to expansion into new markets by the Applied Water Management Group and Homeowner Services Group, as well as costs associated with several new O&M contracts. These changes resulted in a decrease of $54.0 million in operating supplies and services by our Non-Regulated Businesses in 2006 as compared to 2005.

In addition to the decline in our Non-Regulated Businesses operating supplies and services, there was a decrease in accounting, legal and consulting costs in 2006. A significant portion of the decrease was due to lower management charges allocated from Thames Water of $7.7 million in 2006 as compared to 2005 and a recovery of $2.4 million previously disallowed in the regulatory process for our Indiana subsidiary. During 2005, the Company also recorded $3.5 million in expense relating to a special program established to protect the environment along the central coastal area of California. In addition, there was a decrease of $3.9 million relating to costs incurred in 2005 that were subsequently not allowed to be recovered in rates at our Kentucky subsidiary. These decreases were offset by higher expenses related to the RWE Divestiture of $7.4 million and increased costs related to the Company s compliance with the Sarbanes-Oxley Act of $16.9 million from 2005 to 2006.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, decreased by 0.9% in 2006 compared to 2005. The cessation of some O&M contracts managed by our Non-Regulated Businesses was the primary reason for this decrease.

Customer billing and accounting expenses increased by 29.1% in 2006 compared to 2005, due to higher uncollectible expense due to a decline in the quality of our customer accounts receivable, increases in postage costs to mail customer bills and an increased number of bills being sent as a result of customer growth.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. Total other costs decreased in 2006 by 9.8% from 2005, due to improved claims experience following an increase in 2005. Regulatory costs increased during 2006 due to increased regulatory filings by our subsidiaries.

Table of Contents

Depreciation and amortization. Our consolidated depreciation and amortization expense decreased $2.2 million, or 0.8%, from $261.4 million for 2005, to $259.2 million for 2006. The decrease was primarily due to a write-off in 2005 of $21.6 million associated with an abandoned information technology project. This decrease was offset by an increase in depreciation expense due to property placed in service, net of retirements, of $697.1 million as a result of infrastructure replacement in our Regulated Businesses.

General taxes. Our consolidated general taxes expense, which includes taxes for property, payroll, gross receipts and other miscellaneous items, was relatively unchanged from $183.3 million for 2005 to $185.1 million for 2006. The increase was primarily due to higher gross receipts taxes as a result of increased Regulated Businesses operating revenues. Gross receipts and franchise taxes that vary based on operating revenues were higher by 3.5% in 2006 compared to 2005. Property and capital stock taxes that are assessed on the basis of tax values assigned to assets and capitalization were down 3% in 2006 compared to 2005 due to property tax appeals and dispositions.

Loss (gain) on sale of assets. Our consolidated gain on sale of assets was $(6.5) million for 2005, compared to a loss on sale of assets of $0.1 million for 2006. The decrease in 2006 was primarily due to the fact that 2005 included sales of various properties and investments not needed in our utility operations.

Impairment charges. Our consolidated impairment charges were $385.4 million for 2005 and $221.7 million for 2006. The 2005 impairment charge was primarily the result of a change in our strategic business plan for our Non-Regulated Businesses and lower margins than previously forecasted in our Regulated Businesses. The 2006 impairment charge was primarily attributable to higher interest rates in our Regulated Businesses and a change in the potential net realizable value of our Non-Regulated Businesses.

Other income (deductions). Interest expense, the primary component of our consolidated other income (deductions), increased $20.7 million, or 6.0%, from $345.3 million for 2005 to $366.0 million for 2006. This increase was primarily due to higher interest rates for new debt issuances, mitigated by overall reduced borrowings as a result of repaying outstanding debt with new equity contributions.

Provision for income taxes. Our consolidated provision for income taxes decreased $4.1 million, or 8.0%, from $51.0 million for 2005, to $46.9 million for 2006. This decrease was primarily due to the mix of taxable income by jurisdiction.

Net income (loss). Our consolidated net (loss), including results from discontinued operations, decreased $162.8 million, or 50.1%, from $(325.0) million for 2005, to $(162.2) million for 2006. The decrease was primarily due to the changes discussed above.

Liquidity and Capital Resources

Our business is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary, we obtain funds from external sources in the capital markets and through bank borrowings. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. If these business and market conditions deteriorate to the extent that we no longer have access to the capital markets at reasonable terms, we have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to support our commercial paper programs and to issue letters of credit. See Credit Facilities and Short-Term Debt.

In addition, our regulated utility subsidiaries receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods, which vary according to state regulations, as new customers

Table of Contents

begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from rate base. Generally, we depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property. Some of our subsidiaries do not depreciate contributed property, based on regulatory guidelines.

We use our capital resources, including cash, to (i) fund capital requirements, including construction expenditures, (ii) pay off maturing debt, (iii) pay dividends, (iv) fund pension and postretirement welfare obligations and (v) invest in new and existing ventures. We spend a significant amount of cash on construction projects that have a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. See Business Regulation Economic Regulation. As a result of these factors, our working capital, defined as current assets less current liabilities, was in a net deficit position as of December 31, 2007.

We expect to fund future maturities of long-term debt through a combination of external debt and cash flow from operations. We have no plans to reduce debt significantly.

Cash Flows from Operating Activities

Our future cash flows from operating activities will be affected by economic utility regulation; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; and declining per customer usage of water; and weather and seasonality. See Management s Discussion and Analysis of Financial Condition and Results of Operations Factors Affecting our Results of Operations.

Cash flows from operating activities have been a reliable, steady source of cash flow, sufficient to meet operating requirements and a portion of our capital expenditures requirements. We will seek access to debt and equity capital markets to meet the balance of our capital expenditure requirements. There can be no assurance that we will be able to successfully access such markets on favorable terms or at all. Operating cash flows can be negatively affected by changes in our rate regulatory environments. Taking into account the factors noted above, we also obtain cash from non-operating sources such as the proceeds from debt issuances, customer advances and contributions in aid of construction and equity offerings.

The following table provides a summary of the major items affecting our cash flows from operating activities for the periods indicated:

	For the years ended December 31,		
	2005	2006	2007
		(In thousands)	
Net income (loss)	$ (325,040)	$ (162,243)	$ (342,826)
Add (subtract):			
Non-cash operating activities(1)	852,373	664,060	881,013
Changes in working capital(2)	51,348	(96,578)	16,770
Pension and postretirement healthcare contributions	(53,246)	(81,491)	(81,245)
Net cash flows provided by operations	$ 525,435	$ 323,748	$ 473,712

(1) Includes (gain) loss on sale of businesses, depreciation and amortization, impairment charges, removal costs net of salvage, provision for deferred income taxes, amortization of deferred investment tax credits, provision for losses on utility accounts receivable, allowance for other funds used during construction, (gain) loss on sale of assets, deferred regulatory costs, amortization of deferred charges and other non-cash items, net, less pension and postretirement healthcare contributions.

(2) Changes in working capital include changes to accounts receivable and unbilled utility revenue, taxes receivable (including federal income), other current assets, accounts payable, taxes accrued (including federal income), interest accrued and other current liabilities.

61

Table of Contents

The increase in cash flow from operations during 2007 compared to 2006 was primarily due to improvements in working capital mainly driven by changes in taxes accrued and other current liabilities, slightly offset by changes in accounts receivable and unbilled utility revenues.

The decrease in cash flows from operations during 2006 versus 2005 was primarily the result of higher contributions to pension and postretirement healthcare trusts. Excluding this item, changes in our cash flows from operating activities were generally consistent with changes in the results of operations as adjusted by changes in working capital in the normal course of business.

Cash Flows from Investing Activities

Cash flows used in investing activities were as follows for the periods indicated:

	For the years ended December 31,		
	2005	2006	2007
		(In thousands)	
Construction expenditures	$ (558,446)	$ (688,843)	$ (758,569)
Other investing activities, net(1)	28,281	(2,595)	11,991
Net cash flows used in investing activities	$ (530,165)	$ (691,438)	$ (746,578)

(1) Includes allowances for other funds used during construction, acquisitions, proceeds from the sale of assets and securities, proceeds from the sale of discontinued operations, removal costs from property, plant and equipment retirements, receivables from affiliates, restricted funds and investment in equity investee.

Cash flow used in investing activities increased in 2007 compared to 2006 and in 2006 compared to 2005 as we continued to increase our investment in regulated infrastructure projects. Cash flows used in investing activities will continue to rise as construction expenditures are expected to be approximately $900 to $950 million during 2008. We intend to invest capital prudently to provide essential services to our regulated customer base, while working with regulators in the various states in which we operate to have the opportunity to earn an appropriate rate of return on our investment and a return of our investment.

Our infrastructure investment plan consists of both infrastructure renewal programs, where we replace infrastructure as needed, and major capital investment projects, where we will construct new water and wastewater treatment and delivery facilities. Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors.

The following table provides a summary of our historical construction expenditures:

	For the years ended December 31,		
	2005	2006	2007
		(In thousands)	
Transmission and distribution	$ 238,972	$ 314,282	$ 325,333
Treatment and pumping	137,299	133,074	185,832
Services, meter and fire hydrants	84,148	132,610	179,933
General structures and equipment	81,516	72,892	32,336
Sources of supply	16,511	35,985	35,135
Total construction expenditures	$ 558,446	$ 688,843	$ 758,569

Construction expenditures for the periods noted above were partially offset by customer advances and contributions for construction (net of refunds) of $35.8 million, $47.4 million and $52.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. Customer advances and contributions are reflected in net

62

Table of Contents

cash flows from financing activities. Capital expenditures during the periods noted above were related to the renewal of supply and treatment assets, new water mains and customer service lines, as well as rehabilitation of existing water mains and hydrants.

Construction expenditures for 2007 increased by $69.7 million or 10.1% over 2006. The increase consisted mainly of infrastructure replacements and upgrades to treatment facilities at several plants including Joplin, Missouri, Maricapa County, Arizona, Franklin Township, New Jersey and Champaign, Illinois.

Construction expenditures for 2006 increased by $130.4 million or 23.4% over 2005. Expenditures related to transmission and distribution increased by $75.3 million in 2006 over 2005 and meter and fire hydrant replacements increased by $48.5 million in 2006 compared to 2005. These increases occurred due to an increase in the rate of infrastructure replacement. In addition, treatment plant improvements caused an increase from 2005 to 2006 in the amount of $15.2 million. These improvements are taking place primarily at our Joplin, Missouri, Maricapa County, Arizona and Franklin Township, New Jersey facilities.

An integral aspect of our strategy is to seek growth through tuck-ins and other acquisitions which are complementary to our existing business and support the continued geographical diversification and growth of American Water s operations. Generally, acquisitions are funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

We also conduct ongoing reviews of our existing investments. As a result of these reviews, we sold the operations of various non-regulated water-related businesses over the last two years.

The following provides a summary of the major acquisitions and dispositions affecting our cash flows from investing activities in the periods indicated:

2007:

- We paid approximately $15.9 million for the acquisition of a number of water and wastewater systems, the largest of which was S.J. Services Inc., the parent company of Pennsgrove Water Supply Company, Inc. and South Jersey Water Supply Company, Inc. The purchase price, including acquisition costs, for S.J. Services Inc. was $13.5 million in cash.

- We received approximately $9.7 million in cash proceeds from the sale of a group of assets of the Residuals business.

- We received $16.3 million in cash proceeds from the sale of other assets, including $13.0 million of proceeds on a property in Mansfield, New Jersey owned by a Non-Regulated subsidiary.

2006:

- We paid approximately $12.5 million for the acquisition of water and wastewater systems.

- We received approximately $30.2 million in cash proceeds from the sale of discontinued operations including a group of assets of the Residuals business and the Underground business.

2005:

- We received approximately $15.3 million in cash proceeds from the sale of Engineering s Canadian operations and the assets of Ashbrook Corporation.

On December 21, 2007, New Jersey-American Water, our subsidiary, signed an agreement with the City of Trenton, New Jersey to purchase the assets of the city s water system located in Ewing, Hamilton, Hopewell and Lawrence townships for a purchase price of $100 million. The

agreement was approved by the Trenton City Council but requires approval by various regulatory agencies. We can provide no assurances that the agreement will be approved.

Table of Contents

Cash Flows from Financing Activities

Our financing activities include the issuance of long-term and short-term debt, primarily through our wholly owned financing subsidiary, AWCC. In addition, we have received capital contributions from RWE and intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in the registration rights agreement to be entered into with RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of $35.8 million, $47.4 million and $52.0 million for the years ended December 31, 2007, 2006 and 2005, respectively. In connection with the RWE Divestiture, we have made and will continue to make significant changes to our capital structure through debt refinancing and equity offerings.

AWCC issued additional senior notes through private placement offerings totaling $2,117.0 million during 2007. Interest rates ranged from 5.39% to 6.59% and maturities ranged from 7 years to 30 years. RWE made equity contributions to the Company amounting to $1,067.1 million and $1,194.5 million during 2007 and 2006, respectively. The Company used the equity contributions and proceeds from the senior notes to offset loans payable to RWE, to repay outstanding commercial paper and for other corporate purposes.

Additionally, during September 2007, AWCC borrowed $1,750.0 million of RWE redemption notes from RWE. The RWE redemption notes bear interest monthly at the one month London Interbank Offered Rate, which we refer to as LIBOR, plus 22.5 basis points and mature on the earliest of the following to occur (a) March 20, 2009, (b) the date on which the Company and RWE mutually agree to terminate the notes with all accrued and unpaid interest and principal becoming immediately due and payable in full, or (c) the date on which RWE no longer owns more than 80% of the voting rights of the Company. The Company used the proceeds from the RWE redemption notes to redeem $1,750.0 million of its 5.9% mandatory redeemable preferred stock held by RWE.

During October 2007, AWCC issued $750.0 million in new senior notes with a term of 10 years and a fixed interest rate of 6.085% and $750.0 million in new senior notes with a term of 30 years and a fixed interest rate of 6.593%. AWCC used the proceeds to extinguish portions of its debt.

The following long-term debt was issued in 2007:

Company	Type	Interest Rate	Maturity	Amount (In thousands)
American Water Capital Corp.	RWE notes-variable rate	5.72%	2009	$ 1,750,000
American Water Capital Corp.	Senior notes	5.39%-6.59%	2018-2037	2,117,000
Other Subsidiaries	State financing authority loans and miscellaneous	1.00%-1.62%	2013-2025	2,109
Total issuances				$ 3,869,109

In 2007, in connection with the acquisition of S.J. Services Inc, we assumed $3.5 million of long-term debt consisting of senior notes and state financing authority loans with interest rates ranging from 0.00% to 9.10% and maturities ranging from 2008 to 2025.

Table of Contents

The following debt and preferred stock with mandatory redemption requirements were retired through extinguishments, optional redemption or payment at maturity in 2007:

Company	Type	Interest Rate	Maturity	Amount (In thousands)
Long-term debt:				
American Water Capital Corp.	Senior notes-fixed rate	6.87%	2011	$ 28,000
American Water Capital Corp.	RWE notes-fixed rate	4.00%-6.05%	2007-2034	465,300
American Water Capital Corp.	RWE notes-variable rate	5.72%	2009	1,750,000
Various Subsidiaries	Senior notes-fixed rate	7.25%-8.75%	2007-2028	101,531
Various Subsidiaries	Miscellaneous	0%-10.06%	2007-2034	114,340
Preferred stock with mandatory redemption requirements				
American Water Works Company	RWE preferred stock-fixed rate	5.90%	2012	1,750,000
Various Subsidiaries		4.60%-8.88%	2007-2019	388
Total extinguishments, retirements & redemptions				$ 4,209,559

The following long-term debt was issued in 2006:

Company	Type	Interest Rate	Maturity	Amount (In thousands)
American Water Capital Corp.	Senior notes	5.39%-5.77%	2013-2018	$ 483,000
Missouri-American Water Company	Tax exempt first mortgage bonds	4.60%	2036	57,480
Indiana-American Water Company	Tax exempt first mortgage bonds	4.88%	2036	25,770
Other Subsidiaries	State financing authority loans & other	0%-5.00%	2019-2026	16,248
Total issuances				$ 582,498

The following debt was retired through extinguishments, optional redemption or payment at maturity during 2006:

Company	Type	Interest Rate	Maturity	Amount (In thousands)
Long-term debt:				
American Water Works Company, Inc.	RWE notes	4.92%	2006	$ 150,000
American Water Capital Corp.	RWE notes-fixed rate	4.00%-6.05%	2006-2034	1,086,500
American Water Capital Corp.	RWE notes-floating rate	4.02%-4.66%	2006-2015	482,300
Missouri-American Water Company	Mortgage bonds-fixed rate	5.50%-5.85%	2006-2026	57,565
Indiana-American Water Company	Mortgage bonds-fixed rate	5.35%-5.90%	2022-2026	27,004
West Virginia-American Water Company	Mortgage bonds-fixed rate	6.81%	2006	11,000
Other Subsidiaries		0%-9.87%	2006-2034	17,564
Preferred stock with mandatory redemption requirements				
Miscellaneous		4.60%-8.80%	2007-2019	538
Total extinguishments, retirements & redemptions				$ 1,832,471

From time to time and as market conditions warrant, we may engage in long-term debt retirements via tender offers, open market repurchases or other viable alternatives to strengthen our balance sheets.

65

Table of Contents

Credit Facilities and Short-Term Debt

The components of short-term debt at December 31, 2007 were as follows:

	2007
Commercial paper, net of discount	$ 169,267
Book-overdraft	42,198
Other short-term debt	9,049
Total short-term debt	$ 220,514

AWCC has entered into a one-year $10.0 million committed revolving line of credit with PNC Bank, N.A. This line of credit will terminate on December 31, 2008 unless extended and is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on either the prime rate of PNC Bank, N.A. or the applicable LIBOR for the term selected plus 25 basis points. As of December 31, 2007, $9.0 million was outstanding under this revolving line of credit. If this line of credit were not extended beyond its current maturity date of December 31, 2008, AWCC would continue to have access to its $800.0 million unsecured revolving credit facility described below.

On December 21, 2004, AWCC entered into a $550.0 million 364-day unsecured revolving credit facility with RWE. The facility was renewed on October 28, 2006 and was terminated on December 28, 2006. On September 15, 2006, AWCC entered into a new $800.0 million unsecured revolving credit facility syndicated among a group of ten banks. This revolving credit facility, which originally terminated on September 15, 2011, is principally used to support the commercial paper program at AWCC and to provide up to $150.0 million in letters of credit. AWCC had no loans outstanding under the net $800.0 million unsecured revolving credit facility as of December 31, 2007. On September 14, 2007, this revolving credit facility was extended for an additional year by the facility bank group, making the new termination date September 15, 2012.

On December 31, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper.

	Letter of Credit Sublimit (In thousands)	Available Capacity (In thousands)	Outstanding Commercial Paper (Net of Discount) (In thousands)
December 31, 2006	$ 150,000	$ 85,986	$ 321,339
December 31, 2007	$ 150,000	$ 60,659	$ 169,267

Interest rates on advances under the revolving credit facility are based on either prime or LIBOR plus an applicable margin based upon our credit ratings, as well as total outstanding amounts under the agreement at the time of the borrowing. The maximum LIBOR margin is 55 basis points.

The revolving credit facility requires us to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. On December 31, 2007, we were in compliance with the ratio.

Capital Structure

Our capital structure was as follows:

	At December 31, 2005	At December 31, 2006	At December 31, 2007
Common stockholder equity and preferred stock without mandatory redemption rights	29%	40%	48%

Long-term debt	50%	50%	49%
Short-term debt and current portion of long-term debt	21%	10%	3%
	100%	100%	100%

Table of Contents

As a condition to some PUC approvals of the RWE Divestiture, we have agreed to maintain a capital structure which includes a minimum of 45% common equity at the time of the consummation of the initial public offering. RWE has informed us that if it is determined that we do not meet this ratio at the time of the initial public offering, RWE will contribute cash to us in order to remedy the shortfall. This would be a capital contribution, and no shares would be issued to RWE. The proceeds of any such capital contribution would be used to repay indebtedness.

The changes to capital resource mix during 2006 and 2007 were accomplished through the various financing activities noted above. The capital structure at December 31, 2007 more closely reflects our expected future capital structure.

Debt Covenants

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in our ability to pay dividends, issue debt or access our revolving credit lines. We were in compliance with our reporting covenants as of December 31, 2007. See Risk Factors Risks Related to Our Industry and Business Our failure to comply with restrictive covenants under our credit facilities could trigger repayment obligations.

Security Ratings

We primarily access the capital markets, including the commercial paper market, through AWCC. However, we do issue debt at our regulated subsidiaries, primarily in the form of tax exempt securities, to lower overall cost of debt. The following table shows the Company s securities ratings at December 31, 2007:

Securities	Moody s Investors Service	Standard & Poor s Ratings Service
Senior unsecured debt	Baa2	A
Commercial paper	P2	A2

On September 19, 2007, Standard & Poor s Ratings Services (S&P) affirmed its A corporate credit rating on both AWCC and American Water, upgraded its rating on the senior unsecured debt of AWCC to A from BBB+ and affirmed its A-2 rating on AWCC s $700.0 million commercial paper program. On November 15, 2007, S&P placed its A- corporate credit ratings on both AWCC and American Water, as well as AWCC s senior unsecured debt credit ratings, on Credit Watch with negative implications. The ratings on American Water and AWCC remain on CreditWatch with negative implications.

On August 28, 2007, Moody s placed both the long-term and short-term ratings of AWCC on review for possible downgrade. On October 12, 2007, Moody s downgraded to Baa2 from Baa1 the senior unsecured issuer rating of AWCC. In addition, Moody s assigned a Baa2 senior unsecured issuer rating to American Water and affirmed AWCC s P-2 short-term rating. The rating outlook for both American Water and AWCC is stable.

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating.

None of our borrowings are subject to default or prepayment as a result of a downgrading of securities although such a downgrading could increase fees and interest charges under our credit facilities.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit

Table of Contents

rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance. Depending on its net position with a counterparty, the demand could be for the posting of collateral. In the absence of expressly agreed provisions that specify the collateral that must be provided, the obligation to supply the collateral requested will be a function of the facts and circumstances of the Company s situation at the time of the demand. If we can reasonably claim that we are willing and financially able to perform our obligations, it may be possible to successfully argue that no collateral should be posted or that only an amount equal to two or three months of future payments should be sufficient.

Current Credit Market Position

Due to recent market developments, including a series of rating agency downgrades of subprime U.S. mortgage-related assets and a decline in the fair value of subprime-related investments, the Company performed an assessment to determine the impact, if any, of current market conditions on the Company s financial position. As of December 31, 2007 there were no investments in subprime mortgage-related assets within the Company s short-term investment balances.

The Company has also performed an assessment of its investments held in trusts, which will be used by the Company to satisfy future obligations under the Company s pension and postretirement benefit plans. Based upon this assessment, it has determined that a de minimis portion of the holdings within the trusts are directly invested in subprime mortgage-related assets or auction rate debt securities. The Company does not believe that any decline in the fair value of these subprime mortgage-related assets or auction rate securities will have a material impact on its results of operations or its future cash funding requirements.

As of December 31, 2007, the Company had issued $169.6 million of auction rate tax-exempt long-term debt (including $24.9 million of variable rate demand bonds, which are periodically repriced to reflect auction rates) that are insured by AAA-rated insurers Ambac Assurance Corporation and MBIA Insurance Corporation. Due to the exposure that these bond insurers have in connection with recent developments in the subprime credit market, rating agencies have put these insurers on review for possible downgrade. Fitch has lowered the credit ratings of Ambac Assurance Corporation from AAA to AA. While these debt instruments are long-term in nature, and only the variable rate demand bonds can be put back to the Company prior to maturity, the interest rates on these instruments are designed to reset periodically through an auction process. In late February 2008, the Company began to experience failed auctions for a portion of these instruments, which had interest rates of 3.65% to 4.90% as of December 31, 2007. When a failed auction occurs on a series of this debt, the Company is required to begin paying a failed-auction interest rate on the instruments. The failed auction interest rate for the majority of the auction rate debt is 10%. Payment of the failed-auction rate interest rates will continue until the Company is able to either successfully remarket these instruments through the auction process or refund and refinance the existing debt through the issuance of an equivalent amount of tax exempt bonds. In April and May 2008, the Company redeemed an aggregate of $144.7 million of long-term auction rate debt of its subsidiaries with interest rates ranging from 6.48% to 10% per annum and maturities ranging from 2021 to 2032.

At this time the Company does not believe recent market developments significantly impact its ability to obtain financing and expects to have access to liquidity in the capital markets on favorable terms. In addition, the Company has access to unsecured revolving credit facilities, which are not as dependent upon general market conditions, with aggregate bank commitments of $810 million, of which a portion is currently committed primarily to backstop the Company s commercial paper program and letters of credit.

Regulatory Restrictions

The issuance by the Company or AWCC of long-term debt or equity securities does not require authorization of any state PUC if no guarantee or pledge of the regulated subsidiaries is utilized. However, state PUC authorization is required to issue long-term debt or equity securities at most regulated subsidiaries. Our

Table of Contents

regulated subsidiaries normally obtain the required approvals on a periodic basis to cover their anticipated financing needs for a period of time or in connection with a specific financing.

Under applicable law, our subsidiaries can pay dividends only from retained, undistributed or current earnings. A significant loss recorded at a subsidiary may limit the dividends that these companies can distribute to us.

Insurance Coverage

We carry various property, casualty and financial insurance policies with limits, deductibles and exclusions consistent with industry standards. However, insurance coverage may not be adequate or available to cover unanticipated losses or claims. We are self-insured to the extent that losses are within the policy deductible or exceed the amount of insurance maintained. Such losses could have a material adverse effect on our short-term and long-term financial condition and the results of operations and cash flows.

Contractual Obligations and Commitments

We enter into obligations with third parties in the ordinary course of business. These obligations, as of December 31, 2007, are set forth in the table below:

Contractual obligation	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 Years
			(In thousands)		
Long term debt obligations(a)	$ 4,698,219	$ 96,085	$ 100,157	$ 64,699	$ 4,437,278
Interest on long-term debt(b)	4,955,887	280,696	550,115	539,506	3,585,570
Capital lease obligations(c)	1,982	152	363	452	1,015
Interest on Capital Lease obligations(d)	1,967	206	362	293	1,106
Operating lease obligations(e)	227,918	28,248	50,655	29,605	119,410
Purchase water obligations(f)	782,084	44,678	86,641	89,803	560,962
Other purchase obligations(g)	86,338	86,338			
Postretirement benefit plans obligations(h)	27,352	27,352			
Pension ERISA minimum funding requirement	76,000	76,000			
Preferred stocks with mandatory redemption requirements(i)	24,643	218	436	2,146	21,843
Interest on preferred stocks with mandatory redemption requirements	30,056	2,047	4,061	4,005	19,943
Other obligations(i)	163,930	110,850	53,011	69	
Total	$ 11,076,376	$ 752,870	$ 845,801	$ 730,578	$ 8,747,127

(a) Represents sinking fund obligations and debt maturities.
(b) Represents expected interest payments on outstanding long-term debt. Amounts reported may differ from actual due to future refinancing of debt.
(c) Represents future minimum payments under noncancelable capital leases.
(d) Represents expected interest payments on noncancelable capital leases.
(e) Represents future minimum payments under noncancelable operating leases, primarily for the lease of motor vehicles, buildings, land and other equipment.
(f) Represents future payments under water purchase agreements for minimum quantities of water.
(g) Represents the open purchase orders as of December 31, 2007, for goods and services purchased in the ordinary course of business.
(h) Represents contributions expected to be made to postretirement benefit plans.
(i) Represents capital expenditures estimated to be required under legal and binding contractual obligations.

Table of Contents

Off-Balance Sheet Arrangements

From 1997 through 2002, West Virginia-American Water Company, our subsidiary, entered into a series of agreements with various public entities to establish certain joint ventures, commonly referred to as public-private partnerships. West Virginia-American agreed to transfer and convey some of its real and personal property, which we refer to as the transferred facilities, to various public entities, subject to the lien of its General Mortgage Indenture, in exchange for an equal principal amount of industrial development bonds, which we refer to as IDBs, to be issued by the various public entities under a state Industrial Development Bond and Commercial Development Act.

West Virginia-American leased back the transferred facilities under capital leases for a period of 40 years. The leases have payments that approximate the payments required by the terms of the IDBs. In accordance with Financial Accounting Standards Board Interpretation Number 39, *Offsetting of Amounts Related to Certain Contracts*, we have presented the transaction on a net basis in the consolidated financial statements. The carrying value of the transferred facilities was $162.0 million at December 31, 2007.

Market Risk

We are exposed to market risk associated with changes in commodity prices, equity prices and interest rates. We use a combination of fixed-rate and variable-rate debt to reduce interest rate exposure. As of December 31, 2007 a hypothetical 10% increase in interest rates associated with variable rate debt would result in a $1.2 million decrease in our pre-tax earnings. Our risks associated with price increases for chemicals, electricity and other commodities are reduced through long-term contracts and the ability to recover price increases through rates.

Critical Accounting Policies and Estimates

The application of critical accounting policies is particularly important to our financial condition and results of operations and provides a framework for management to make significant estimates, assumptions and other judgments. Although our management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on our financial condition and results of operations as reflected in our consolidated financial statements.

Our financial condition, results of operations and cash flow are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. Management believes that the areas described below require significant judgment in the application of accounting policy or in making estimates and assumptions in matters that are inherently uncertain and that may change in subsequent periods. Our management has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with our Audit Committee. In addition, our management has also reviewed the following disclosures regarding the application of these critical accounting policies with the Audit Committee.

Regulatory Accounting

Our regulated utility subsidiaries are subject to regulation by state PUCs and the local governments of the states in which they operate. As such, we account for these regulated operations in accordance with SFAS No. 71, Accounting for the Effects of Certain Types of Regulation, which we refer to as SFAS No. 71, which requires us to reflect the effects of rate regulation in our financial statements. Use of SFAS No. 71 is applicable to utility operations that meet the following criteria: (1) third-party regulation of rates; (2) cost-based rates; and (3) a reasonable assumption that all costs will be recoverable from customers through rates. As of December 31, 2007, we had concluded that the operations of our regulated subsidiaries meet the criteria. If it is concluded in a future period that a separable portion of the businesses no longer meets the criteria, we are required to eliminate

Table of Contents

the financial statement effects of regulation for that part of the business, which would include the elimination of any or all regulatory assets and liabilities that had been recorded in the consolidated financial statements. Failure to meet the criteria of SFAS No. 71 could materially impact our consolidated financial statements as a one-time extraordinary item and through impacts on continuing operations.

Regulatory assets represent costs that have been deferred to future periods when it is probable that the regulator will allow for recovery through rates charged to customers. Regulatory liabilities represent revenues received from customers to fund expected costs that have not yet been incurred. As of December 31, 2007, we have recorded $628.0 million of net regulatory assets within our consolidated financial statements. Also, at December 31, 2007, we had recorded $192.7 million of regulatory liabilities within our consolidated financial statements. See Note 7 of the Notes to Consolidated Financial Statements for further information regarding the significant regulatory assets.

For each regulatory jurisdiction where we conduct business, we continually assess whether the regulatory assets and liabilities continue to meet the criteria for probable future recovery or settlement. This assessment includes consideration of factors such as changes in applicable regulatory environments, recent rate orders to other regulated entities in the same jurisdiction, the status of any pending or potential deregulation legislation and the ability to recover costs through regulated rates.

Goodwill

As of December 31, 2007, we had $2,457.0 million of goodwill. The goodwill is associated primarily with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E Town Corporation in 2001, representing the excess of the purchase price over the fair value of the net tangible and intangible assets acquired, and was assigned to reporting units based on the fair values at the date of the acquisition. The Regulated Businesses have been aggregated and deemed a single reporting unit because they have similar economic characteristics. In the Non-Regulated Businesses segment, the business is organized into eight reporting units.

In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, which we refer to as SFAS 142, goodwill is reviewed annually, or more frequently if changes in circumstances indicate the carrying value may not be recoverable. To test for impairment, we utilize discounted estimated future cash flows and comparable public company market data analyses for the regulated segment to measure fair value for each reporting unit. This calculation is highly sensitive to both the estimated future cash flows of each reporting unit, the discount rate assumed and the change in market data in these calculations. Annual impairment reviews are preformed in the fourth quarter. Application of the goodwill impairment test requires management s judgments, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. In addition, we will consider the market price of our common stock at the initial public offering date or the change over a period of time of our stock price following the consummation of the initial public offering.

For the years ended December 31, 2007, 2006 and 2005, we determined that our goodwill was impaired and recorded impairments of $509.3 million, $227.8 million and $396.3 million, respectively, including impairment charges from discontinued operations (See Note 8 of the Notes to our Consolidated Financial Statements.) Our annual goodwill impairment test is completed during the fourth quarter. We have processes to monitor for interim triggering events. During the third quarter of 2007, as a result of our debt being placed on review for a possible downgrade and the anticipated sale of a portion of the Company in the initial public offering, management determined at that time that it was appropriate to update its valuation analysis before the next scheduled annual test.

Based on this assessment, we performed an interim impairment test and recorded an impairment charge to goodwill to our Regulated Businesses in the amount of $243.3 million in the third quarter of 2007. The decline

Table of Contents

was primarily due to a slightly lower long-term earnings forecast caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

We completed our annual goodwill impairment test for 2007 and recorded an additional goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007. We determined that an impairment had occurred based upon new information regarding our market value. We incorporated this indicated market value into our valuation methodology and, based on those results, an additional impairment to our carrying value was recorded.

We may be required to recognize additional impairments in the future due to, among other things, the market value of our stock, a decline in our forecasted results as compared to the business plan, changes in interest rates or a change in rate case results. Further recognition of additional material impairments of goodwill would negatively affect our results of operations and total capitalization. It is reasonably possible that further goodwill impairment charges will be required depending upon changes in market conditions or circumstances. Based on the initial public offering price, we have determined that it is probable we will record an impairment to goodwill when we report results for the quarter ended March 31, 2008. Whether such an impairment to goodwill is recognized will depend on an analysis of the factors described above. The size of any such impairment to goodwill, if any, cannot be determined at this time.

Impairment of Long-Lived Assets

Long-lived assets, other than goodwill which is discussed above, include land, buildings, equipment and long-term investments. Long-lived assets, other than investments, land and goodwill, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market price of a long-lived asset, a significant adverse change in the manner in which the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, we estimate the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets and compares that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recognized equal to the amount by which the asset s carrying value exceeds its fair value. The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. A variation in the assumptions used could lead to a different conclusion regarding the realizability of an asset and, thus, could have a significant effect on the consolidated financial statements.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

We performed a valuation of long-lived assets, other than investments and goodwill, as of December 31, 2007, 2006, and 2005. As a result of the impairment analyses, we recorded pre-tax charges of $24.0 million including impairments recorded associated with discontinued operations for the year ended December 31, 2005. No impairment charges were recorded in 2007 and 2006. The 2005 impairment primarily resulted from lower than expected growth, slower development compared with original expectations and changes in the value of a building with a carrying value that exceeded its fair value. These charges are included in impairment charges in the statements of operations. The remaining values as of December 31, 2007, 2006 and 2005 were determined to be appropriate.

Table of Contents

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which we invest, as well as volatility inherent in the external markets. In assessing potential impairment for these investments, we consider these factors and in one case also receive annual appraisals. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset s carrying value exceeds its fair value. We determined the values of long-term investments were appropriate for the years ended December 31, 2007, 2006 and 2005.

Revenue Recognition

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are delivered to customers and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period. Unbilled revenues as of December 31, 2007 and 2006 were $134.3 million and $123.2 million, respectively. Increases in volumes delivered to the utilities customers and favorable rate mix due to changes in usage patterns in customer classes in the period could be significant to the calculation of unbilled revenue. Changes in the timing of meter reading schedules and the number and type of customers scheduled for each meter reading date would also have an effect on the estimated unbilled revenue; however, since the majority of our customers are billed on a monthly basis, total operating revenues would remain materially unchanged.

Revenue from non-regulated operations is recognized as services are rendered. Revenues from certain construction projects are recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities on the balance sheet until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Accounting for Income Taxes

We participate in a consolidated federal income tax return for United States tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

We estimate the amount of income tax payable or refundable for the current year and the deferred income tax liabilities and assets that results from estimating temporary differences resulting from the treatment of certain items, such as depreciation, for tax and financial statement reporting. These differences result from the recognition of a deferred tax asset or liability on our consolidated balance sheet and require us to make judgments regarding the probability of the ultimate tax impact of the various transactions we enter into. Based on these judgments we may record tax reserves or adjustments to valuation allowances on deferred tax assets to reflect the expected realization of future tax benefits. Actual income taxes could vary from these estimates and changes in these estimates can increase income tax expense in the period that these changes in estimate occur.

Accounting for Pension and Postretirement Benefits

We maintain noncontributory defined benefit pension plans covering eligible employees of our regulated utility and shared service operations. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 will be provided with a 5.25% of base pay defined contribution plan. We also maintain postretirement benefit plans for eligible retirees. The retiree welfare plans are closed for union employees hired

Table of Contents

on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002. We follow the guidance of SFAS 87, Employers Accounting for Pensions, and SFAS 106, Employers Accounting for Postretirement Benefits Other Than Pensions, when accounting for these benefits. In addition, we adopted the recognition and disclosure requirements of SFAS 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, effective December 31, 2006. See Note 14 of the Notes to Consolidated Financial Statements for further information regarding the accounting for the defined benefit pension plans and postretirement benefit plans.

Under these accounting standards, assumptions are made regarding the valuation of benefit obligations and the performance of plan assets. Delayed recognition in earnings of differences between actual results and expected or estimated results is a guiding principle of these standards. This delayed recognition of actual results allows for a smoothed recognition of costs over the working lives of the employees who benefit under the plans. The primary assumptions are:

Discount Rate The discount rate is used in calculating the present value of benefits, which are based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due;

Expected Return on Plan Assets Management projects the future return on plan assets considering prior performance, but primarily based upon the plans mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs we record currently;

Rate of Compensation Increase Management projects employees annual pay increases, which are used to project employees pension benefits at retirement; and

Health Care Cost Trend Rate Management projects the expected increases in the cost of health care.

In selecting a discount rate for our pension and postretirement benefit plans, a yield curve was developed for a portfolio containing the majority of United States-issued Aa-graded non-callable (or callable with make-whole provisions) corporate bonds. For each plan, the discount rate was developed as the level equivalent rate that would yield the same present value as using spot rates aligned with the projected benefit payments. The discount rate for determining pension benefit obligations was 6.27%, and the discount rate for determining other post-retirement benefit obligations was 6.20%, at December 31, 2007. The discount rate for determining both the pension obligations and other postretirement benefit obligations was 5.90% and 5.65%, at December 31, 2006 and 2005, respectively.

In selecting an expected return on plan assets, we considered tax implications, past performance and economic forecasts for the types of investments held by the plans. The long-term expected rate of return on plan assets (EROA) assumption used in calculating pension cost was 8.00% for 2007, 8.25% for 2006 and 8.75% for 2005. The weighted average EROA assumption used in calculating other postretirement benefit costs was 7.38% for 2007, 7.95% for 2006, and 8.40% in 2005.

In selecting a rate of compensation increase, we consider past experience in light of movements in inflation rates. Our rate of compensation increase was 4.25% for 2007 and 2006 and 4.75% for 2005.

In selecting health care cost trend rates, we consider past performance and forecasts of increases in health care costs. Our health care cost trend rate used to calculate the periodic cost was 9% in 2007, gradually declining to 5% in 2011 and thereafter.

Table of Contents

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

Change in Actuarial Assumption	Impact on Other Postretirement Benefit Obligation at December 31, 2007	Impact on 2007 Total Service and Interest Cost Components
Increase assumed health care cost trend by 1%	$ 57,868	$ 6,143
Decrease assumed health care cost trend by 1%	$ (48,220)	$ (5,001)

We will use a discount rate and EROA of 8% and 5.9%, respectively, for estimating our 2007 pension costs. Additionally, we will use a discount rate and expected return on plan assets of 8% and 5.9%, respectively, for estimating our 2007 other postretirement benefit costs.

The assumptions are reviewed annually and at any interim remeasurement of the plan obligations. The impact of assumption changes is reflected in the recorded pension and postretirement benefit amounts as they occur, or over a period of time if allowed under applicable accounting standards. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. As these assumptions change from period to period, recorded pension and postretirement benefit amounts and funding requirements could also change.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board, which we refer to as FASB issued Statement of Financial Accounting Standard No. 160, Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51 , which we refer to as SFAS 160. SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 will be effective for us on January 1, 2009. We are currently evaluating the effect, if any, that the adoption of SFAS 160 will have on our results of operations, financial position and cash flows.

Also in December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations , which we refer to as SFAS 141(R). SFAS 141(R), which will significantly change the accounting for business combinations, is effective for business combinations finalized on or after January 1, 2009. We are currently evaluating the effect, if any, that the adoption of SFAS 141(R) will have on our results of operations, financial position and cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115 , which we refer to as SFAS 159. This standard permits entities to choose to measure many financial instruments and certain other items of fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for the current year and was adopted by the Company on January 1, 2008. The Company has not elected to exercise the fair value irrevocable option. The adoption of SFAS 159 did not have an impact on the Company s results of operations, financial position or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R), which we refer to as SFAS 158. This statement requires the recognition of the

Table of Contents

overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, actuarial gains and losses, prior service costs or credits, and transition obligations and assets that have not be recognized in net periodic benefit cost under previous accounting standards will be recognized as a regulatory asset for the portion of the underfunded liability that meets the recovery criteria prescribed in SFAS 71 and as accumulated other comprehensive income, net of tax effects, for that portion of the underfunded liability that does not meet SFAS 71 regulatory accounting criteria. We adopted the recognition and disclosure requirements of the statement on December 31, 2006.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements , which we refer to as SFAS 157. SFAS 157 establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. In February 2008, the FASB issued FASB Staff Position FAS 157-2 which allows a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment and goodwill) that are required to be measured at fair value on a non-recurring basis (such as at acquisition or impairment). Accordingly, SFAS 157 will be adopted for the Company s nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009. On January 1, 2008, the Company adopted the provisions of SFAS 157 for financial assets and liabilities and nonfinancial assets and liabilities with recurring measurements. The Company s assets and liabilities measured at fair value on a recurring basis during the period were cash and cash equivalents, restricted funds and short-term debt. These assets and liabilities were measured at fair value on the balance sheet date using quoted prices in active markets (level 1 inputs, as defined by SFAS 157). The adoption of SFAS 157 for the Company s financial assets and liabilities did not have a significant effect on the Company s results of operations, financial position or cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements, which we refer to as SAB 108. SAB 108 provides guidance on how prior year misstatements should be considered when quantifying misstatements in current year financial statements for purposes of determining whether the current year s financial statements are materially misstated. SAB 108 was effective for the fiscal year ended December 31, 2006.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, which we refer to as FIN 48, an Interpretation of SFAS No. 109, Accounting for Income Taxes. FIN 48 is intended to address inconsistencies among entities with the measurement and recognition in accounting for income tax deductions for financial statement purposes. Specifically, FIN 48 addresses the timing of the recognition of income tax benefits. FIN 48 requires the financial statement recognition of an income tax benefit when we determine that it is more-likely-than-not that the tax position will be sustained. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted it as required on January 1, 2007, and it did not have a significant effect on our results of operations or financial position.

During 2006, the Emerging Issues Task Force of the Financial Accounting Standards Board ratified EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (that is, Gross versus Net Presentation), which we refer to as EITF 06-3. The Task Force reached a consensus that the scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and that the presentation of such taxes is an accounting policy that should be disclosed. Our accounting policy is to present these taxes on a net basis (excluded from revenues).

See Note 2 Significant Accounting Policies in the notes to the audited consolidated financial statements for a discussion of new accounting standards recently adopted or pending adoption.

Table of Contents

BUSINESS

Our Company

Founded in 1886, we are the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our nearly 7,000 employees provide approximately 15.6 million people with drinking water, wastewater and other water-related services in 32 states and Ontario, Canada. In 2007, we generated $2,214.2 million in total operating revenue, representing approximately four times the operating revenue of the next largest investor-owned company in the United States water and wastewater business, and $15.1 million in operating income, which includes $509.3 million of impairment charges relating to continuing operations, and a net loss of $342.8 million.

For 2007, our Regulated Businesses generated $1,987.6 million in operating revenue, which accounted for 89.8% of total operating revenue. For the same period, our Non-Regulated Businesses generated $242.7 million in operating revenue, prior to inter-segment eliminations, which accounted for 11.0% of consolidated operating revenue.

Our History as a Public Company

We were founded in 1886 as the American Water Works & Guarantee Company, for the purposes of building and purchasing water systems in McKeesport, Pennsylvania. In 1935, the Company was reorganized under its current name, and in 1947 the common stock of the Company became publicly traded on the New York Stock Exchange. Prior to being acquired by RWE in 2003, we were the largest publicly traded water utility company in the United States.

Our Acquisition by RWE

In 2003, we were acquired by RWE and became a private company. The RWE acquisition resulted in certain changes in our business. For example, our operations and management were managed through Thames Water. Also, we agreed not to file rate cases with certain state PUCs for specified periods of time as a condition of the acquisition. All rate stay-out provisions associated with the RWE acquisition have expired. In 2005, RWE decided to divest American Water. In March 2006, RWE decided to divest American Water through the sale of shares in one or more public offerings.

Corporate & Industry Milestones

Year	Event
1886	Founding of American Water as the American Water Works & Guarantee Company
1935	Reorganizes as American Water Works Company, Inc. in response to the Public Utility Company Holding Act
1947	First listing of common stock on the New York Stock Exchange under the symbol AWK
1958	Acquires operations in Connecticut, Massachusetts and New Hampshire
1962	Acquires contract operations and water systems in Maryland, Pennsylvania and New Jersey through merger with Northeastern Water Company
1965	Purchases the water utility assets of Southern Gas and Water Company in West Virginia
1966	Purchases the water utility assets of California Water & Telephone Company
1969	Joins Fortune magazine s list of 50 largest United States public utility companies Acquires Paradise Valley Water Company in Arizona
1972	Passage of Clean Water Act

Table of Contents

Year	Event
1972	Western Pennsylvania Water Company formed through merger of 17 operating subsidiaries
1974	Passage of Safe Drinking Water Act
1986	Acquires operations in New Mexico from Southwest Public Service Company
1989	Western Pennsylvania Water Company and Keystone Water Company merge to form Pennsylvania American Water Company
1993	Acquires operations in Indiana, Missouri and Ohio from Avatar Holdings
1996	Acquires the water service assets of Pennsylvania Gas & Water Company
1998	Acquires wastewater operations in Hawaii
1999	Acquires National Enterprises Inc. with operations in Missouri, Illinois, Indiana and New York
2000	Acquires water utilities in Missouri, Indiana, Illinois and Virginia from United Water Resources
2001	Acquires Azurix North America Corporation
	RWE signs an agreement to acquire the Company
2002	Acquires water subsidiaries of Citizens Communications Company in Arizona, California, Illinois, Indiana, Ohio and Pennsylvania
2003	RWE completes acquisition of the Company
	RWE combines the Company with the United States operations of Thames Water (including E Town Corporation, Inc.) to form the North American Water reporting unit of RWE Thames Water
2005	RWE announces its intention to divest the Company
2008	Initial public offering and listing of our common stock on the New York Stock Exchange with the symbol AWK

Regulated Businesses Overview

Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial and industrial customers. Our subsidiaries that provide these services are generally subject to economic regulation by the state PUCs in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters. We report the results of this business in our Regulated Businesses segment.

Table of Contents

The following charts set forth operating revenue and customers, respectively, for 2007 for the states in which our Regulated Businesses provide services:

Regulated Businesses Operating Revenue

(dollars in millions)

Regulated Businesses Customers

Non-Regulated Businesses Overview

We also provide services that are not subject to economic regulation by state PUCs through our Non-Regulated Businesses. Our Non-Regulated Businesses include:

- our Contracts Operations Group, which enters into public/private partnerships, including O&M, and DBO contracts for the provision of services to water and wastewater facilities for municipalities, the United States military and other customers;
- our Applied Water Management Group, which works with customers to design, build and operate small water and wastewater treatment plants;
- our Homeowner Services Group, which provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes; and Terratec Environmental Services Inc., which primarily provides wastewater, residuals, transport, disposal and management services to municipal and industrial customers in Ontario, Canada.

We report the results of these lines of business in our Non-Regulated Businesses segment. For 2007, operating revenue for our Non-Regulated Businesses was $242.7 million, prior to inter-segment eliminations, accounting for 11.0% of total operating revenue for the same period.

Our Industry

Overview

The United States water and wastewater industry has two main segments: (i) utility, which involves supplying water and wastewater services to consumers, and (ii) general services, which involves providing water- and wastewater-related services to water and wastewater utilities and other customers on a contract basis.

Table of Contents

The utility segment includes municipal systems, which are owned and operated by local governments or governmental subdivisions, and investor-owned systems. Government-owned systems make up the vast majority of the United States water and wastewater utility segment, accounting for approximately 84% of all United States community water systems and approximately 98% of all United States community wastewater systems. Investor-owned water and wastewater systems account for the remainder of the United States water and wastewater community water systems. Growth of service providers in the utility segment is achieved through acquisitions, including tuck-ins, of other water and wastewater systems and organic growth of the population served by such providers.

The utility segment is characterized by high barriers to entry, including high capital spending requirements. Investor-owned water and wastewater utilities also face regulatory approval processes in order to do business, which may involve obtaining relevant operating approvals, including certificates of public convenience and necessity (or similar authorizations) from state PUCs. Investor-owned water and wastewater systems are generally economically regulated by the state PUCs in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters for both investor-owned and government-owned water and wastewater utilities.

The general services segment includes engineering and consulting companies and numerous other fee-for-service businesses. These include the building and operating of water and wastewater utility systems, system repair services, lab services, sale of water infrastructure and distribution products (such as pipes) and other specialized services. The general services segment is characterized by aggressive competition and market-driven growth and profit margins.

The aging water and wastewater infrastructure in the United States is in constant need of modernization and facilities replacement. Increased regulations to improve water quality and the management of wastewater discharges, which began with passage of the Clean Water Act in 1972 and the Safe Drinking Water Act in 1974, have been among the primary drivers of the need for modernization. The EPA estimates that approximately $277 billion of capital spending will be necessary between 2003 and 2022 to replace aging infrastructure and to comply with quality standards to ensure quality water systems across the United States. In addition, the EPA estimates that approximately $388 billion of capital spending will be necessary between 2000 and 2019 to replace aging infrastructure and ensure quality wastewater systems across the United States.

The following chart sets forth estimated capital expenditure needs through 2022 for United States water systems:

Table of Contents

Capital expenditures related to municipal water supply, treatment and distribution and wastewater collection and treatment facilities are typically funded by water and wastewater rates, taxes or the issuance of bonds. However, raising large amounts of funds is challenging for municipal water utilities, which impacts their ability to increase capital spending. In order to meet their capital spending challenges, many municipalities are examining a combination of privatizations and partnerships with the private sector. Privatization involves a transfer of responsibility for, and ownership of, the utility from the municipality to the private sector. Partnerships between municipalities and the private sector include DBO contracts, own, operate and transfer contracts and own, leaseback and operate contracts. Under these types of contracts, the municipality maintains ownership of the water system and the private sector takes responsibility for managing and operating the system.

Fragmentation and Consolidation

The utility segment of the United States water and wastewater industry is highly fragmented, with approximately 53,000 community water systems and approximately 16,000 community wastewater facilities, according to the EPA. As shown in the charts below, the majority of the approximately 53,000 community water systems are very small, serving a population of 500 or less.

The following charts set forth the total United States water industry by system type and the total population served by system type, respectively, for 2005:

Number of United States Water Systems by Type:*	United States Population Served by Water System Type:*

This large number of relatively small water and wastewater utilities results in inefficiencies in the marketplace, since smaller utilities may not have the operating expertise, financial and technological capability or economies of scale to provide services or raise capital as efficiently as larger utilities. These inefficiencies may lead to industry consolidation in the future, as the larger investor-owned utilities acquire smaller, local water and wastewater systems. Larger utilities that have greater access to capital are generally more capable of making mandated and other necessary infrastructure upgrades to both water and wastewater systems. In addition, water and wastewater utilities with large customer bases spread across broad geographic regions may more easily

Table of Contents

absorb the impact of adverse weather, such as droughts, excessive rain and cool temperatures in specific areas. Larger utilities are able to spread overhead expenses over a larger customer base, thereby reducing the costs to serve each customer. Since many administrative and support activities can be efficiently centralized to gain economies of scale and sharing of best practices, companies that participate in industry consolidation have the potential to improve operating efficiencies, lower unit costs and improve service at the same time.

Water and Wastewater Rates

Investor-owned water and wastewater utilities generate operating revenue from customers based on rates that are established by state PUCs through a rate-setting process that may include public hearings, evidentiary hearings and the submission by the utility of evidence and testimony in support of the requested level of rates. In evaluating a rate case, state PUCs typically focus on five areas: (i) the amount and prudence of investment in facilities considered used and useful in providing public service; (ii) the operating and maintenance costs and taxes associated with providing the service (typically by making reference to a representative 12-month period of time, known as a test year); (iii) the appropriate rate of return; (iv) the tariff or rate design that allocates operating revenue requirements equitably across the customer base; and (v) the quality of service the utility provides, including issues raised by customers.

For most consumers, water and wastewater bills make up a relatively small percentage of household expenditures compared to other utility services.

The following chart sets forth the relative cost of water in the United States as a percentage of total household utility expenditures:

Our Strengths

We believe that we are distinguished by the following key competitive strengths:

Market leader with broad national footprint and strong local presence. We are the largest and most geographically diversified investor-owned water and wastewater utility company in the United States. With operations in 32 states and Ontario, Canada, we serve a population of approximately 15.6 million people, which we estimate is approximately 5 times the population served by the next largest investor-owned water and wastewater company in the United States. Our scale and geographic scope enable us to capitalize effectively on growth opportunities across our service areas, while helping to insulate us from adverse conditions in any one geographic area.

Regulatory, weather and economic diversity. State regulatory decisions, regional droughts and floods and local and regional economic downturns can have a major effect on geographically concentrated

Table of Contents

water and wastewater utilities. Our presence in numerous jurisdictions and localities across the United States promotes more stable and predictable financial performance across our overall business.

Economies of scale. As the largest investor-owned water and wastewater utility company in the United States, our Regulated Businesses span 375 individual service areas and include approximately 45,000 miles of distribution and collection mains, 84 surface water treatment plants, 623 groundwater treatment plants and 45 wastewater treatment facilities. Our scale and long-standing history with suppliers provide us with a competitive advantage in procuring goods and services reliably and economically, which enables us to provide high quality, cost-effective service to our customers and allows us to economically employ industry experts to serve all our systems. In addition, our experience in operating utilities in many jurisdictions results in the identification and application of best practices across the entire company.

Active community involvement supports customer satisfaction. We establish an active presence in the local communities where we operate, supported by strong, ongoing community relations and corporate responsibility. We work closely with these communities to help create detailed water development plans, collaborate on growth initiatives and implement various water infrastructure and conservation projects. We are involved in local charities, schools and community organizations. In 2007, we donated approximately $1.7 million to a wide array of charitable projects in communities that we serve. This strong local presence and community involvement complements our high quality service and helps us to achieve high levels of customer satisfaction. We work with internal and external audiences to develop and support activities that contribute to a responsible business and to achieve high economic, social and environmental standards while balancing the needs of our key stakeholders through a multi-faceted corporate responsibility approach. See Business Community Relations.

Regulated Businesses provide financial stability. Our core Regulated Businesses, which consist of locally managed utility subsidiaries that generally are economically regulated by the states in which they operate, accounted for approximately 89.8% of our consolidated operating revenue in 2007. Our Regulated Businesses provide a high degree of financial stability because (i) high barriers to entry provide limited protection from competitive pressures, (ii) economic regulation promotes predictability in financial planning and long-term performance through the rate-setting process and (iii) our largely residential customer base promotes consistent operating results.

Barriers to entry. Generally, water and wastewater utilities operate pursuant to certificates of public convenience and necessity (or similar authorizations) issued by the state PUC in which they operate, which creates a barrier to entry. The requirement to hold such a certificate typically prevents investor-owned water and wastewater utilities from competing with us in our authorized areas. In addition, the high cost of constructing a new water or wastewater system generally inhibits competitive entry into our markets, including by municipal or government-owned utilities, which must either construct new systems or convert our assets to public ownership in order to compete directly with us in our authorized areas. Both of these factors provide a framework that allows us to operate our Regulated Businesses on a predictable and consistent basis.

Economic regulation. Economic regulation in the water and wastewater utility industry exists as a substitute for competition. The primary regulatory model used by state PUCs involves a determination of an applicable rate base (consisting of allowed investments made in infrastructure), the recovery of prudently incurred operating expenses and an opportunity to earn an appropriate rate of return on our invested capital and a return of our invested capital. This model allows us to project our return on our investment and a return of our investment and recovery of expenses and promotes predictability in financial planning and long-term performance of our Regulated Businesses.

Residential customer base. Residential customers accounted for approximately 91% of the total customers served by our Regulated Businesses and approximately 58% of total operating revenue for our Regulated Businesses in 2007. Residential usage of water tends to be stable because residential customers need water for daily health and sanitary needs regardless of economic or other external

Table of Contents

factors. In addition, residential customers generally do not have the option of switching to another service provider. For these reasons, residential customers represent a stable customer platform, generating consistent operating results for our company over time and across our geographic service areas.

Experience in securing appropriate rates of return and promoting constructive regulatory frameworks. We seek an appropriate rate of return on our investment and a return of our investment and recovery of prudently incurred operating expenses from state PUCs in the form of rate increases. We have a strong track record of providing reliable service at cost-effective rates, which has typically resulted in high customer satisfaction and has generally allowed us to maintain positive relations with local communities and regulators. We have generally been granted rate relief in a timely manner after application, and prior to our acquisition by RWE we often were successful in securing appropriate rate relief when we filed rate cases. In the period following RWE s acquisition of the Company, as a condition to the approval of the acquisition, we agreed with certain state PUCs that we would not file rate cases for specified periods of time, also known as rate stay-outs. All rate stay-out provisions associated with the RWE acquisition have expired.

A number of states in which our Regulated Businesses operate have adopted efficient rate policies, including some form of single tariff pricing, forward-looking test years, pass-through provisions or infrastructure surcharges. Pennsylvania, New Jersey, West Virginia, Ohio, Indiana and Illinois are examples of states that have adopted a full or partial single rate policy, under which all customers in a state or certain regions within a state are charged utilizing a single rate structure, regardless of which of our individual systems serves them. The single tariff structure is based on costs that are determined on a statewide or intra-state regional basis, thereby moderating the impacts of periodic fluctuations in local costs while lowering administrative costs for us and our customers. In addition, a number of states in which we operate allow utilities to utilize some form of forecast or forward-looking test year. Forward-looking test years and infrastructure surcharges reduce the regulatory lag associated with the traditional method of recovering rates from state PUCs through lengthy rate cases based on historical information. The forward-looking test year mechanism allows us to earn on a more timely basis a return of our current or projected costs and a rate of return on our current or projected invested capital and other known and measurable changes in our business. Pass-through provisions allow for an increase in certain operating costs, such as purchased power and property taxes, to be passed on to, and recovered from, customers outside of a general rate case proceeding. The infrastructure surcharge mechanism allows our rates to be adjusted and charged to customers outside the context of a general rate proceeding for pre-specified portions of our capital expenditures to replace aging infrastructure closer to the time these expenses are incurred. Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio are examples of states that have permitted some form of infrastructure surcharge for investments to replace aging infrastructure. These constructive regulatory mechanisms encourage us to maintain a steady capital expenditure program to repair and improve water and wastewater systems as needed by reducing the regulatory lag on the recovery of prudent expenditures.

Significant growth opportunities with a low risk business profile. We believe we are well positioned to benefit from favorable industry dynamics in the water and wastewater sectors, which provide significant opportunities for future growth in both our Regulated Businesses and complementary Non-Regulated Businesses.

Replacement of aging infrastructure. The EPA estimates that approximately $277 billion of capital spending will be needed between 2003 and 2022 to replace aging water infrastructure and comply with stricter water quality standards, and the EPA estimates that approximately $388 billion will be needed between 2000 and 2019 to replace aging wastewater infrastructure. We intend to invest capital prudently to enable us to continue to provide essential services to our regulated water and wastewater utility customers.

In addition, approximately 84% of community water systems are owned by municipalities or government entities that have varying access to financial resources and may have less extensive experience with large construction programs. In order to meet their capital spending challenges, we believe that municipalities will increasingly examine a range of strategies, including privatizations and

Table of Contents

partnerships with the private sector. We have successfully developed expertise in managing large capital investment projects and programs as an owner-operator and have an established track record of investing to upgrade, replace and add new pipes, treatment and pumping facilities and other water system infrastructure. In addition, we have experience designing, building and operating water treatment plants, which treat water from major rivers as well as lakes, reservoirs and groundwater sources within the United States. Our experience and resources position us favorably to partner with municipalities to upgrade and manage their infrastructure projects.

Fragmented industry provides consolidation opportunities. With approximately 53,000 community water systems and roughly 16,000 community wastewater systems in the United States, the water and wastewater industry is significantly more fragmented than the other major utility industries. We expect the factors driving industry consolidation to increase in the future. These include economies of scale, environmental regulations, capital investment needs and need for technical and regulatory expertise. With the presence of our Regulated Businesses in 20 states, we have a large platform on which to grow both organically and through consolidation of this fragmented market. Historically, we have been able to successfully identify, acquire and integrate water and wastewater systems.

Opportunities for non-regulated growth. Our expertise and geographic diversity increases our ability to make opportunistic investments in non-regulated businesses that are complementary to our Regulated Businesses. Our national footprint and public/private partnership experience, including O&M, military and DBO contracts and services, position us to participate in existing and emerging non-regulated water businesses. These include contracting for the supply and treatment of water and wastewater with the United States military, for which we operate and maintain the water and wastewater networks at Forts Leavenworth, Sill and Rucker and for which we have been awarded contracts at Fort A.P. Hill and Scott Air Force Base.

Experienced senior management team. Our three senior managers have an average of 27 years of experience in the utilities industry. Donald L. Correll, our President and Chief Executive Officer, Ellen C. Wolf, our Senior Vice President and Chief Financial Officer, and John S. Young, our Chief Operating Officer, have all held senior management positions at publicly traded companies. Our 14 state presidents have an average of 25 years of experience in the utilities industry.

Industry leader in water quality, testing and research. As the largest investor-owned United States water and wastewater utility company, we are experts in water quality testing, compliance and treatment and have established and own industry-leading water testing facilities. Our technologically advanced quality control and testing laboratory in Belleville, Illinois is certified in 23 states and Puerto Rico. Our laboratories and other facilities perform more than one million water quality tests per year.

Our Strategy

Our goal is to consistently provide customers with safe, high quality drinking water and reliable water and wastewater services. Our business strategies include:

continuing to invest prudently in regulated water and wastewater infrastructure projects;

earning an appropriate rate of return on our investments from state PUCs;

growing our Regulated Businesses through acquisitions; and

continuing to pursue public/private partnerships, including O&M and military contracts and services and other non-regulated businesses that are complementary to our Regulated Businesses.

Continue our prudent investment in regulated infrastructure projects. We intend to invest capital prudently to enable us to continue to provide essential services to our regulated water and wastewater utility customers, while working with regulators in the various states in which we operate to have the opportunity to earn an appropriate rate of return on our investment and a return of our investment.

85

Table of Contents

Over the next five years, we estimate that Company-funded capital investment will total between approximately $4,000 and $4,500 million. We anticipate spending between approximately $770 and $950 million yearly on Company-funded capital investment for the foreseeable future, depending upon the timing of major capital projects. Our capital investment includes both infrastructure renewal programs, where we replace existing infrastructure, as needed, and construction of facilities to meet new customer growth. Over the next five years, we estimate we will invest approximately $1,700 million to replace aging infrastructure including mains, meters, and supply and treatment facilities. We estimate that we will invest approximately $1,300 million in facilities to serve new customer growth over this same period. In addition, we estimate that complying with water quality standards and other regulatory requirements will require approximately $700 million of investment over the same period. Projects to enhance system reliability, security, and efficiency, or to meet other needs are projected to account for approximately an additional $500 million of investment over the same period.

The charts below set forth our estimated percentage of projected capital expenditures for 2007 to 2011 by purpose of investment and by asset type, respectively:

Earn an appropriate rate of return on our investments. A critical competency of a regulated utility is filing and completing rate cases with state PUCs. We will focus on the timely filing and completion of these rate cases in order to earn an appropriate return on our investments and to obtain recovery of prudently incurred expenses.

Grow our Regulated Businesses through acquisitions. We intend to continue to expand our regulated footprint geographically by acquiring water and wastewater systems in our existing markets and certain markets in the United States where we do not currently operate our Regulated Businesses. Our experienced development team evaluates potential acquisition targets across the country, particularly in higher-growth areas. Before entering new markets, we will evaluate the regulatory environment to ensure that we will have the opportunity to achieve an appropriate return on our investment while maintaining our high standards for quality, reliability and compliance with environmental, health and safety and water quality standards. These acquisitions may include large acquisitions of companies that have operations in multiple markets.

We also intend to continue to grow our regulated footprint through tuck-in acquisitions of small water and/or wastewater systems, typically serving fewer than 10,000 customers, in close geographic proximity to where we currently operate our Regulated Businesses. Tuck-ins allow us to integrate systems, operations and management and achieve efficiencies.

Continue to pursue complementary businesses. While our business mix will continue to focus predominantly on regulated activities, we are pursuing opportunities in non-regulated businesses that are

Table of Contents

complementary to our Regulated Businesses and our capabilities. We plan to focus on our public/private partnerships, including O&M and military contracts and services. We intend to capitalize on our O&M expertise as well as our existing municipal and government relationships to identify and bid for new ventures that have attractive risk and return characteristics. We also intend to continue to expand our non-regulated Homeowner Services business, which provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes, in areas within and beyond our existing regulated footprint.

Our Regulated Businesses

Overview of Networks, Facilities and Water Supply

Our Regulated Businesses operate in approximately 1,625 communities spread out across 375 individual service areas in 20 states in the United States. Our primary operating assets include 84 surface water treatment plants, 623 groundwater treatment plants, 1,027 groundwater wells, 45 wastewater treatment facilities, 970 treated water storage facilities, 1,226 pumping stations, 99 dams and approximately 45,000 miles of mains and collection pipes, 40,000 miles of which are water mains and 5,000 miles of which are sewer mains. We own substantially all of the assets used by our Regulated Businesses.

We generally own the land and physical assets used to store, extract and treat source water. Typically, we do not own the water itself, which is held in public trust and is allocated to us through contracts and allocation rights granted by federal and state agencies or through the ownership of water rights pursuant to local law. Sources of supply are seasonal in nature and weather conditions can have a pronounced effect on supply. In connection with supply planning for most surface or groundwater sources, we employ sophisticated models to determine safe yields under different rainfall and drought conditions. Surface and groundwater levels are routinely monitored for all supplies so that supply capacity may be predicted and, as needed, mitigated through demand management and additional supply development.

The following chart sets forth the sources of water supply for our Regulated Businesses for 2007 by volume:

The level of water treatment that we apply varies significantly depending upon the quality of the water source. Surface water sources, such as rivers, typically require significant filtration, while some groundwater sources, such as aquifers, require chemical treatment only. In addition, a small amount of treated water is purchased from neighboring water purveyors. Treated water is transported through an extensive transmission and distribution network, which includes underground pipes, above ground storage facilities and numerous pumping facilities with the ultimate distribution of the treated water to the customers premises. We also have installed meters to measure the water that we deliver through our distribution network. We employ a variety of methods of

Table of Contents

meter reading to monitor consumption, ranging from basic mechanical meters read by traveling meter readers to remote drive-by electronic meter reading equipment. The majority of new meters are able to support future advances in electronic meter reading.

The provision of wastewater services involves the collection of wastewater from customers premises through sewer lines. The wastewater is then transported through a sewer network to a treatment facility where it is treated to meet required effluent standards. The treated wastewater is finally returned to the environment as effluent, and the solid waste byproduct of the treatment process is disposed of in accordance with local standards.

Maintenance of our networks is a key activity of our Regulated Businesses. We have ongoing main renewal programs in all states in which our Regulated Businesses operate. These programs consist of both rehabilitation of existing mains and replacement of mains that have reached the end of their useful service life. We generally replace rather than rehabilitate our mains, subject to considerations of cost, feasibility and customer service impact.

The following table sets forth operating revenue, operating income and number of customers for 2007 for our regulated subsidiaries in the states where our Regulated Businesses provide services:

	Operating Revenue ($ in millions)	% of Total	Number of Customers (at December 31, 2007)	% of Total
New Jersey	$ 505.3	25.4%	634,957	19.2%
Pennsylvania	416.2	20.9%	644,720	19.5%
Missouri	179.9	9.1%	465,087	14.0%
Illinois	179.1	9.0%	306,740	9.2%
Indiana	146.5	7.4%	283,088	8.5%
California	124.4	6.3%	171,445	5.2%
West Virginia	105.6	5.3%	167,744	5.1%
Subtotal (Top Seven States)	1,657.0	83.4%	2,673,781	80.7%
Other	330.6	16.6%	638,847	19.3%
Total Regulated Businesses	$ 1,987.6	100.0%	3,312,628	100.0%

Includes data from our operating subsidiaries in the following states: Arizona, Georgia, Hawaii, Iowa, Kentucky, Maryland, Michigan, New Mexico, New York, Ohio, Tennessee, Texas and Virginia.

Approximately 83.4% of operating revenue from our Regulated Businesses in 2007 were generated from 2.7 million customers in our seven largest states, as measured by operating revenues. In fiscal year 2007, no single customer accounted for more than 1% of our annual operating revenue.

The operational characteristics of our Regulated Businesses, including water and wastewater networks and infrastructure and water sources and supply, vary on a state-by-state basis, as explained below with respect to our top seven states by Regulated Businesses revenues.

New Jersey

New Jersey-American Water serves a population (including resale) of approximately 2.59 million and generated approximately $505.3 million of operating revenue in 2007, representing approximately 25.4% of operating revenue of our Regulated Businesses for that period.

In New Jersey, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including streams, lakes and reservoirs) and groundwater sources. In 2007, we obtained 68% of our water supply from surface water sources and 22% from groundwater sources. Purchased raw water and treated water each accounted for 5% of water supply, respectively, for the same period.

88

Table of Contents

New Jersey-American Water currently operates seven surface water treatment plants and 152 groundwater treatment plants, which process water extracted from 173 groundwater wells. We maintain 123 treated water storage facilities, 206 pumping stations and seven dams, and our water and wastewater collection and distribution systems comprise 8,113 miles of mains and collection pipes. Our Applied Water Management Group currently provides wastewater treatment services to small communities in New Jersey.

In New Jersey, in order to ensure that we have adequate sources of water supply, we utilize reservoirs, aquifer storage supplies and seasonal wells to provide for water needs during peak summer seasons. Through the optimization of ground and surface water rights, we are able to balance seasonal fluctuations and provide sufficient water supply to our customers year round. We also maintain drought and emergency plans to ensure service reliability through a wide range of weather fluctuations.

Pennsylvania

Pennsylvania American Water Company serves a population of approximately 2.1 million and generated approximately $416.2 million of operating revenue in 2007, representing approximately 20.9% of operating revenue of our Regulated Businesses for that period.

In Pennsylvania, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including streams, lakes and reservoirs) and groundwater sources. In 2007, we obtained 92% of our water supply from surface water sources and 6% from groundwater sources. Purchased treated water accounted for 2% of our water supply for the same period.

Pennsylvania American Water Company currently operates 36 surface water treatment plants and 71 groundwater treatment plants, which process water extracted from 108 groundwater wells. We maintain 182 treated water storage facilities, 288 pumping stations and 65 dams, and our water and wastewater collection and distribution systems comprise 9,238 miles of mains and collection pipes. We currently operate four wastewater treatment facilities in Pennsylvania.

In Pennsylvania, in order to ensure that we have adequate sources of water supply, we maintain active drought contingency plans in each of our public water systems. The plans identify the source of supply operations that are used during normal and drought weather conditions and specify measures to be taken at different drought trigger levels to increase supply and/or curtail water demand. Water allocation and passing-flow requirements must be managed to maintain adequate supply to our production facilities. In addition, we have taken action to augment supply in systems that have historically had drought-related supply issues (such as Butler, Pennsylvania) by finding alternative raw water sources and making finished water interconnections with other systems. In another of our drought-sensitive areas, Coatesville, Pennsylvania, we are currently in the planning and design stage of a supplemental interconnection with a neighboring water authority and long-term development of additional raw water sources.

Missouri

Missouri American Water Company serves a population of approximately 1.55 million and generated approximately $179.9 million of operating revenue in 2007, representing approximately 9.1% of operating revenue of our Regulated Businesses for that period.

In Missouri, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including rivers, streams, lakes and reservoirs) and groundwater sources. In 2007, we obtained 90% of our water supply from surface water sources and 10% from groundwater sources.

Missouri American Water Company currently operates six surface water treatment plants and 15 groundwater treatment plants, which process water extracted from 36 groundwater wells. We maintain 61 treated

Table of Contents

water storage facilities, 39 pumping stations and one dam, and our water and wastewater collection and distribution systems comprise 5,671 miles of mains and collection pipes. We currently operate four wastewater treatment facilities in Missouri.

In our Joplin service area in Missouri, our source of water supply is limited. To manage this issue on the demand side, the water use of a large industrial customer has been restricted under an interruptible tariff. Additional wells have and will be developed to address supply and reliability deficiencies.

Illinois

Illinois American Water Company serves a population of approximately 1.27 million and generated approximately $179.1 million of operating revenue in 2007, representing approximately 9.0% of operating revenue of our Regulated Businesses for that period.

In Illinois, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including rivers, streams, lakes and reservoirs) and groundwater sources. In 2007, we obtained 51% of our water supply from surface water sources and 38% from groundwater sources. Purchased treated water accounted for 11% of water supply for the same period.

Illinois American Water Company currently operates seven surface water treatment plants and 31 groundwater treatment plants, which process water extracted from 64 groundwater wells. We maintain 59 treated water storage facilities, 97 pumping stations and three dams, and our water and wastewater collection and distribution systems comprise 3,853 miles of mains and collection pipes. We currently operate 11 wastewater treatment facilities in Illinois.

In Illinois, we utilize a comprehensive planning process to assess source of supply adequacy. This assessment addresses both water quantity and quality features. Future customer demand projections are prepared. Existing system delivery infrastructure is evaluated to determine the capabilities of addressing anticipated demands. In addition to determining source of supply quantity adequacy, the ability to deliver the appropriate water quality is assessed. This would include compliance with environmental regulations as well as company water quality goals. The planning efforts result in a list of improvements that include source of supply upgrades.

Indiana

Indiana American Water Company, Inc. serves a population of approximately 1.26 million and generated approximately $146.5 million of operating revenue in 2007, representing approximately 7.4% of operating revenue of our Regulated Businesses for that period.

In Indiana, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including rivers, streams, lakes and reservoirs) and groundwater sources. In 2007, we obtained 44% of our water supply from surface water sources and 55% from groundwater sources. Purchased treated water accounted for 1% of water supply for the same period.

Indiana American Water Company, Inc. currently operates six surface water treatment plants and 31 groundwater treatment plants, which process water extracted from 139 groundwater wells. We maintain 71 treated water storage facilities, 51 pumping stations and six dams, and our water and wastewater collection and distribution systems comprise 4,164 miles of mains and collection pipes. We currently operate one wastewater treatment facility in Indiana.

At Indiana American Water Company, we employ several measures to ensure that we have adequate sources of water supply. Indiana American Water conducts and updates comprehensive planning studies for each of its water utilities to identify and plan for long term customer demand trends. In order to provide uninterrupted water

Table of Contents

service, new source of supply and water treatment capital projects are planned and timed to match increases in customer demand and/or changes in the yield of existing sources of supply and treatment capacities. For example, to serve our high growth Indianapolis southern Suburban market, our London Road Project will utilize a new well field and treatment plant that will satisfy the significant needs of increased population and economic development. Further, these facilities are built to be incrementally expandable to match further growth over the next 10 years. In cases of extreme demand (such as drought conditions), customer demand-management plans are in place to sustain water sources through to normal demand conditions. Indiana American s Noblesville District, a high growth northern suburb of Indianapolis, successfully managed high demand in 2007 s heat wave/drought condition through the use of its demand management plan. Further, emergency connections to alternate water sources are in place in some drought-sensitive Indiana American Water districts.

California

California American Water Company serves a population of approximately 0.63 million and generated $124.4 million of operating revenue in 2007, representing approximately 6.3% of operating revenue of our Regulated Businesses for that period.

In California, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including rivers, streams, lakes and reservoirs) and groundwater sources. In 2007, we obtained 1% of our water supply from surface water sources and 72% from groundwater sources. Purchased treated water accounted for 27% of water supply for the same period.

California American Water Company currently operates two surface water treatment plants and 149 groundwater treatment plants, which process water extracted from 178 groundwater wells. We maintain 90 treated water storage facilities, 115 pumping stations and three dams, and our water and wastewater collection and distribution systems comprise 2,704 miles of mains and collection pipes. We currently operate eight wastewater treatment facilities in California.

In California, in order to ensure that we have adequate sources of water supply we are in the permitting stages to obtain approval for the construction of a desalination plant to serve our customers on the Monterey Peninsula, we are designing new groundwater wells in our Larkfield district, and in other areas, we are making arrangements to extend or expand our purchase of water from neighboring water providers.

West Virginia

West Virginia American Water Company serves a population of approximately 0.58 million and generated approximately $105.6 million of operating revenue in 2007, representing approximately 5.3% of operating revenue of our Regulated Businesses for that period.

In West Virginia, our infrastructure and assets are designed to collect, treat and distribute water from a variety of surface water sources (including streams, lakes and reservoirs), and in 2007 we obtained 100% of our water supply from surface water sources.

West Virginia American Water Company currently operates nine surface water treatment plants. We maintain 168 treated water storage facilities, 213 pumping stations and four dams, and our water collection and distribution systems comprise 2,995 miles of mains and collection pipes. We do not currently provide wastewater services in West Virginia.

In West Virginia, our surface water supplies are sufficient to meet demand under all but the most extreme drought conditions. Such conditions would be atypical for West Virginia, which has an average annual rainfall of 44 inches.

Table of Contents

Customers

We have a large and geographically diverse customer base in our Regulated Businesses. For the purposes of our Regulated Businesses, each customer represents a connection to our water or wastewater networks. As in the case of apartment complexes, businesses and many homes, multiple individuals may be served by a single connection. See Industry and Market Data for the methodology we employ to estimate population served.

Residential customers make up the large majority of customers in all of the states in which we operate. In 2007, residential customers accounted for 91% of the customers and 58% of the operating revenue of our Regulated Businesses. Residential customers are highly predictable water and wastewater services consumers and they generate stable operating revenue over time and across regions. We also serve commercial customers, such as shops and businesses, industrial customers, such as large-scale manufacturing and production operations, and public authorities, such as government buildings and other public sector facilities, including schools. We supply water to private fire customers for use in fire suppression systems in office buildings and other facilities and also provide bulk water supplies to other water utilities that distribute them to their own customers.

The following table sets forth the number of water and wastewater customers by customer class for our Regulated Businesses in 2005, 2006 and 2007:

	Year Ended December 31,					
	2005		2006		2007	
	Water	Wastewater	Water	Wastewater	Water	Wastewater
Residential	2,821,083	128,886	2,866,036	134,624	2,887,134	135,313
Commercial	230,187	5,756	229,354	5,922	227,831	5,825
Industrial	4,768	11	4,668	13	4,658	13
Private Fire	32,106	10	33,208	10	34,542	9
Public Authority & Other	16,844	178	16,990	177	17,130	173
Total	3,104,988	134,841	3,150,256	140,746	3,171,295	141,333

The following table sets forth water services operating revenue by customer class and wastewater services operating revenue, excluding other water revenues, for our Regulated Businesses for 2005, 2006 and 2007:

	Year ended December 31,		
	2005	2006	2007
		(In millions)	
Water service			
Residential	$ 1,068.2	$ 1,067.9	$ 1,146.1
Commercial	353.7	362.7	385.3
Industrial	97.2	92.0	94.7
Public and other	223.4	230.2	247.6
Total water services	1,742.5	1,752.8	1,873.7
Wastewater services	66.3	72.2	75.6
Total	$ 1,808.7	$ 1,825.0	$ 1,949.3

Substantially all of our regulated water customers are metered, which allows us to measure and bill for our customers water consumption, typically on a monthly basis. Our wastewater customers are billed either on a fixed charge basis or based on their water consumption.

Customer usage of water is affected by weather conditions, in particular during the summer. Our water systems experience higher demand in the summer due to the warmer temperatures and increased usage by

92

Table of Contents

customers for lawn irrigation and other outdoor uses. Summer weather that is cooler and wetter than average generally serves to suppress customer water demand and can have a downward effect on water operating revenue and operating income. Conversely, when weather conditions are extremely dry, our systems may be affected by drought-related warnings and/or water usage restrictions imposed by governmental agencies, also serving to reduce customer demand and operating revenue. These restrictions may be imposed at a regional or state level and may affect our service areas, regardless of our readiness to meet unrestricted customer demands.

The principal factor of any increase in our Regulated Businesses customer base is due to customers added through acquisitions and organic growth. From 2004 to 2007, our Regulated Businesses customer base increased at an average annual rate of 1.1%.

Supplies

Our water and wastewater operations require an uninterrupted supply of chemicals, energy and fuel, as well as maintenance material and other critical inputs. Many of these inputs are subject to short-term price volatility. Long-term volatility is partially mitigated through existing procurement contracts, current supplier continuity plans and the regulatory rate setting process.

Because of our geographic diversity, we maintain relationships with many chemical, equipment and service suppliers in the marketplace, and we do not rely on any single entity for a material amount of our supplies. We also employ a strategic sourcing process intended to ensure reliability in supply and long-term cost effectiveness. As a result of our strategic sourcing process and our strong relationships with suppliers, we are able to mitigate interruptions in the delivery of the products and services that are critical to our operations. For example, during Hurricane Katrina, we were challenged to locate chemical suppliers not affected by the hurricane. As a result of our previously negotiated and established relationships with a network of preferred suppliers, we were able to secure an uninterrupted supply of materials and to continue our operations in the affected areas without interruptions.

We have back-up energy sources at key facilities that are able to keep our operations running in the event of a temporary loss of our primary energy supplies.

Regulation

Economic Regulation

Our subsidiaries in the states in which we operate our Regulated Businesses are generally subject to extensive economic regulation by their respective state PUCs. The term economic regulation is intended to indicate that these state PUCs regulate the economic aspects of service to the public from systems that fall within their jurisdiction but do not generally establish water quality standards, which are set by the EPA and/or state environmental authorities and enforced through state environmental or health agencies. State PUCs have broad authority, derived from state laws and state constitutions under which they operate, to regulate many of the economic aspects of the utilities that fall within their jurisdiction. For example, state PUCs issue certificates of public convenience and necessity (or similar authorizations) that may be required for a company to provide public utility services in specific areas of the state. They also must approve the rates and conditions under which service is provided to customers and have extensive authority to establish rules and regulations under which the utilities operate. Although specific authority might differ from state to state, in most states, these state PUCs must approve rates, accounting treatments, long-term financing programs, significant capital expenditures and plant additions, transactions between the regulated subsidiary and affiliated entities, reorganizations and mergers and acquisitions, in many instances prior to their completion. The jurisdiction exercised by each state PUC is prescribed by state laws and regulations and therefore varies from state to state. Regulatory policies not only vary from state to state, they may change over time. These policies will affect the timing as well as the extent of recovery of expenses and the realized return on invested capital.

Table of Contents

Economic regulation of utilities deals with many competing, and occasionally conflicting, public interests and policy goals. The primary responsibility of state PUCs is to achieve the overall public interest by balancing the interests of customers and the utility and its stockholders. Although the specific approach to economic regulation does vary, certain general principles are consistent across the states in which our regulated subsidiaries operate. Based on the United States Constitution and state constitutions that prohibit confiscation of property without due process of law and just compensation, as well as state statutory provisions and court precedent, utilities are entitled to recover, through rates charged to customers, prudent and reasonable operating costs as well as an opportunity to earn an appropriate return on our prudent, used and useful capital investment necessary to provide service to customers and a return of our prudent, used and useful capital investment necessary to provide service to customers. The state PUCs will also generally accord a utility the right to serve specific areas and will also provide investor-owned utilities with limited protection from competition because the requirement of an investor-owned utility to operate pursuant to a certificate of public convenience and necessity (or similar authorizations) typically prevents other investor-owned utilities from competing with it in the authorized area. In return, the utility undertakes to provide reliable service on a nondiscriminatory basis to all customers within the authorized area.

Our operating revenue is typically determined by reference to the volume of water supplied to a customer multiplied by a price-per-gallon set by a tariff approved by the relevant state PUC. Certain states, such as, for example, Pennsylvania, West Virginia, New Jersey, Ohio, Indiana and Illinois, have utilized a full or partial single rate policy, under which all customers in a state or certain regions within a state are charged utilizing a single rate structure, regardless of which of our individual systems serves them. The single tariff structure is based on costs that are determined on a state-wide or intra-state regional basis, thereby moderating the impact of periodic fluctuations in local costs while lowering administrative costs for us and our customers.

The process to obtain approval for a change in rates, or rate case, involves filing a petition with the state PUC on a periodic basis as determined by our capital expenditures needs and our operating costs. Rate cases are normally initiated by the regulated utility whenever the utility determines it needs to recover increased operating expenses or a return on new capital investment, or otherwise determines that its current authorized return is not sufficient, given current market conditions, to provide a reasonable return on investment. Typically a rate case will not be filed, however, unless the current or expected future return is below the allowed rate of return currently authorized by the regulator. A state PUC may also initiate a rate proceeding or investigation if it believes a utility may be earning in excess of its authorized rate of return. Rate cases often involve a lengthy and costly administrative process. The utility, the state PUC staff, consumer advocates and any other interveners who may participate in the process prepare and file evidence, consisting of supporting testimony and documentation. This is presented in public hearings in connection with the rate case. These hearings, which are economic and service quality fact-finding in nature, are typically conducted in a trial-like setting before the state PUC or an administrative law judge. During the process, the utility is required to provide staff and interveners with all relevant information they may request concerning the utility s operations, expenses and investments. The sworn evidentiary record then forms the basis for a state PUC decision.

Some state PUCs are more restrictive than others with regard to the types of expenses and investments that may be recovered in rates as well as with regard to the transparency of their rate-making processes, and how they reach their final rate determinations. However, in evaluating a rate case, state PUCs typically focus on five areas:

- the amount and prudence of investment in facilities considered used and useful in providing public service;
- the operating and maintenance costs and taxes associated with providing the service (typically by making reference to a representative 12-month period of time, known as a test year);
- the appropriate rate of return;
- the tariff or rate design that allocates operating revenue requirements equitably across the customer base; and
- the quality of service the utility provides, including issues raised by customers.

94

Table of Contents

The decisions of state PUCs and the timing of those decisions can have a significant impact on the operations and earnings of our Regulated Businesses. Rate cases and other rate-related proceedings can take several months to over a year to complete. Therefore, there is frequently a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating expense increase and when those costs are reflected in rates. For instance, an unexpected increase in chemical costs or new capital investment that is not appropriately reflected in the most recently completed rate case will generally not be recovered by the regulated subsidiary until the next rate case is filed and approved by the state PUC. Our rate case management program is guided by the goals of obtaining efficient recovery of costs of capital and utility operating and maintenance costs, including costs incurred for compliance with environmental regulations. The management team at each of our regulated subsidiaries anticipates the time required for the regulatory process and files a rate case with the goal of obtaining rates that reflect as closely as possible the cost of providing service at the time the rates become effective. Even if rates are sufficient, we face the risk that we will not achieve the rates of return on our invested capital and a return of our invested capital that are permitted by the state PUC.

Our regulated subsidiaries also pursue methods to minimize the adverse impact of regulatory lag and have worked with state PUCs and legislatures to implement a number of approaches to achieve this result. For example, an increasing number of states are permitting rates to be adjusted outside of a general rate case for certain costs, such as a return on capital investments to replace aging infrastructure or increases in expenses beyond the utility s control, such as purchased water costs. For example, Pennsylvania, Illinois, Missouri, Indiana, New York and Ohio have in the past allowed tariffs that permit the imposition of surcharges on customers bills for infrastructure replacement. New Jersey, California, Virginia and Illinois have allowed surcharges for purchased water costs and California has allowed surcharges for power.

Some states have permitted use of some form of forecast or forward looking test year instead of historical data to set rates. Examples of these states include Illinois, Kentucky, Ohio, Pennsylvania, New York and California. In addition, a number of states in which we operate have allowed the utility to update historical data for certain changes that occur for some limited period of time subsequent to the historical test year. This allows the utility to take account of some more current costs or capital investments in the rate-setting process. Examples of these states include New Mexico, Texas, Missouri, Iowa, Virginia, Maryland, Tennessee, West Virginia, New Jersey and Arizona.

Also, some of the states in which we operate permit pass-through provisions that allow for an increase in certain operating costs, such as purchased power and property taxes to be passed on to and recovered from customers outside of a general rate case proceeding.

Another regulatory mechanism to address issues of regulatory lag includes the ability, in certain circumstances, to recover in rates a return on utility plant before it is actually in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Texas, Pennsylvania, Ohio, Kentucky and California.

The ability of the Company to seek regulatory treatment as described above does not guarantee that the state PUCs will accept the Company s proposal in the context of a particular rate case. However, the Company strives to use these and other regulatory policies to address issues of regulatory lag wherever appropriate and to expand their use in areas where they may not currently apply.

Environmental, Health and Safety and Water Quality Regulation

Our water and wastewater operations are subject to extensive United States federal, state and local, and in the case of our Canadian operations, Canadian laws and regulations governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights and the manner in which we collect, treat and discharge wastewater. We are also subject to certain regulations regarding fire protection services in the areas we serve. These regulations include the Safe Drinking Water Act, the Clean Water Act and other federal, state, local and Canadian laws and regulations governing the provision of water and

Table of Contents

wastewater services, particularly with respect to the quality of water we distribute. We also are subject to various federal, state, local and Canadian laws and regulations governing the storage of hazardous materials, the management and disposal of hazardous and solid wastes, discharges to air and water, the cleanup of contaminated sites, dam safety and other matters relating to the protection of the environment, health and safety. State PUCs also set conditions and standards for the water and wastewater services we deliver.

We maintain a comprehensive environmental policy including responsible business practices, compliance with environmental laws and regulations, effective use of natural resources, and stewardship of biodiversity. We believe that our operations are in material compliance with, and in many cases surpass, minimum standards required by applicable environmental laws and regulations. Water samples across our water system are analyzed on a regular basis in material compliance with regulatory requirements. Across the Company, we conduct nearly one million water quality tests each year at our laboratory facilities in addition to continuous on-line instrumentations such as monitoring turbidity levels, disinfectant residuals and adjustments to chemical treatment based on changes in incoming water. For 2007, we achieved greater than a 99.9 percent compliance rate for meeting state and federal drinking water standards and 99.4 percent for compliance with wastewater requirements.

American Water participates in the Partnership for Safe Water, the United States EPA s voluntary program to meet more stringent goals for reducing microbes. Currently, 65 of our facilities have received the program s Director award and 57 have maintained it for more than five years.

For 2008, American Water s aggregate capital expenditures for environmental, health and safety and water quality regulatory compliance are expected to be approximately $150.0 million.

Safe Drinking Water Act

The federal Safe Drinking Water Act and regulations promulgated thereunder establish national quality standards for drinking water. The EPA has issued rules governing the levels of numerous naturally occurring and man-made chemical and microbial contaminants and radionuclides allowable in drinking water and continues to propose new rules. These rules also prescribe testing requirements for detecting contaminants, the treatment systems which may be used for removing contaminants and other requirements. Federal and state water quality requirements have become increasingly more stringent, including increased water testing requirements, to reflect public health concerns.

For example, in 2001, the EPA decreased permissible arsenic levels in drinking water and required compliance by water systems by January 2006. In 2003, a new EPA rule governing non-radon radionuclides became effective, regulating uranium in drinking water for the first time and requiring initial monitoring under state programs by the end of 2007. We believe that we are in material compliance with both these rules.

In order to remove or inactivate microbial organisms, the EPA has promulgated various rules to improve the disinfection and filtration of drinking water and to reduce consumers exposure to disinfectants and byproducts of the disinfection process. In January 2006, the EPA promulgated the Long Term 2 Enhanced Surface Water Treatment Rule and the Stage 2 Disinfectants and Disinfection Byproduct Rule. In October 2006, the EPA finalized the Ground Water Rule, applicable to water systems providing water from underground sources. In 2006, the EPA also proposed revisions to the monitoring and reporting requirements of the existing Lead and Copper Rule.

Although it is difficult to project the ultimate costs of complying with the above or other pending or future requirements, we do not expect current requirements under the Safe Drinking Water Act to have a material impact on our operations or financial condition. In addition, capital expenditures and operating costs to comply with environmental mandates traditionally have been recognized by state public utility commissions as appropriate for inclusion in establishing rates. As a result, we expect to fully recover the operating and capital costs resulting from these pending or future requirements.

Table of Contents

Clean Water Act

The federal Clean Water Act regulates discharges from drinking water and wastewater treatment facilities into lakes, rivers, streams and groundwater. In addition to requirements applicable to our sewer collection systems, our operations require discharge permits under the National Pollutant Discharge Elimination System, or NPDES, permit program established under the Clean Water Act. Pursuant to the NPDES program, the EPA or implementing states set maximum discharge limits for wastewater effluents and overflows from wastewater collection systems. We believe that we maintain the necessary permits and approvals for the discharges from our water and wastewater facilities. From time to time, discharge violations occur at our facilities, some of which result in fines. We do not expect any such violations or fines to have a material impact on our results of operations or financial condition.

Other Environmental, Health and Safety and Water Quality Matters

Our operations also involve the use, storage and disposal of hazardous substances and wastes. For example, our water and wastewater treatment facilities store and use chlorine and other chemicals and generate wastes that require proper handling and disposal under applicable environmental requirements. We also could incur remedial costs in connection with any contamination relating to our operations or facilities or our off-site disposal of wastes. Although we are not aware of any material cleanup or decontamination obligations, the discovery of contamination or the imposition of such obligations in the future could result in additional costs. Our facilities and operations also are subject to requirements under the United States Occupational Safety and Health Act and are subject to inspections thereunder. For further information, see Our Business Research and Development.

Certain of our subsidiaries are involved in pending legal proceedings relating to environmental matters. These proceedings are described further in the section entitled Our Business Legal Proceedings .

Acquisitions

In the course of pursuing our growth strategy, we periodically acquire water and wastewater utilities by making acquisitions in our existing markets and certain markets in the United States where we do not currently operate our Regulated Businesses. These acquisitions may include large corporate acquisitions of companies that have operations in multiple markets. We have executed a number of large acquisitions in the past 10 years. In 1996, our regulated subsidiary, Pennsylvania American Water Company, acquired the regulated water utility operations of Pennsylvania Gas and Water Company, a subsidiary of Pennsylvania Enterprises Inc., for approximately $409.4 million. In 1999, we acquired the privately held National Enterprises Inc., in a transaction valued at $700.0 million. In 2002, we acquired the water and wastewater facilities in six states from Citizens Communications Company for an aggregate purchase price of $979.8 million. We also acquire water and wastewater utilities through tuck-ins. The proximity of tuck-in opportunities to our regulated footprint allows us to integrate and manage the acquired systems and operations using our existing management and to achieve efficiencies. Historically, pursuing tuck-ins has been a fundamental part of our growth strategy, and we intend to resume our active pursuit of tuck-ins.

Table of Contents

The chart below sets forth our historical tuck-ins for 1996 through 2007:

Competition and Condemnation

In our Regulated Businesses, we generally do not face direct or indirect competition in providing services in our existing markets because (i) we operate within those markets pursuant to certificates of public convenience and necessity (or similar authorizations) issued by state PUCs and (ii) the high cost of constructing a new water and wastewater system in an existing market creates a barrier to market entry. Our Regulated Businesses do face competition from governmental agencies, other investor-owned utilities and strategic buyers in connection with entering new markets and making strategic acquisitions. Consolidation is changing the competitive landscape as small local utilities struggle to meet their capital spending requirements and look to partner with investor-owned utilities. We also face competition in offering services to new real estate developers, where we compete with others on the basis of the financial terms we offer for our services, the availability of water and our ability to commence providing services on a timely basis. Our largest investor-owned competitors are Aqua America Inc., United Water (owned by Suez), American States Water Co. and California Water Services Group.

The certificates of public convenience and necessity (or similar authorizations) pursuant to which we operate our Regulated Businesses do not prevent municipalities from competing with us to provide water and wastewater utility services. Further, the potential exists that portions of our subsidiaries utility assets could be acquired by municipalities or other local government entities through one or more of the following methods:

- eminent domain (also known as condemnation);
- the right of purchase given or reserved by a municipality or political subdivision when the original certificate was granted; and
- the right of purchase given or reserved under the law of the state in which the utility subsidiary was incorporated or from which it received its certificate.

The sale price for such a transaction initiated by a local government may be determined consistent with applicable eminent domain law, or the price may be negotiated or fixed by appraisers as prescribed by the law of the state or in the particular franchise or charter. We believe our operating subsidiaries would be entitled to fair market value for any assets required to be sold, and we are of the opinion that fair market value would be in excess of the book value for such assets.

We are periodically subject to condemnation proceedings in the ordinary course of business. The last sale under threat of condemnation occurred in 2003 in California. A referendum on condemnation was held on November 7, 2006 in respect of assets of our Kentucky American Water Company subsidiary in Lexington,

Table of Contents

Kentucky. A majority of voters voted against the condemnation proposal, and therefore we anticipate that no further action with respect to this condemnation proceeding will be taken. On March 1, 2007, California American Water Company was served with a First Amended Complaint in Eminent Domain seeking to condemn the water and wastewater system we currently operate in Felton, California. The Felton system serves approximately 1,300 customers. We are contesting the complaint. We actively monitor condemnation activities that may affect us as soon as we become aware of them. We do not believe that condemnation poses a material threat to our ability to operate our Regulated Businesses.

Our Non-Regulated Businesses

In addition to our Regulated Businesses, we operate the following Non-Regulated Businesses which generated $242.7 million of operating revenue in 2007, representing 11.0% of total operating revenue for the same period. No single group within our Non-Regulated Businesses generates in excess of 10% of our aggregate revenue.

Contracts Operations Group

Our Contracts Operations Group enters into public/private partnerships, including O&M and DBO contracts for the provision of services to water and wastewater facilities for municipalities, the United States military and other customers. We typically make no capital investment under these contracts, instead performing our services for a fee. Our Contract Operations Group generated revenue of $139.0 million in 2007, representing 57.3% of revenue for our Non-Regulated Businesses.

We are currently party to more than 45 contracts across the United States and Canada, with contracts ranging in term from two to 20 years. The services provided under our O&M contracts vary in size and scope. For instance, 25 of our O&M contracts are purely operational in nature and do not involve the design or construction of the facilities. Annual operating revenue from the O&M contracts varies from $0.26 million to $9.0 million per contract.

We are an active participant in the Department of Defense s recently adopted Utility Privatization Program, or UPP. In 2003 we were awarded 50-year contracts for the operation and maintenance of the water and wastewater systems at Forts Leavenworth, Sill and Rucker and in September 2007 we were awarded 50-year contracts for the operation and maintenance of the water and wastewater systems at Fort A.P. Hill and Scott Air Force Base worth approximately $160.0 million in total. Our responsibilities under these contracts include system project management, regulatory and environmental compliance, planning and long-term operations and maintenance. Additionally, under a three-year contract awarded in 2006, we were selected by Harnett County and the City of Fayetteville, North Carolina to operate, maintain and manage the existing water and wastewater treatment plants at Fort Bragg for an interim period until construction of new connections to the Harnett County and City of Fayetteville systems is completed.

In general, the Contract Operations Group is engaged in providing these services to systems with over 3,000 customers (and in many cases far larger) as distinguished from the O&M services provided by our Applied Water Management Group usually to systems with less than 3,000 customers. However, there is some overlap in size of systems served due to geographic and operational considerations.

Applied Water Management Group

Our Applied Water Management Group works with customers to design, build and operate smaller-scale water and wastewater treatment plants (typically serving up to 3,000 customers). Our typical customers are real estate developers, industrial companies and new or expanding communities. We specialize in providing reliable, advanced and eco-friendly water and wastewater solutions to suit each customer s water needs. Our Applied Water Management Group generated revenue of $33.3 million in 2007, representing 13.7% of revenue for our Non-Regulated Businesses.

Table of Contents

The Applied Water Management Group currently serves our customer base primarily in the Northeastern United States and was responsible for the design, construction and operation of advanced wastewater treatment recycling systems for sites as varied as residential buildings in Battery Park City in New York City and Gillette Stadium in Foxborough, Massachusetts. Approximately 30% of the Applied Water Management Group s business involves operating and maintaining smaller-scale water and wastewater plants, made up of a mixture of facilities that we designed and built, and some which we only operate.

Homeowner Services Group

Our Homeowner Services Group provides services to domestic homeowners to protect against the cost of repairing broken or leaking pipes inside and outside their homes. We initially offered these services within territories covered by our regulated subsidiaries, but have expanded to enable other utilities outside our territories to offer the services to their customers. In the marketing of these services, we focus on educating homeowners about their service line ownership responsibility and providing convenient and cost effective solutions to internal and external water line and sewer line repairs. Our Homeowner Services Group generated revenue of $40.4 million in 2007, representing 16.6% of revenue for our Non-Regulated Businesses.

Our Service Line Protection Programs offer customers various service contracts for a monthly fee that cover repair of water line leaks and breaks, sewer line clogs and blockages and emergency in-home plumbing problems. In the event of a problem, customers contact our national call center and we dispatch local contractors to the customer s home to undertake the necessary repairs.

The Homeowners Services Group currently has over 600,000 customer contracts in 14 of the states where we operate our Regulated Businesses. We intend to expand our service offering to the remaining key states in which we operate our Regulated Businesses.

Building on the success of its Service Line Protection Programs, our Homeowner Services Group recently introduced LineSaver , an exclusive program for municipalities and public water systems that is available across the country. The LineSaver program involves partnering with municipalities to offer our protection programs to homeowners serviced by the municipal system while providing an income opportunity to the municipality or public water system. We entered into our first Service Line Protection Program partnership with the city of Trenton, New Jersey and are currently discussing partnerships with municipalities across the nation.

Other Non-Regulated Businesses

Our Non-Regulated Businesses also include (i) our Carbon Services Group, which provides granular activated carbon for water purification to our Regulated Businesses as well as certain outside customers and (ii) our Residuals Group, Terratec, which provides safe and efficient treatment and disposal of biosolids and wastewater residuals. Our United States-based Residuals Group was divested effective June 29, 2007. These other Non-Regulated Businesses generated revenue of $30.0 million in 2007 in the aggregate, representing 12.3% of revenue for our Non-Regulated Businesses.

Competition

We face competition in our Non-Regulated Businesses from a number of service providers including Veolia, OMI and Southwest Water, particularly in the area of O&M contracting. Securing new O&M contracts is highly competitive, as these contracts are awarded based on a combination of customer relationships, service levels, competitive pricing, references and technical expertise. We also face competition in maintaining existing O&M contracts to which we are a party, as these frequently come up for renegotiation and are subject to an open bidding process.

Table of Contents

Research and Development

We established a formal research and development program in 1981 with the goal of improving water quality and operational effectiveness in all areas of our businesses. Our research and development personnel are located at two of our facilities: the regional center in Voorhees, New Jersey and our research laboratory in Delran, New Jersey. In addition, our quality control and testing laboratory in Belleville, Illinois supports research through sophisticated testing and analysis. Since its inception, our research and development program has evolved to become a leading water-related research program, achieving advancements in the science of drinking water, including sophisticated water testing procedures and desalination technologies.

Since the formation of the EPA in 1970, we have collaborated with the agency to achieve effective environmental, health and safety and water quality regulation. This relationship has developed to include sharing of our research and national water quality monitoring data in addition to our treatment and distribution system optimization research. Our engagement with the EPA has helped us to achieve a leadership position for our company within the water and wastewater industry and has provided us with early insight into emerging regulatory issues and initiatives, thereby allowing us to anticipate and to accommodate our future compliance requirements.

In 2007, we spent $2.0 million on research and development, which represents an increase of 5.3% over the $1.9 million spent in 2006. Approximately one-third of our research budget is comprised of competitively awarded outside research grants. Such grants reduce the cost of doing research and allow collaboration with leading national and international researchers.

We believe that continued research and development activities are critical to maintaining our leadership position in the industry and will provide us with a competitive advantage as we seek additional business with new and existing customers.

Support Services

Our American Water Works Service Company subsidiary provides centrally administered professional services to our Regulated Businesses under the terms of contracts with these companies that have been approved by state PUCs, where necessary. These services, which are provided at cost, may include accounting, administration, business development, communications, corporate secretarial, engineering, financial, health and safety, human resources, information systems, legal, operations, procurement, rates, security, risk management, water quality and research and development. Similar services may be provided to our Non-Regulated Businesses. These arrangements afford our affiliated companies professional and technical talent on an economical and timely basis.

We operate two national customer service centers, with personnel located in Alton, Illinois and Pensacola, Florida. These centers employ nearly 700 people in total and process telephone calls from customers across all of our service areas.

Community Relations

Communication activities for our Regulated Businesses are designed to ensure that our customers, regulators, elected and appointed officials, as well as, community leaders are fully informed about water and wastewater-related issues affecting their communities. We focus on developing effective relationships and have in place experienced staff members in the areas of community relations, government relations, media relations and marketing. We believe that an informed customer is more likely to be a satisfied customer.

Our primary focus for our Regulated Businesses is on consumer education. We target our communications to ensure that all of our audiences are well informed and up-to-date on water and wastewater-related issues through community outreach meetings, bill inserts to our customers, newspaper articles on timely topics, paid

Table of Contents

advertisements on important issues, annual water quality reports or one-on-one meetings to update key community and government leaders. We continually provide information on topics such as the need for infrastructure investments that we are making within a community, the impact on rates and services, water supply needs, water conservation requirements, as well as information on water quality. We believe that educating our customers about these topics leads to greater understanding of the service issues that we face and results in a higher level of customer satisfaction. For instance, we believe that our customers are less likely to react negatively to a rate increase if they have been informed that the rate increase is necessitated by an infrastructure investment necessary to continue to provide high quality water service. We also believe that customers would be less likely to have a negative reaction to water use restrictions if they understand the reasons behind the restrictions and that all customers were being impacted by the same inconveniences.

Communications activities for our Non-Regulated Businesses focus on identifying prospective market opportunities for growth and expansion and educating target markets on the value we can bring to solving specific water supply, water quality or other water and wastewater-related issues. Our experienced business development team reinforces the expertise, experience and capabilities we can provide to communities or developers through industry trade shows, public speaking opportunities, industry conferences and paid advertising, public-private partnerships or contract relationships which may include DBO projects for customers or providing experienced O&M services for various sized water and wastewater-related projects.

Employee Matters

Currently we employ approximately 7,000 full-time employees. Of these, approximately 3,600 or approximately 51% are represented by unions. We have 75 collective bargaining agreements in place with the 18 different unions representing our unionized employees. Approximately one-third of our local union contracts expire annually. We maintain good relations with our unionized workforce and have no significant history of strikes or labor stoppages.

Training

We place emphasis on the selection of well qualified employees and seek to provide the best and most up-to-date training to ensure that our water and wastewater operations function efficiently and safely. We provide extensive internal training programs designed to meet the standards demanded by the regulatory authorities in the states where we operate our regulated business.

Security

Due to terrorist and other risks, we have heightened security at our facilities over the past several years and have taken added precautions to protect our employees and the water delivered to customers. We have a security programs department that provides oversight and governance of physical and information security throughout our operations and is responsible for designing, implementing, monitoring and supporting active and effective physical and information security controls.

In 2002, federal legislation was enacted that resulted in new regulations concerning security of water facilities, including submitting vulnerability assessment studies to the federal government. We have complied with EPA regulations concerning vulnerability assessments and have made filings to the EPA as required. Vulnerability assessments are conducted regularly to evaluate the effectiveness of existing security controls and serve as the basis for further capital investment in security for the facility. Information security controls are deployed or integrated to prevent unauthorized access to company information systems, assure the continuity of business processes dependent upon automation, ensure the integrity of our data and to support regulatory and legislative compliance requirements. In addition, communication plans have been developed as a component of our procedures. While we do not make public comments on the details of our security programs, we have been in contact with federal, state, and local law enforcement agencies to coordinate and improve the security of our water delivery systems and to safeguard our water supply.

Table of Contents

Legal Proceedings

In 2001, our California American Water Company subsidiary, which we refer to as CAWC, entered into a conservation agreement with the National Oceanic and Atmospheric Administration, which we refer to as NOAA, requiring CAWC to implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed, study the removal of the San Clemente Dam and explore long-term water sources other than a new reservoir in the Carmel River. Since that time, CAWC has implemented a number of measures to reduce the impact of its operations on the steelhead trout and other species and has begun the environmental review and permitting process for our Coastal Water Project, which is intended to remedy some of the foregoing deficiencies. In early 2004, NOAA informed CAWC of its concern that CAWC s ongoing operations would cause the take of significant numbers of steelhead trout during the several remaining years required to implement the Coastal Water Project. In June 2006, CAWC and NOAA entered a settlement agreement whereby CAWC agreed to fund certain additional projects to improve habitat conditions for and aid in the recovery of steelhead trout in the Carmel River watershed. Under the settlement agreement, CAWC is required, among other things, to make an initial payment of $3.5 million and annual installments of $1.1 million for the lesser of six years or until such time as CAWC is in compliance with the State Water Resource Board s Order to obtain permits or contract for water rights for the Carmel River or to obtain water from another source of supply. The settlement agreement requires that all payments made by CAWC to NOAA to be used for mitigation projects in the Carmel River watershed. NOAA is currently unable to ensure that settlement payments will be used for mitigation projects in the Carmel River watershed, and no payments have been made to date. Once NOAA is able to confirm that settlement payments will be applied as required by the settlement agreement, CAWC will make the settlement payments. We have established a reserve for the settlement agreement payments. NOAA has agreed not to assess any penalties or otherwise prosecute CAWC for any take of steelhead trout, so long as CAWC complies with the settlement agreement. On March 14, 2008, the Sierra Club and the Carmel River Steelhead Association notified CAWC of their intent to file a citizen suit, 60 days therefrom, for violations of the federal Endangered Species Act alleging the take of steelhead trout by CAWC along the Carmel River and seeking injunctive relief to reduce river water diversions and increase river flow and fish passage facilities. Although CAWC believes it has continued to comply with the settlement agreement and would defend any such allegations, we cannot assure you that such a claim would not result in additional costs or obligations to us.

New Jersey

In February 2004, the New Jersey Department of Environmental Protection, which we refer to as NJDEP, issued to New Jersey-American Water, which we refer to as NJAW, a notice of violation alleging that NJAW had exceeded annual diversion limits contained in NJAW s water allocation permits for certain wells in our Lakewood system during the years 2001 through 2003. NJDEP initially assessed a penalty of $0.6 million. NJAW subsequently submitted a voluntary statewide Self Disclosure Report identifying all such exceedances for the period of 1999 through 2003. In December 2007, NJAW finalized an administrative consent order with NJDEP to resolve the above violations under which NJAW has paid a civil fine of $0.1 million and has undertaken a $0.4 million environmental project. We have established a reserve for the project costs and believe NJAW is currently operating in compliance with the applicable diversion limits in its water allocation permits.

CAWC, NJAW and Long Island Water Company are each plaintiffs in lawsuits relating to contamination by methyl tertiary butyl ether (MTBE) and other gasoline additives, which seek to recover cleanup and treatment costs and to protect certain of their groundwater supplies. The defendants in both cases are oil and chemical companies that manufacture MTBE, refine gasoline containing MTBE, and/or supply gasoline containing MTBE to retail gasoline stations. The cases were consolidated with cases involving other plaintiffs in multidistrict litigation pending in the United States District Court for the Southern District of New York (In Re: Methyl Tertiary Butyl Ether Products Liability Litigation, Case No. MDL 1358 SAS) and stayed pending certain test cases and court ordered mediation. As a result, of the mediation, CAWC, NJAW, Long Island Water Company and the other plaintiffs have been in settlement discussions with some of the named defendants, who represent a significant portion of the total national refining capacity for MTBE. CAWC, NJAW and Long Island Water

Table of Contents

Company expect to continue to litigate their claims against any non-settling defendants. Thus, at this time, there can be no guarantee that CAWC, NJAW or Long Island Water Company will be able to recover their respective costs relating to any past or future discovery of MTBE in their wells from any of the defendants to the pending cases or otherwise.

Periodically, we are involved in other proceedings or litigation arising in the ordinary course of business. We do not believe that the ultimate resolution of these matters will materially affect our financial position or results of operations.

Table of Contents

MANAGEMENT

Directors and Executive Officers

The following table sets forth information with respect to the members of our board of directors and our executive officers as of the date of this prospectus.

Name[1]	Age	Position
Donald L. Correll	57	President, Chief Executive Officer and Director
John S. Young	54	Chief Operating Officer
Ellen C. Wolf	54	Senior Vice President and Chief Financial Officer
Laura L. Monica	51	Senior Vice President, Corporate Communications and External Affairs
George W. Patrick	65	Senior Vice President, General Counsel and Secretary
Sean G. Burke	52	Senior Vice President, Human Resources
James M. Kalinovich	40	Vice President and Treasurer
Mark Chesla	48	Vice President and Controller
Terry L. Gloriod	61	President, Central Region
Walter J. Lynch	45	Executive Vice President, Eastern Division
Mark F. Strauss	56	President, American Water Enterprises
Paul G. Townsley	51	President, Western Region
George MacKenzie	59	Director and Chairman of the Board
Martha Clark Goss	58	Director
Dr. Manfred Döss	50	Director
William J. Marrazzo	58	Director
Dr. Rolf Pohlig	55	Director
Andreas G. Zetzsche	52	Director

Donald L. Correll is our President and Chief Executive Officer and a member of our board of directors. Prior to joining American Water on April 17, 2006, Mr. Correll spent three years serving as President and Chief Executive Officer and member of the board of directors of Pennichuck Corporation, a New Hampshire-based water utility holding company. He previously spent 25 years with United Water Resources, an investor-owned water services company, where he served as Chairman, President and Chief Executive Officer from 1991 through 2001. Mr. Correll serves on the boards of a variety of civic, professional and business organizations, including the Environmental Financial Advisory Board of the United States Environmental Protection Agency and the National Association of Water Companies. In addition, he is a member of the board of directors of HealthSouth Corp. and is a Commissioner of the New Jersey Water Supply Authority. He was formerly a member of the board of directors of Interchange Financial Services Corporation.

John S. Young is our Chief Operating Officer. Mr. Young began his career with us in 1977 and has held a variety of operations, engineering and executive positions, including Vice President of Engineering, Vice President of Technical Services and Vice President of Operations and Investment Performance. Mr. Young is a member of several professional organizations, including the Design/Build Institute of America (board member), the American Water Works Association (board member, section chair and Fuller Awardee) and the American Society of Civil Engineers. He also serves on the National Drinking Water Advisory Council.

Table of Contents

Ellen C. Wolf is our Senior Vice President and Chief Financial Officer. Ms. Wolf served as a member of our board of directors from March 2006 until August 8, 2007. Prior to re-joining us, Ms. Wolf served as Senior Vice President and Chief Financial Officer of USEC Inc., a global energy company, a position she held since December 2003. From 1999 through 2003, Ms. Wolf was employed by us as Vice President and Chief Financial Officer. Ms. Wolf s career began in the accounting firm of Deloitte Haskins & Sells. From 1987 through 1999 Ms. Wolf held various positions in corporate accounting, finance and business development for Bell Atlantic and several of its subsidiaries, including Bell Atlantic Enterprises International, Bell Atlantic Mobile, and Bell Atlantic Corporation. Currently, Ms. Wolf also serves on the board of directors of C&D Technologies, Inc., where she serves as chair of its audit committee, the board of directors of the National Association of Water Companies and the board of directors of Water for People, a humanitarian organization.

Laura L. Monica has been our Senior Vice President, Corporate Communications and External Affairs since October 2006. From 1991 to 2006, Ms. Monica was president and founder of High Point Communications Group, Inc., which we refer to as High Point, a strategic communications firm in Bow, New Hampshire. There she worked with a wide variety of clients in both the public and private sector, assisting them in developing and implementing comprehensive, strategic communications plans. Before forming High Point, Ms. Monica was head of corporate communications for Numerica Financial Corporation.

George W. Patrick is our Senior Vice President, General Counsel and Secretary. Mr. Patrick served as Vice President, General Counsel and Secretary from May 2004 to September 2007. Prior to this, he served as Vice President and Secretary of American Water Works Service Company, a position he held from September 1999 to May 2004. Prior to joining us, Mr. Patrick served as a Partner at Dechert LLP from July 1976 to September 1999.

Sean G. Burke is our Senior Vice President Human Resources. Prior to joining American Water on December 17, 2007, Mr. Burke was the principal of Executive Alignment, LLC, in Falmouth, Maine, since 2005. Previously, Mr. Burke held executive positions at American Ref-Fuel Company, in Houston, Texas and Montvale, New Jersey from 1988 to 2005, with comprehensive oversight of the Human Resources function. Before that, he held leadership positions with other companies including Air Products and Chemicals Inc., Frito-Lay and National Steel Corp.

James M. Kalinovich is our Vice President and Treasurer. Prior to joining us in 2004, Mr. Kalinovich served as Vice President and Treasurer of Amkor Technology, Inc. from 2000 to 2004. Previously, he held executive positions at Merck & Company, Inc. in the United States and London from 1994 to 2000, and worked at Deloitte and Touche as a certified public accountant.

Mark Chesla is our Vice President and Controller. Prior to joining American Water on November 19, 2007, Mr. Chesla was Vice President and Controller of Oglethorpe Power Corporation, in Atlanta, Georgia, where he was the Chief Accounting Officer providing direct leadership over all aspects of the accounting, internal financial management, regulatory and SEC reporting (including Sarbanes-Oxley Act compliance) functions, from 2001 to 2007. Previously, Mr. Chesla was Vice President, Administration/Controller of SouthStar Energy Services LLC, in Atlanta, Georgia, from 1998 to 2001. Before that, he held management positions with several other companies, including Piedmont Natural Gas Co., Inc., Aegis Technologies, Inc., Deloitte & Touche LLP and Carolina Power & Light Company.

Terry L. Gloriod is President of our Central Region, headquartered in St. Louis County, Missouri. Mr. Gloriod originally joined us in 1999 as president of Illinois American Water, our wholly owned subsidiary. Prior to joining us, Mr. Gloriod had been with Continental Water Company, the water subsidiary of National Enterprises, Inc., for nearly 30 years, spending most of that time with its largest subsidiary, St. Louis County Water Company. He served as Continental s Vice President of Operations where he supervised engineering and operations of the Continental subsidiary companies. He also served as Chairman of each of Continental s four former subsidiaries: St. Louis County Water Company, Northern Illinois Water Company, Northwest Indiana Water Company and Long Island Water Company in New York. Mr. Gloriod is a Diplomat in the American

Table of Contents

Academy of Environmental Engineers. He has also participated in a variety of professional organizations, including the American Water Works Association, the AWWA Research Foundation and the National Association of Water Companies.

Walter J. Lynch was named Executive Vice President, Eastern Division, in July 2007. Prior to that date, he served as president of New Jersey-American Water, Long Island American Water and our Northeast Region. Mr. Lynch joined us in 2001 and most recently served as President of our Products and Services Group where he was responsible for overseeing our non-regulated businesses. Prior to this, he was President of the Southwest Region of American Water Services. Mr. Lynch has over 16 years of experience in engineering, sales and marketing, operations and business development. Before joining us, he was involved with various start-up and growth organizations in the environmental industry. Mr. Lynch worked for Mobil Oil Corporation following his departure from the United States Army where he attained the rank of Captain.

Mark F. Strauss is President of American Water Enterprises, which administers our Non-Regulated Businesses. Previously, Mr. Strauss was President and Chief Executive Officer of our Applied Water Management Group, which provides customized water and wastewater management solutions to real estate developers, industrial clients and small to midsized communities nationwide. Mr. Strauss joined Applied Water Management Group in 1997 as Corporate Counsel and Secretary. He was promoted to Chief Operating Officer in 2002, a position he held until his appointment as Division President and Chief Executive Officer in 2003. Prior to that, he served as Vice President and General Counsel of Vizzoni Brothers Construction, Inc. Mr. Strauss concurrently serves as a director of Skylands Community Bank. Mr. Strauss was also at the law firms of Ozzard, Rizzolo, Klein, Mauro & Savo and Toolan, Romond, Abbot and Domenichetti.

Paul G. Townsley is President of our Western Region, headquartered in Phoenix, Arizona. Mr. Townsley originally joined us in 2002 as President of our California, Arizona, New Mexico, Hawaii and Texas subsidiaries. He has also been responsible for our Non-Regulated Businesses located in six western states. Prior to joining American Water, Mr. Townsley held a number of senior management positions with Citizens Utilities Company, where he had responsibility for that company s electricity, natural gas, telecom, and water/wastewater utilities in Arizona, and later for all its water/wastewater utilities nationwide. In total, Mr. Townsley has over 27 years of utility industry experience. Mr. Townsley is a licensed professional engineer and marine engineer.

Board of Directors

In addition to Donald L. Correll, our board of directors consists of the following members:

George MacKenzie began his appointment as Chairman of our board of directors on May 17, 2006. He most recently served as our Interim President and Chief Executive Officer from January 1, 2006 to April 17, 2006 until the appointment of Donald L. Correll, which took effect April 17, 2006. He has been a member of our board of directors since August 2003 and was the Chair of the Audit Committee of the Board from February 2004 until December 2005. In addition to his role with American Water, Mr. MacKenzie has been a Director on the Boards of Safeguard Scientifics, Inc. since February 2003, Tractor Supply Co. since May 2007, and C&D Technologies, Inc. since March 1999. He previously served on the boards of Central Vermont Public Service Corp. from May 2001 to May 2006 and traffic.com from December 2005 to March 2007. He also serves on the Board of Trustees of the Medical Center of Delaware and is a member of the Investment Committee at the University of Delaware. Mr. MacKenzie previously served as Vice Chairman of the Board and Chief Financial Officer of Hercules Incorporated from 1979-2001, a global manufacturer of chemical specialties. During his 22-year career with Hercules he served in a variety of senior management roles including President of the Chemical Specialty Division. From September 2001 to June 2002, Mr. MacKenzie was Executive Vice President and Chief Financial Officer of P.H. Glatfelter Company, a specialty paper manufacturer. From June 2002, Mr. MacKenzie served on the boards of directors of the aforementioned companies and in the interim positions noted.

Martha Clark Goss began her tenure as a member of our board of directors on October 22, 2003, and she has served as Chair of the Audit Committee since December 2005. Ms. Goss has been Chief Operating Officer

Table of Contents

and Chief Financial Officer of Amwell Holdings/Hopewell Holdings LLC, a holding company for a healthcare reinsurance start-up, since 2003. Since July 2006, she has also served as the non-executive Chair of Channel Reinsurance Ltd. From 2002 to 2004, she was a subcontractor for Resources Global Professionals. Previously, Ms. Goss served as the Chief Financial Officer of Booz-Allen & Hamilton and held various senior executive positions at Prudential Insurance Company from 1981 until 1995. In addition to her position with American Water, Ms. Goss currently is a director and audit committee member of Ocwen Financial Corporation.

Dr. Manfred Döss began his tenure on our board of directors on August 8, 2007. He has served as General Counsel and Chief Compliance Officer of RWE since January 2005. From 1990 to 2004, Dr. Döss held various positions at Metallgesellschaft AG, including serving as a member of the supervisory board and as Senior Vice President and General Counsel.

William J. Marrazzo began his tenure as a member of our board of directors on October 22, 2003. In addition, Mr. Marrazzo has been the Chief Executive Officer and President of WHYY, Inc., a public television and radio company, since 1997. He served as Water Commissioner for the Philadelphia Water Department from 1971 to 1988 and Managing Director for the City of Philadelphia from 1983 to 1984. From 1988 to 1997 Mr. Marrazzo served as Chief Executive Officer of Roy F. Weston, Inc., an environmental and redevelopment firm. He has also served on the board of Amerigas Partners, L.P. (including on its audit committee) since April 2000 and Woodward & Curran since October 2001.

Dr. Rolf Pohlig began his tenure as a member of our board of directors on August 8, 2007. He has served as Chief Financial Officer of RWE since January 2007. From 2000 to 2006, Dr. Pohlig served as Executive Vice President, Mergers & Acquisitions of E.ON AG.

Andreas G. Zetzsche began his tenure as a member of our board of directors on August 17, 2007. He has served as an executive officer within the RWE group since 1997, and from January 2007 to April 7, 2007 he served as Vice President, Group Corporate Development and Mergers & Acquisitions of RWE, and since April 7, 2007 he has served as Vice President, Mergers & Acquisitions of RWE.

Composition of the Board of Directors

Our business and affairs are managed under the direction of our board of directors. Our board of directors currently consists of seven members, three of whom, Martha Clark Goss, George MacKenzie and William J. Marrazzo, have been determined by our board of directors to be independent under currently applicable listing standards of the NYSE and applicable SEC rules. Within one year of listing on the NYSE, our board of directors will consist of 10 members, six of whom will be independent under applicable SEC rules and currently applicable listing standards of the NYSE.

Committees of the Board of Directors

Our board of directors conducts its business through three standing committees: the audit committee, the compensation committee and the nominating/corporate governance committee. In addition, from time to time, special committees may be established under the direction of our board of directors, when necessary, to address specific issues. Our audit committee, our compensation committee and our nominating/corporate governance committee will be required to be composed of a majority of independent directors within 90 days following the completion of the initial public offering and entirely of independent directors within one year following the completion of the initial public offering.

Audit Committee

Our audit committee consists of Martha Clark Goss (Chair), George MacKenzie and Dr. Rolf Pohlig. Our board of directors has designated Martha Clark Goss and George MacKenzie as the members of the audit

Table of Contents

committee who currently meet the requirements for independence under the rules and regulations of the SEC and the NYSE. Our board of directors has designated Martha Clark Goss and George MacKenzie as audit committee financial experts, as defined in Item 407 of Regulation S-K. Our board of directors has adopted a written charter for the audit committee, which will be available on our website. The audit committee has responsibility for, among other things:

- appointing the independent auditor to audit the consolidated financial statements of the Company and its subsidiaries;
- reviewing the arrangements for and scope of the audit;
- reviewing the results of the audit of the consolidated financial statements;
- reviewing audit problems and management responses;
- reviewing adjustments or estimates proposed by the independent auditor;
- reviewing any significant deficiency or material weakness in the design or operation of internal accounting controls identified by the independent auditor;
- reviewing all critical accounting policies and practices;
- reviewing all alternative accounting treatments of financial information within generally accepted accounting principles that have been discussed with management;
- reviewing other material written communications between the independent auditor and members of management;
- resolving any disagreement between management and the independent auditor regarding financial reporting;
- reviewing the independent auditors report describing internal quality control procedures and material issues raised by the most recent quality control review;
- discussing with management and the independent auditor the Company s audited financial statements and quarterly financial statements;
- reviewing and discussing SEC filings with management and, to the extent that such filings contain financial information, with the independent auditor;

discussing earnings press releases, as well as financial information and earnings guidance, if any, provided to analysts and ratings agencies;

overseeing policies and procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting and other controls, auditing matters and suspected infractions of our Code of Ethics;

reviewing the reports of any internal auditor with respect to any financial safeguard problem that has not resulted in corrective action; and

reviewing with the General Counsel any legal matter that could have a significant impact on the Company s financial statements.

Compensation Committee

Our compensation committee consists of George MacKenzie (Chair), Martha Clark Goss, William J. Marrazzo and Dr. Rolf Pohlig. Our board of directors has designated George MacKenzie, Martha Clark Goss and William J. Marrazzo as the members of the compensation committee who currently meet the requirements for independence under the rules and regulations of the NYSE. Our board of directors has adopted a written charter

Table of Contents

for the compensation committee, which will be available on our website. The compensation committee has responsibility for, among other things:

- establishing and reviewing the overall compensation philosophy of the Company;
- setting compensation for the Company s Chief Executive Officer and the other executive officers of the Company;
- reviewing and making recommendations to our board of directors, or approving, all awards of stock or stock options pursuant to the Company s equity-based plans; and
- reviewing and evaluating the short and long-term succession plans relating to the Chief Executive Officer and other executive officer positions and making recommendations to our board of directors with respect to the selection of individuals to occupy these positions.

Nominating/Corporate Governance Committee

Our nominating/corporate governance committee consists of George MacKenzie (Chair), William J. Marrazzo and Dr. Manfred Döss. Our board of directors has designated George MacKenzie and William J. Marrazzo as the members of the nominating/corporate governance committee who currently meet the requirements for independence under the rules and regulations of the NYSE. Our board of directors has adopted a written charter for the nominating/ corporate governance committee, which will be available on our website. The nominating/corporate governance committee has responsibility for, among other things:

- establishing criteria for the selection of new directors to serve on our board of directors;
- identifying qualified candidates to serve on our board of directors and recommending their election to our board of directors;
- making recommendations to our board of directors as to whether members of our Board should stand for re-election; and
- developing and recommending to our board of directors our corporate governance guidelines, assessing those guidelines annually and making recommendations to our board of directors in light of such assessments as may be appropriate.

Compensation Committee Interlocks and Insider Participation

None of our executive officers will serve as a member of our compensation committee, and none of them has served, or will be permitted to serve, on the compensation committee (or any other committee serving a similar function) of any entity of which an executive officer is expected to serve as a member of our compensation committee.

Code of Business and Financial Conduct and Corporate Governance Guidelines

Our board of directors has adopted a Code of Ethics applicable to our directors, officers and employees and corporate governance guidelines, each in accordance with applicable rules and regulations of the SEC and the NYSE. The Code of Ethics and the corporate governance guidelines are available on our website.

Compensation Discussion and Analysis

This compensation discussion and analysis explains our compensation philosophy, policies and practices with respect to Donald L. Correll, who has served as our President and Chief Executive Officer since April 17, 2006; Ellen C. Wolf, who has served as our Senior Vice President and Chief Financial Officer since March 1, 2006; John S. Young, who has served as our Chief Operating Officer since October 1, 2005; Walter J. Lynch, who has served as our Executive Vice President of Business Operations, Eastern Division, since July 2, 2007;

Table of Contents

Paul G. Townsley, who has served as the President of our Western Region since 2002 and also serves as the President of our Arizona, New Mexico, Hawaii and Texas subsidiaries; Dietrich Firnhaber, who served as our Senior Vice President of Legal from January 1, 2003 through July 31, 2007; and Volker Heischkamp, who served as our Senior Vice President of Capital Markets from November 15, 2005 through April 23, 2008. These individuals are collectively referred to as the named executive officers. Mr. Firnhaber and Dr. Heischkamp are referred to as the Germany-based named executive officers and the other named executive officers are referred to as the U.S.-based named executive officers.

Overview of our Compensation Programs

From January 2003 until April 28, 2008, American Water was wholly-owned and controlled by RWE, and our compensation strategy for our named executive officers was primarily determined by the management of RWE based on its internal compensation practices and, until 2006, was managed by Thames Water. Our Chief Executive Officer approved the compensation of the other named executive officers prior to its final determination by RWE. Prior to our Chief Executive Officer s approval of the compensation, he reviewed it with our Chief Operating Officer and our Chief Financial Officer.

We have recently established an independent compensation committee that administers and oversees our compensation and employee benefits programs, including our executive compensation programs and policies. We have not yet determined what the role of our named executive officers will be in establishing executive compensation. However, pursuant to our compensation committee charter, as part of the compensation committee s review and establishment of the performance criteria and compensation of our named executive officers, it will meet separately on at least an annual basis with our Chief Executive Officer, our principal human resources executive and any other officers, as it deems appropriate. The compensation committee will also meet regularly without such officers present. No individual officer will be present at any meeting at which his or her performance and compensation are being discussed and determined.

Mr. Correll participates in the same programs and receives compensation based on the same factors as our other named executive officers. However, Mr. Correll s overall compensation reflects a greater degree of policy- and decision-making authority and a higher level of responsibility with respect to the strategic direction and financial and operating results of American Water.

Certain of our named executive officers are parties to employment agreements with us, which are described below under Narrative Disclosure to 2007 Summary Compensation Table and 2007 Grants of Plan-Based Awards Table Employment Agreements. We do not have any specific policy that controls whether we enter into employment agreements with our named executive officers.

Elements of Compensation

Our compensation program has traditionally included the following key elements, which we expect to remain the key elements of our compensation program: base salary, annual incentives, long-term equity incentives and other benefits. In 2006, we granted cash retention bonuses, which are described below, in lieu of long-term equity incentives for the U.S.-based named executive officers. We did not grant long-term equity incentives in 2007 to our U.S.-based named executive officers due to our contemplated initial public offering.

All elements of compensation have traditionally been paid to participants in cash, but our new omnibus equity compensation plan provides for awards that pay out in equity.

Table of Contents

Base Salary

We believe competitive base salaries are necessary to attract and retain an effective executive management team. At the meeting of the board of directors of American Water that occurred in the first quarter of 2007, our directors and the management of RWE revised the base salaries for the named executive officers as follows, in light of the competitive market environment and to recognize individual performance.

Name	New Base Salary	Percent Increase	Effective Date
Donald C. Correll	$ 566,500	3.0%	March 26, 2007
Ellen C. Wolf	$ 463,500	3.0%	March 26, 2007
John S. Young	$ 412,000	3.0%	March 26, 2007
Walter J. Lynch[1]	$ 350,000	16.67%	July 2, 2007
Paul G. Townsley	$ 278,000	2.96%	March 26, 2007
Dietrich Firnhaber[2]	$ 324,525	3.0%	March 26, 2007

(1) Base salary increase commensurate with expanded role and responsibilities that Mr. Lynch assumed when he became Executive Vice President, Business Operations, Eastern Division, which encompasses eight states. Previously he had responsibility only for the Northeast Region, which encompassed only two states.

(2) Base salary of 138,020 Euros and functional allowance of 106,193 Euros converted to United States dollars using the March 26, 2007 exchange rate of 1.32886.

The base salaries paid to the named executive officers in 2007 are set forth below in the 2007 Summary Compensation Table.

Annual Incentive Compensation

Annual incentive compensation is made available to all managerial, professional and supervisory employees, including the named executive officers. It is designed to provide incentives for achieving short-term financial and operational goals for the Company as a whole and for its subsidiaries and individual business units, including goals that enhance customer service, as well as individual goals. Annual incentive compensation is provided to the named executive officers, other than Dr. Heischkamp, through American Water s annual incentive plan. Dr. Heischkamp participates in RWE s short-term incentive plan.

For 2007, management, including the named executive officers and subsidiary and business unit leaders, worked with RWE to establish goals for American Water s annual incentive plan that were aligned with American Water s business plan for the applicable year. For 2008, the goals were established in the same manner. The compensation committee has assumed responsibility for setting the goals for the annual incentive plan.

The target payout opportunities chosen by RWE for the named executive officers under the 2007 annual incentive plan, which were the bonus amounts that would have been paid at 100% achievement of each performance component of the plan, are shown as percentages of annual base salary in the following table.

Named Executive Officer	Target (as % of December 31, 2007 base salary)
Donald L. Correll	80%
Ellen C. Wolf	50%
John S. Young	50%
Walter J. Lynch	40%
Paul G. Townsley	40%
Dietrich Firnhaber	35%

The 2007 annual incentive plan included three performance components: financial, operational and individual. For Messrs. Lynch and Townsley, the financial component was determined at the Company and regional levels, while for the other named executive officers, it was determined only at the Company level. Only

112

Table of Contents

Messrs. Lynch and Townsley had operational goals. Each participant s bonus opportunity was allocated among the components based on their relative weights for the participant, which depended upon the importance of the applicable component to the responsibilities of the participant and his or her subsidiary or business unit and American Water s view of the relative importance of the components. The following table shows the 2007 weightings of the financial, operational and individual components for the named executive officers.

	Mr. Correll	Ms. Wolf	Mr. Young	Mr. Lynch	Mr. Townsley	Mr. Firnhaber
Company Financial	70%	50%	50%	40%	40%	40%
Regional Financial				20%	20%	
Operational				20%	20%	
Individual	30%	50%	50%	20%	20%	60%

At the end of the year, payments under the annual incentive plan are determined by evaluating the performance of each component, and then adding the results of all components, factoring in their relative weightings.

Target and maximum achievement levels are established for each performance component. Target is set consistent with the achievement of the business plan objectives. Maximum is set at a level that significantly exceeds the business plan and has a low probability of payout.

For 2007, the Company and regional financial components for the annual incentive plan were based on operating income, which was defined as earnings before interest, taxes and other non-operating expenses, excluding impairment charges and costs related to the initial public offering. The Company operating income target (as adjusted for impairment charges and costs of the initial public offering) was approximately $542.9 million and the regional operating income targets (as adjusted for impairment charges and costs of the initial public offering) were $152.7 million for the Northeast Region, of which Mr. Lynch was President until July 2, 2007, when he was named Executive Vice President of Business Operations, Eastern Division, and $31.5 million for the Western Region, of which Mr. Townsley is President. More than 80% of the operating income target for the entire Company had to be achieved before any payout could have been made on the Company financial component of the plan. In addition, more than 70% of the operating income target for the entire Company had to be achieved before any payout could have been made on any component of the plan. With respect to both the Company and regional financial components, if 85% of the operating income target had been achieved, 25% of the target payouts for the financial components would have been awarded; at 100% achievement of the operating income target, 100% of the target payouts would have been awarded; and at 125% achievement of the operating income target, 150% of the target payouts would have been awarded. Linear interpolation would have been used to determine payouts at achievement levels between the levels indicated. The 2007 Company operating income result (as adjusted as described above) was $545.4 million and the 2007 regional operating income results (as adjusted as described above) were $166.6 million for the Northeast Region and $24.3 million for the Western Region, producing payouts for these financial components of 100.9%, 118.1% and 0% of target, respectively.

The actual financial results used for assessment under the annual incentive plan may be amended to reflect the impact of events that are not considered to be within the control of local management. Any such amendments will require the explicit approval of our Chief Executive Officer and our Chief Financial Officer and if material, our board of directors, whose decisions will be final. The following items are those most likely to be considered for amendment: weather conditions having a material impact on the financial results, the impact of movements in foreign exchange rates, disposal/acquisition of businesses not anticipated in the business plan but subsequently mandated by our board of directors, goodwill impairments and costs related to the initial public offering.

For Messrs. Lynch and Townsley, the operational component for the 2007 annual incentive plan consisted of customer satisfaction, customer service quality, environmental, and health and safety goals, with 25% of the component allocated to each category of goal. Customer satisfaction measures overall satisfaction with the services offered by American Water that directly benefit the customer. This is measured by a study conducted

Table of Contents

annually in the fourth calendar quarter of approximately 1,100 American Water-regulated water or wastewater customers. Customer service quality measures customer satisfaction with field and customer service contacts. This is measured by a study conducted throughout the year of approximately 900 American Water-regulated water or wastewater customers each quarter. Environmental performance is measured by notices of violation, which is the number of times that an official notice is issued by a primacy agency for failure to comply with a federal, state or local environmental statute or regulation that is covered by the Environmental Management Plan. Health and safety performance is measured by the lost workday case rate, which is the number of total Occupational Safety and Health Administration recordable injuries or illness cases with lost workdays per 200,000 hours worked.

For the Northeast Region, the 2007 targets were 95%, 80%, 4 and 2.2 for customer satisfaction, customer service quality, notices of violation and lost workday case rate, respectively. For the Western Region, the 2007 targets were 95%, 80%, 4 and 1.4 for customer satisfaction, customer service quality, notices of violation and lost workday case rate, respectively. Payouts on customer satisfaction would have been 0% of target if 90% or less of the target goal had been achieved, 100% of target if 95% of the target goal had been achieved and 120% of target if 97% or more of the target goal had been achieved. Payouts on customer service quality would have been 0% of target if 75% or less of the target goal had been achieved, 100% of target if 80% of the target goal had been achieved and 120% of target if 90% or more of the target goal had been achieved. Payouts on environmental and health and safety would have been 0% of target if 130% or more of the target goal had been achieved, 100% of target if 100% of the target goal had been achieved and 120% of target if 50% or less of the target goal had been achieved. Linear interpolation would have been used to determine payouts for performance between the levels indicated. If total notices of violation for the Company as a whole were less than or equal to 21, payouts on the environmental component would have been made to all participants regardless of the individual region results. The Company target for notices of violation would have been increased for any significant growth (i.e., one notice would have been added per 5% growth in customers served, rounded down).

The 2007 results for the Northeast Region were 85%, 78%, 1 and 1.38 for customer satisfaction, customer service quality, notices of violation and lost work day case rate, respectively, producing payouts for these components of 0%, 40%, 100% and 115% of target, respectively. The 2007 results for the Western Region were 86%, 84%, 7 and .97 for customer satisfaction, customer service quality, notices of violation and lost workday case rate, respectively, producing payouts for these components of 0%, 108%, 100% and 112% of target, respectively.

The individual component for the annual incentive plan includes performance targets that relate to the participant s function in the Company as agreed between each participant and his or her manager. For 2007, each participant had five performance targets, which were each weighted according to their relative importance. Payouts on the individual component would have been 0% of target if performance had not met expectations, 25-74% of target if performance targets had been only partially achieved, 75-99% of target if performance targets had been largely achieved, 100% of target if performance targets had been fully achieved and 101-120% of target if performance had exceeded expectations. Once evaluated, the individual performance target ratings are added and averaged to determine an overall individual rating.

Mr. Correll s four primary individual measures were (1) lead and drive the American Water management team in delivering financial and operational performance (weighted at 40%), (2) lead and manage RWE Divestiture activities with RWE (weighted at 25%), (3) reestablish and bolster critical relationships with key stakeholders and continue implementation of a culture of business development and growth (weighted at 15%) and (4) lead and support strategic planning and forward thinking for the pre- and post- initial public offering business environment (weighted at 20%). Mr. Correll s performance results for the four measures were 101%, 101%, 101% and 101%, respectively, and his overall individual rating was 101%.

Ms. Wolf s four primary individual measures were (1) lead and drive successful achievement of the business plan and complete all required financial disclosure for the initial public offering (weighted at 30%),

Table of Contents

(2) lead and manage RWE Divestiture activities with RWE, Securities and Exchange Commission compliance, including timely and accurate financial reporting, Sarbanes-Oxley implementation and compliance and projects for the enhancement of American Water s information technology systems (weighted at 30%), (3) establish and monitor appropriate service agreements between the American Water Works Service Company and the business units and maintain a team atmosphere among management (weighted at 20%) and (4) lead and drive employee development (weighted at 20%). Ms. Wolf s performance results for the four measures were 110%, 110%, 95% and 100%, respectively, and her overall individual rating was 105%.

Mr. Young s four primary individual measures were (1) lead and drive business plan commitments and drive enhanced value for capital expenditure program (weighted at 40%), (2) lead and drive continuous improvement in operational integrity and efficiencies in the Regulated Businesses (weighted at 30%), (3) lead and drive improvements in customer service and achievement of environmental management excellence (weighted at 20%) and (4) serve as ambassador and coach throughout American Water in an effort to instill and reinforce American Water s core values (weighted at 10%). Mr. Young s performance results for the four measures were 105%, 100%, 90% and 100%, respectively, and his overall individual rating was 100%.

Mr. Lynch s four primary individual measures were (1) financial oversight of the eastern United States to achieve the 2007 business plan goals for net income and net operating cash flow and support the regulatory approval of the RWE Divestiture (weighted at 40%), (2) drive customer satisfaction by delivering reliable, high-quality customer service, and build brand equity through effective communications (weighted at 20%), (3) process oversight of company-wide diversity plan for Northeast Region and sustain and enhance operational performance (weighted at 30%) and (4) and enhance employee talent and capability to promote employment satisfaction and engagement (weighted at 10%). Mr. Lynch s performance results for the four measures were 120%, 95%, 110% and 100%, respectively, and his overall individual rating was 110%.

Mr. Townsley s four primary individual measures were (1) lead and drive the management team in the western United States in delivering financial and operational performance (weighted at 40%), (2) reestablish and bolster critical relationships with key stakeholders, while increasing industry and external organizational participation (weighted at 20%), (3) lead and support the implementation of business solutions and programs in the western United States (weighted at 30%) and (4) lead and drive employee development (weighted at 10%). Mr. Townsley s performance results for the four measures were 30%, 100%, 95% and 100%, respectively, and his overall individual rating was 70%.

Mr. Firnhaber s four primary individual measures were (1) financial oversight for the 2007 legal function and budget (weighted at 20%), (2) lead and support enhancement of customer and stakeholder satisfaction through effective and timely legal business advice (weighted at 20%), (3) lead and support the RWE Divestiture throughout 2007 (weighted at 50%) and (4) lead and drive employee development (weighted at 10%). Mr. Firnhaber s performance results for the four measures were 100%, 100%, 100% and 100%, respectively, and his overall individual rating was 100%.

To be eligible to receive an annual incentive award, a participant must be actively employed at the end of the plan year for which the award is earned. However, in the case of disability, retirement, layoff or death during the plan year, a prorated award may be payable. Employees who resign or are terminated for cause at any time prior to payment are not eligible. Awards are usually determined and paid in cash as soon as possible after the release of financial results. American Water has the discretion to pay the annual incentive awards even if the applicable performance goals are not met, but would generally not exercise this discretion to pay awards at greater than maximum levels permitted by the plan absent unusual circumstances. Our board of directors also has the right to withhold all incentive payments in certain circumstances, such as failing to meet financial goals.

The actual annual incentive plan payments made to the named executive officers for the fiscal year ended December 31, 2007 are set forth below in the 2007 Summary Compensation Table.

Table of Contents

RWE s short-term incentive plan is similar to American Water s annual incentive plan. In 2007, Dr. Heischkamp s goals were based 30% on company and 70% on individual measures. Dr. Heischkamp s company component was based on RWE s, rather than American Water s, performance. It was based on RWE s achievement of Value Added , which is defined as operating result minus the product of average operating assets of the period and the weighted average cost of capital, and which is a key performance indicator that measures the ability of RWE s operating activities to cover and exceed the cost of invested operating assets. Dr. Heischkamp s target incentive opportunity for 2007 was 34.7% of his base pay (including his functional allowance), and his bonus paid out based on achievement of company performance at 113% of target and individual performance at 108% of target.

Long-Term Equity Incentive Compensation

RWE has a global long-term equity incentive program in place in which certain named executive officers participate. It is known as the Beat program, because it aims to incentivize the RWE group to perform successfully as one integrated team acting in one rhythm, or beat.

Under RWE s 2005 Beat program, performance shares were granted to participants in 2005, based on a 2005-2007 award cycle. The awards are scheduled to pay out in cash in 2008 to participants who remain employed for the full award cycle, or whose employment is terminated without cause during the award cycle. The value of the performance shares that will pay out at the end of the cycle is determined based on RWE s performance, measured by total stockholder return, which we refer to as TSR, which takes into account both the share price and reinvested dividends. RWE s TSR is ranked against those of other companies within the DJ Stoxx Utilities Index, which consists of the top European utility companies, to determine a payout factor. The factor does not only measure RWE s rank within the list but also takes into account which competitors were outperformed. Each company within the list has a weighting according to its free float market capitalization (the total value of its shares on the stock market). The payout factor therefore depends on RWE s position within the list and the sum of the index weightings of the outperformed companies. In order for any payouts to be made under the Beat program, RWE must perform better than at least 25% of the index weighting. The final value of a performance share is equal to the product of the payout factor and the average RWE share price in the last 20 days prior to the end of the award cycle. The maximum amount that may be paid to a participant with respect to a performance share is limited to three times the grant value of the performance share, which is the expected value of the share set forth at the beginning of the award cycle. The grant value for the 2005-2007 award cycle was 18.62 Euros per share, and three times this amount is 55.86 Euros per share. Since the value of each 2005-2007 performance share, without taking the cap into consideration, was greater than 55.86 Euros per share, the maximum payouts will be made under the program. The amount to be paid to each participant with respect to the 2005 Beat program will be equal to the product of the number of performance shares granted to the participant and 55.86 Euros.

No long-term incentive awards were granted to the United States-based named executive officers under the Beat program in 2006 or 2007. However, Mr. Firnhaber and Dr. Heischkamp were granted long-term equity incentive awards under the Beat program for the 2006-2008 and 2007-2009 award cycles. The terms of these awards are the same as for the 2005-2007 awards, except that the maximum amount that may be paid to a participant is limited to two times the grant value of the performance shares, which grant value was 17.48 Euros per performance share for the 2006-2008 award cycle and 24.99 Euros per performance share for the 2007-2009 award cycle.

Prior to 2005, RWE had other long-term equity incentive programs in place. Pursuant to the 2004 Thames Water/RWE long-term incentive program, restricted stock units with respect to shares of RWE common stock were granted to participants in 2004. The units were paid out to participants who were actively employed on July 24, 2007. The plan provided that the amount paid to each participant would be determined by multiplying the number of restricted stock units granted to that participant by the closing price of a share of RWE stock on July 23, 2007, provided that for purposes of the plan the RWE share price could not exceed $90. Since the

Table of Contents

closing price of an RWE share on July 23, 2007 was greater than $90, the maximum payouts were made under the plan.

For further information on the long-term equity incentive awards granted to the named executive officers, see the 2007 Grants of Plan-Based Awards table, the 2007 Outstanding Equity Awards at Fiscal Year-End table and the 2007 Option Exercises table.

Other Benefits

Other benefits offered to the named executive officers by American Water include qualified and nonqualified retirement benefit plans, an executive severance policy and perquisites. American Water also provides medical and dental coverage and life insurance to each named executive officer to generally the same extent as such benefits are provided to other American Water employees. These benefits are intended to provide for the health, well-being and retirement planning needs of the named executive officers.

Retirement Benefit and Deferred Compensation Plans

American Water sponsors qualified and nonqualified defined benefit retirement plans that cover certain employees who commenced employment prior to January 1, 2006, when the plans were closed to certain new entrants. Some of the defined benefit plans are predecessor company plans that American Water assumed in acquisitions. Employees hired or rehired on or after January 1, 2006, such as Mr. Correll and Ms. Wolf, are eligible for defined contribution plans only, except that Ms. Wolf has a benefit in our qualified defined benefit pension plan due to prior service. We transitioned from defined benefit to defined contribution plans for several reasons. Defined contribution plans provide to employees a retirement savings opportunity that is portable, which is important to us, since our workforce is more mobile than the traditional water utility workforce. In addition, we desired to be able to predict our fixed costs for retirement benefits on an ongoing basis, rather than having our costs depend on the fluctuation of capital markets. Further, defined contribution plans permit employees to defer the taxation of the compensation that they contribute to the plan, and allow American Water to contribute to the plan on behalf of employees in a relatively tax-efficient manner.

At the recommendation of Towers Perrin, a compensation consulting firm, based on its experience with companies both in the utility industry and outside of it, we have recently established two deferred compensation plans, one for certain of our key employees, including the named executive officers, and one for our directors. The plans permit the deferral, on a tax-favored basis, of base salary and bonus, in the case of employees, and director fees, in the case of directors. The deferred compensation plan for employees provides benefits under the same formula as our 401(k) plan, but without regard to the pay and benefit limitations applicable to qualified plans. For employees hired on or after January 1, 2006, the deferred compensation plan also provides an employer contribution of 5.25% of annual incentive plan awards, which is not applicable for the same contribution under our 401(k) plan. Executives hired prior to January 1, 2006 are eligible for an additional 2.5% employer matching contribution on base pay above the pay limit for the year, which is intended to replace benefits lost under the qualified plan due to pay and benefit limitations. Accounts of participants in both plans will be credited with returns in accordance with the deemed investment options elected by the participant.

For information on the named executive officers potential retirement and deferred compensation plan benefits, please see the 2007 Pension Benefits table, the 2007 Nonqualified Deferred Compensation table and Potential Payments on Termination or Change in Control.

Executive Severance Policy

Our executive severance policy was established in June 2006 to provide certainty with respect to the payments and benefits to be provided upon certain termination events. It provides severance benefits to executives whose employment is involuntarily terminated by American Water for reasons other than cause. For further information about the executive severance policy, see Potential Payments on Termination or Change

Table of Contents

in Control. The number of months of salary to be paid as severance was decided upon with reference to surveys that Towers Perrin has done and its experience in the general industry.

Change in Control

Most of our compensation plans and policies do not contain change in control triggers. As described in Potential Payments on Termination or Change in Control, certain Company contributions to the deferred compensation plan will vest upon a change in control of American Water. Also, pursuant to the AWW Inc. Executive Retirement Plan, our nonqualified defined benefit pension plan, our board of directors has the discretion to vest benefits upon certain terminations of employment following a change in control. However, a change in control was not triggered by the initial public offering for purposes of these plans, and all of the named executive officers who participate in the AWW Inc. Executive Retirement Plan are already vested in their pension benefits.

Perquisites

American Water provides limited perquisites, which represent a small part of our overall compensation package. The primary perquisites that we offer are financial planning, executive physicals and a vehicle allowance. We believe that good financial planning by experts reduces the amount of time and attention that senior management must spend on that topic and maximizes the net financial reward to the employee of compensation received from American Water. Furthermore, since our leadership team has the greatest impact on our success, the executive physical is important. Healthy leaders are better prepared to perform physically and mentally. None of the named executive officers used the Company s financial planning services in 2007.

Special Policies for RWE Employees on Assignment at American Water

During 2007, two RWE employees, Dietrich Firnhaber, our former Senior Vice President, Legal, and Volker Heischkamp, our former Senior Vice President, Capital Markets, worked for American Water.

RWE provided Mr. Firnhaber and Dr. Heischkamp with various elements of compensation on account of their United States assignments, including vehicle and housing allowances, home leave and travel reimbursements and cost of living allowances. RWE provides these elements of compensation in order to ensure that the expatriate s lifestyle while on assignment is broadly comparable to what it would be in his or her domestic country. RWE views its expatriates as essential links among its companies worldwide. It also views expatriate assignments as an opportunity for personal and professional development and as an important component in the career development of individuals for management positions. In designing its international assignment policies, RWE aims to manage the interface between the home and the host companies, and to ensure that all tax, social security and labor requirements are met and that participating employees receive optimal care before, during and after the assignment.

Transaction-related Bonuses

Retention Bonuses

American Water established a retention bonus program in 2006 that was intended to retain employees in key leadership roles through the timely completion of American Water s initial public offering. The retention bonus program provided that if a participant remained employed by American Water through the earlier of March 31, 2008 or one year after the date of American Water s initial public offering, the participant would receive a cash retention bonus based on a predetermined percentage of his or her base salary in effect on January 1, 2006, or his or her hire date, if he or she was hired after January 1, 2006. Retention bonuses were paid on March 28, 2008. Retention bonuses were payable to employees whose employment was terminated without cause prior to the payment date. The retention bonus was offered to employees in lieu of a 2006 grant under the RWE long-term incentive program.

Table of Contents

The named executive officers who participated in the retention bonus program were entitled to retention bonuses in amounts equal to the following percentages of their base salaries:

Named Executive Officer	Retention Bonus Opportunity (as percentage of base salary)
Donald L. Correll	120%
Ellen C. Wolf	100%
John S. Young	100%
Walter J. Lynch	80%
Paul G. Townsley	80%

RWE determined these retention bonus opportunities by doubling the target percentage opportunities that would have applied to the named executive officers long term equity incentives (as determined by RWE), had we granted such incentives in 2006, since the long-term equity incentives would have had the potential to pay out at levels significantly greater than target.

Completion Bonuses

American Water offered a completion bonus to reward selected senior executives for their contributions to the initial public offering. Each eligible executive was entitled to receive a cash bonus based on a predetermined percentage of his or her base salary in effect on December 31, 2007.

The named executive officers who participated in the completion bonus program were entitled to completion bonuses in amounts equal to the following percentages of their base salaries:

Named Executive Officer	Completion Bonus Opportunity (as percentage of base salary (including functional allowance for Mr. Firnhaber and Dr. Heischkamp))
Donald L. Correll	100%
Ellen C. Wolf	100%
John S. Young	100%
Walter J. Lynch	75%
Paul G. Townsley	75%
Dietrich Firnhaber	75%
Volker Heischkamp	18.8%

With respect to each executive other than Dr. Heischkamp, 50% of each executive s completion bonus was awarded solely because the initial public offering was consummated. The remaining 50% was payable at the discretion of RWE, based upon the executive s leadership and support in positively marketing the business and preparing for the initial public offering. All of Dr. Heischkamp s completion bonus was discretionary, based on his personal contribution to the initial public offering.

New Omnibus Equity Compensation Plan

American Water has adopted an omnibus equity compensation plan in connection with the initial public offering pursuant to which equity-based awards are granted to certain employees and non-employee directors of American Water. The plan encourages participants to contribute materially to the growth of the Company, thereby benefiting American Water s stockholders. The terms of the omnibus equity compensation plan are described below under 2007 Omnibus Equity Compensation Plan.

Table of Contents

Two grants of performance-based non-qualified stock options and performance-based restricted stock units were made to employees, including the named executive officers, under the plan. We have chosen to use stock options and restricted stock units as forms of equity-based compensation in order to align our program with common market practice. The amount of the named executive officers awards was determined by RWE based on certain performance conditions, as described below. Sixty percent of the award value granted under the plan is in the form of stock options and 40% is in the form of restricted stock units. The exercise price of the stock options is the fair market value of the underlying shares on the grant date. One grant of the options will expire on December 31, 2013, and the other grant of the options will expire on December 31, 2014. One grant of the awards will vest on January 1, 2010, and the other grant of the awards will vest on January 1, 2011, if the applicable participant remains employed with American Water through such dates, subject, in the case of the named executive officers, to certain performance conditions described below.

The target values of the long-term incentive awards that vest and become exercisable are 120% of base salary for Mr. Correll, with respect to the first grant of awards, and 150% of base salary for Mr. Correll, with respect to the second grant of awards, 115% of base salary for Ms. Wolf and Mr. Young (for each grant of awards), 45% of base salary for Mr. Lynch, with respect to the first grant of awards, and 80% of base salary for Mr. Lynch, with respect to the second grant of awards, and 45% of base salary for all other named executive officers (for each grant of awards) (other than Mr. Firnhaber, who was no longer employed as of the initial public offering and did not receive a grant). Other employees have received awards with target values of 45% or 20% of their base salaries for the first grant of awards, and 45%, 20% or 10% of their base salaries for the second grant of awards. For these purposes, December 31, 2007 base salaries were used for the first grant of awards, and January 1, 2008 base salaries were used for the second grant of awards.

The vesting of the named executive officers awards will be based on American Water s net income, as adjusted for certain non-recurring items related to the initial public offering, impairments, the settlement of income tax audits, changes in benefit plan costs that are not related to management decisions, effects resulting from changes in accounting principles and other items.

With respect to the first grant, the number of stock options that become exercisable, and the number of restricted stock units that vest, as a percentage of the targeted number of awards for each named executive officer, will be determined by comparing (1) the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s actual audited net income for 2008 (as adjusted as described above) to (2) the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s target net income for 2008 (as adjusted as described above) at the time of the initial public offering. If the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s actual audited net income for 2008 (as adjusted as described above) is 100% of the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s target net income for 2008 (as adjusted as described above) at the time of the initial public offering, then 100% of each named executive officer s target number of awards will become exercisable and vest. If the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s actual audited net income for 2008 (as adjusted as described above) is 80% of the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s target net income for 2008 (as adjusted as described above) at the time of the initial public offering, then 25% of each named executive officer s target number of awards will become exercisable and vest. All awards will be forfeited if the applicable percentage is less than 80%. The maximum percentage of awards that become exercisable and vest will be 175% of each named executive officer s target number awards, which percentage will be achieved if the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s actual audited net income for 2008 (as adjusted as described above) is 120% or more of the sum of American Water s actual audited net income for 2007 (as adjusted as described above) and American Water s target net income for 2008 (as adjusted as described above) at the time of the initial public offering.

Table of Contents

With respect to the second grant of awards, the number of awards that become exercisable and vest will be determined in the same manner as described above, except that the relevant comparison will be the sum of American Water s actual audited net income for 2008 (as adjusted as described above) and American Water s actual audited net income for 2009 (as adjusted as described above) to the sum of American Water s target net income for 2008 (as adjusted as described above) at the time of the initial public offering and American Water s target net income for 2009 (as adjusted as described above) at the time of the initial public offering.

The number of stock options and restricted stock units initially granted at the time of the initial public offering were determined by RWE based on its goals for our 2007, 2008 and 2009 net income.

Options to purchase a total of 2,077,814 shares of common stock, 89,921 restricted stock awards and 269,254 restricted stock units were granted to employees in connection with the initial public offering . Of this total, the following named executive officers received the following numbers of options and restricted stock units:

Named Executive Officer	Options (first grant)	Options (second grant)	Restricted Stock Units (first grant)	Restricted Stock Units (second grant)
Donald L. Correll	154,241	210,433	19,561	27,666
Ellen C. Wolf	120,939	131,999	15,338	17,354
John S. Young	107,502	117,333	13,634	15,426
Walter J. Lynch	35,736	69,340	4,532	9,116
Paul G. Townsley	28,384	30,980	3,600	4,073

We have not yet determined whether, and the extent to which, the Compensation Committee will be able to exercise discretion to cause to vest fewer or more awards than would vest based on the mechanisms described above, or to cause awards to vest absent attainment of the relevant performance goals.

On the vesting date or shortly thereafter, subject to the service and performance conditions having been met, the restricted stock units will be converted into an equivalent number of shares of American Water common stock, and the stock options will become exercisable. If any dividends are declared with respect to American Water common stock during the vesting period, American Water will credit dividend equivalents with respect to the restricted stock units, and participants will receive cash equal to the value of the dividend equivalents that accumulate with respect to any of their restricted stock units that are not forfeited. Awards will generally be forfeited upon a termination of employment prior to vesting. Awards will fully time-vest upon death or disability, but will remain subject to performance conditions until the end of the performance cycle. Awards will time-vest on a pro rata basis upon retirement, but will remain subject to performance conditions until the end of the performance cycle. If a change in control occurs, awards will vest based on actual performance through the most recent reporting period prior to the change in control.

Executives will be required to hold 50% of the shares underlying their awards in order to comply with minimum ownership requirements, which are set at 300% of base salary for Mr. Correll, 200% of base salary for Ms. Wolf and Mr. Young, and 100% of base salary for other senior management positions.

New Employee Stock Purchase Plan

American Water has established an employee stock purchase plan in order to more closely align our employees goals with those of our stockholders. The plan will allow certain employees to purchase shares of American Water s common stock at a discount of 10% from the lower of the prevailing market price on the first day and the prevailing market price on the last day of each purchase period. The terms of the employee stock purchase plan are described below under Nonqualified Employee Stock Purchase Plan.

Table of Contents

Tax and Accounting Consequences

Section 162(m) of the Internal Revenue Code imposes a limit on the amount of compensation that we may deduct in any one year with respect to certain of our named executive officers, unless certain specific and detailed criteria are satisfied. Performance-based compensation, as defined in the Internal Revenue Code, is fully deductible if the applicable compensation programs are approved by our stockholders and meet other requirements. We seek to maintain flexibility to compensate our executives in a manner designed to promote our corporate goals, and therefore we have not adopted a policy requiring all compensation to be deductible. However, from time to time, we intend to monitor whether it might be in our interest to structure our compensation programs to satisfy the requirements of Section 162(m).

2007 Summary Compensation Table

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Award(s) ($)(8)	Option Awards ($)	Non-Equity Incentive Plan Compensation ($)(9)	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)(10)	All Other Compensation ($)(11)	Total ($)(12)
Donald L. Correll President and Chief Executive Officer(1)	2007	$ 562,059	$	$	$	$ 457,415	$	$ 82,843	$ 1,102,317
Ellen C. Wolf Senior Vice President and Chief Financial Officer(2)	2007	$ 459,865	$	$	$	$ 238,587	$	$ 66,578	$ 765,030
John S. Young Chief Operating Officer(3)	2007	$ 408,771	$	$ 226,486	$	$ 206,927	$ 208,700	$ 26,183	$ 1,077,067
Walter J. Lynch Executive Vice President Business Operations, Eastern Division(4)	2007	$ 318,769	$	$ 209,911	$	$ 138,698	$ 22,197	$ 17,761	$ 707,336
Paul G. Townsley President, Western Region(5)	2007	$ 275,847	$	$ 207,204	$	$ 78,240	$ 71,615	$ 84,224	$ 717,130
Dietrich Firnhaber Senior Vice President, Legal(6)	2007	$ 205,846	$	$ 122,760	$	$	$	$ 1,124,889	$ 1,453,495
Volker Heischkamp Senior Vice President, Capital Markets(7)	2007	$ 390,872	$	$ 136,556	$	$ 148,703	$ 7,051	$ 108,944	$ 792,126

(1) Mr. Correll has served as our President and Chief Executive Officer since April 17, 2006.
(2) Ms. Wolf has served as our Senior Vice President and Chief Financial Officer since March 1, 2006. Ms. Wolf is entitled to a fixed and frozen pension benefit of $17,748, payable at age 65 from the American Water qualified pension plan. Changes in assumptions, particularly the discount rate, have made the present value of this benefit decrease by $920 from December 31, 2006 to December 31, 2007.
(3) Mr. Young has served as our Chief Operating Officer since October 1, 2005.
(4) Mr. Lynch has served as our Executive Vice President, Business Operations, Eastern Division, since July 2, 2007. Previously, he served as President of our Northeast Region.
(5)

Mr. Townsley has served as the President of our Western Region since 2002. He also serves as the President of our Arizona, New Mexico, Hawaii and Texas subsidiaries. Previously, he served as the President of our California subsidiary.

(6) Mr. Firnhaber joined the RWE group on January 1, 1996, and began working for American Water on January 1, 2003. He resigned effective July 31, 2007. His compensation was denominated in Euros but was paid to him in the equivalent number of United States dollars. Mr. Firnhaber s salary (including functional allowance) that he received prior to March 26, 2007 was converted using the exchange

Table of Contents

rate of 1.20311, which was the exchange rate on March 27, 2006, and the rest of his salary (including functional allowance) was converted using the exchange rate of 1.32806, which was the exchange rate on March 26, 2007. The rest of his compensation shown in the table was converted based on the rate of 1.3326 (which was the rate actually used in converting such compensation in dollars), except that for purposes of the column titled Change in Pension Value and Nonqualified Deferred Compensation Earnings, the December 31, 2006 exchange rate of 1.32027 was used to determine 2006 pension values and the December 31, 2007 exchange rate of 1.4721 was used to determine 2007 pension values.

(7) Dr. Heischkamp joined the RWE group on August 1, 2002, and was seconded to American Water as its Senior Vice President, Capital Markets from November 15, 2005 through April 23, 2008. He was compensated in Euros. All items of his compensation reported here were converted from Euros to United States dollars based on the December 31, 2007 exchange rate of 1.4721, except that for purposes of the column titled Change in Pension Value and Nonqualified Deferred Compensation Earnings, the December 31, 2006 exchange rate of 1.32027 was used to determinate 2006 pension values.

(8) The amounts shown under this column reflect the 2004 Thames Water/RWE long-term incentive awards and the 2005-2007, 2006-2008 and 2007-2009 RWE long-term incentive awards. The values in the table for the 2004 Thames Water/RWE long term incentive awards and for the 2005-2007 RWE long-term incentive awards were computed in accordance with Statement of Financial Accounting Standards No. 123(R) Share Based Payment (SFAS 123(R)). With respect to the 2006-2008 RWE long-term incentive award values in the table and the 2007-2009 RWE long-term incentive award values in the table, the fair values used to calculate the amounts were provided by RWE. RWE used a valuation model based solely on historic volatility to calculate the grant date fair value of the awards. SFAS 123(R) generally requires the consideration of expected volatility. The Company believes that the consideration of expected volatility in the fair value calculations would have a de minimis impact on these values. For further information on these awards see Compensation Discussion and Analysis Elements of Compensation Long-Term Equity Incentive Compensation.

(9) The amounts shown in this column reflect payments for 2007 performance under American Water s and RWE s annual incentive plans made in March, 2008. For further information about these plans, see Compensation Discussion and Analysis Elements of Compensation Annual Incentive Compensation.

(10) The amounts shown in this column reflect the aggregate changes in the actuarial present values of the named executive officers accumulated benefits under our defined benefit pension plans (including supplemental plans) from the pension plan measurement date used for our audited financial statements for 2006 to the pension plan measurement date used for our audited financial statements for 2007. For further information on the pension plans, see 2007 Pension Benefits. There were no above-market earnings on the named executive officers deferred compensation in 2007.

(11) The following tables show the components of the amounts listed in the All Other Compensation column for each named executive officer:

Name	401(k) Company Match ($)	401(k) Defined Contribution Account ($)(a)	Company Contributions to Deferred Compensation Plan ($)(b)	Executive Physicals and Associated Travel ($)	Vehicle Allowance ($)	Foreign Service Allowance ($)(c)	Relocation Expenses ($)	Company-Paid Life Insurance Premiums ($)
Donald L. Correll	$ 8,067	$ 11,813	$ 38,109		$ 18,000			$ 480
Ellen C. Wolf	$ 9,000	$ 11,813	$ 30,885		$ 14,400			$ 480
John S. Young	$ 5,500		$ 4,594	$ 6,009	$ 9,600			$ 480
Walter J. Lynch	$ 3,689		$ 2,200	$ 2,639	$ 8,400		$ 353	$ 480
Paul G. Townsley	$ 3,602		$ 1,271	$ 2,918	$ 8,400		$ 43,315	$ 480
Dietrich Firnhaber					$ 6,355	$ 23,689		
Volker Heischkamp					$ 14,460			

Name	Housing Allowance and Related Expenses ($)	Home Leave, Travel and Flight Allowance ($)	COLA ($)(d)	Gross Up for Taxes ($)(e)	Severance ($)(f)	Spousal Travel Expenses to Industry Conferences
Donald L. Correll						$ 6,374
Paul G. Townsley				$ 24,238		
Dietrich Firnhaber	$ 37,385	$ 125,383		$ 33,099	$ 898,978	
Volker Heischkamp	$ 70,058	$ 18,748	$ 5,678			

(a) The Defined Contribution Account is an account in our 401(k) plan to which American Water contributes 5.25% of each employee s total cash compensation (which includes base pay and annual incentive plan payouts), subject to limits on compensation that may be taken into account pursuant to Section 401(a)(17) of the Internal Revenue Code.

(b) The amounts in this column represent matching and other annual contributions that the Company has made to the named executive officers accounts in the Nonqualified Savings and Deferred Compensation Plan for Employees of the Company. For further information on this plan, please see 2007 Nonqualified Deferred Compensation.

(c) The amount in this column was paid to Mr. Firnhaber on account of his working in the United States.

(d) The amount in this column represents a payment made to Dr. Heischkamp to compensate him for the differences in the cost of living between the United States and Germany.

123

Table of Contents

(e) The amounts in this column represent a payment made to Mr. Townsley to compensate him for taxes on his relocation payments and United States income taxes paid by American Water on Mr. Firnhaber s behalf.

(f) For more information on the amounts paid to Mr. Firnhaber as severance, see Potential Payments on Termination or Change in Control.

(12) The totals shown in this column do not include non-equity incentive plan compensation. See footnote (2) above.

2007 Grants of Plan-Based Awards

The following table provides certain information regarding plan-based awards granted to our named executive officers during the fiscal year ended December 31, 2007.

			Estimated Future Payouts Under Non-Equity Incentive Plan Awards		Estimated Future Payouts Under Equity Incentive Plan Awards		
Name	Plan	Grant Date	Target ($)	Maximum ($)	Target (#)	Target ($)	Maximum ($)
Donald L. Correll	2007 Annual incentive plan(1)		$ 453,200	$ 639,012			
Ellen C. Wolf	2007 Annual incentive plan(1)		$ 231,750	$ 312,863			
John S. Young	2007 Annual incentive plan(1)		$ 206,000	$ 278,100			
Walter J. Lynch	2007 Annual incentive plan(1)		$ 140,000	$ 193,200			
Paul G. Townsley	2007 Annual incentive plan(1)		$ 111,200	$ 153,456			
Dietrich Firnhaber	2007 Annual incentive plan(1)(2)		$ 113,601	$ 149,953			
	2007-2009 Beat award(3)	January 1, 2007			1,441	$ 53,011	$ 106,022
Volker Heischkamp	RWE Short-term bonus(4)		$ 135,801	$ 175,184			
	2007-2009 Beat award(3)	January 1, 2007			1,441	$ 53,011	$ 106,022

(1) The annual incentive plan is American Water s annual cash bonus plan. For further information on the plan, see Compensation Discussion and Analysis Annual Incentive Compensation. The 2008 bonus payments that were made for 2007 performance are shown in the 2007 Summary Compensation Table in the column titled Non-Equity Incentive Plan Compensation.

(2) Mr. Firnhaber s annual incentive plan target and maximum amounts were based on his base pay (including a functional allowance) and were converted to United States dollars based on the March 26, 2007 exchange rate of 1.32886.

(3) The amounts reported in these rows represent outstanding awards under RWE s 2007-2009 long-term incentive plan. Participants were initially granted a target number of performance shares. Based on the performance of RWE, the final value of the shares that vest will be adjusted by a payout factor. The target value of the performance shares included in the table is the grant value, or the expected value of the shares set forth at the beginning of the award cycle, which was 24.99 Euros per performance share. The maximum amount that may be paid to a participant under the plan is limited to two times the grant value of the performance shares. For purposes of determining the dollar amounts in the table, the expected value was converted to dollars based on the December 31, 2007 exchange rate of 1.4721. For further information on the plan, see Compensation Discussion and Analysis Long-Term Equity Incentive Compensation.

(4) Dr. Heischkamp s short-term bonus is described under Compensation Discussion and Analysis Annual Incentive Compensation. His 2008 bonus payment for 2007 performance is shown in the 2007 Summary Compensation Table in the column titled Non-Equity Incentive Plan Compensation.

Narrative Disclosure to 2007 Summary Compensation Table and 2007 Grants of Plan-Based Awards Table

Employment Agreements

Below are descriptions of the material terms of our employment agreements with our named executive officers. For further information on the items included in the 2007 Grants of Plan-Based Awards table, see Compensation Discussion and Analysis. For information on Mr. Firnhaber s severance agreement, see Potential Payments on Termination or Change in Control.

Table of Contents

Donald L. Correll. Mr. Correll entered into an employment letter agreement with American Water, dated March 10, 2006, and restated as of February 15, 2008. According to the agreement, Mr. Correll will have the title of President and Chief Executive Officer of the Company, and will serve as a member of American Water s board of directors. The agreement provides for Mr. Correll s annual base salary of $566,500 and his participation in the annual incentive plan. The agreement also provides for Mr. Correll s retention and completion bonuses and for his participation in American Water s new 2007 Omnibus Equity Compensation Plan with a target award of 120% of his base salary. The agreement also provides for Mr. Correll s participation in the Company s deferred compensation, retirement and benefit plans. The agreement also provides that Mr. Correll will receive $1,500 per month as an auto allowance.

The agreement also provides for certain relocation benefits for Mr. Correll. Effective as of March 2008, the Company will pay Mr. Correll a monthly living allowance of $10,000 per month to cover living expenses incurred by him as a result of his maintaining a residence in the Voorhees, New Jersey/Philadelphia, Pennsylvania area up to a maximum of $250,000. The living allowance will cease if Mr. Correll closes on the sale of his primary residence within one year from the date of the initial public offering, in which case he will be entitled to a one-time relocation allowance in the amount of $350,000, reduced by any monthly living allowance payments he received.

The agreement provides that in the event the Company terminates Mr. Correll s employment other than for cause, Mr. Correll will be provided with at least six months prior written notice and will be covered under our executive severance policy. The amounts Mr. Correll is entitled to receive under the severance policy are described under Potential Payments on Termination or Change in Control.

Ellen C. Wolf. Ms. Wolf entered into an employment letter agreement with American Water dated December 29, 2005, and restated as of February 15, 2008. According to the agreement, Ms. Wolf will have the title of Senior Vice President and Chief Financial Officer of American Water. The agreement provides for Ms. Wolf s annual base salary of $463,500 and her participation in the annual incentive plan. The agreement also provides for Ms. Wolf s retention and completion bonuses and for her participation in American Water s new 2007 Omnibus Equity Compensation Plan with a target award of 115% of her base salary. In addition, Ms. Wolf is eligible to participate in the Company s deferred compensation, retirement and benefit plans. The agreement also provides that Ms. Wolf will receive $1,200 per month as an auto allowance.

Ms. Wolf s employment letter agreement provides that if the Company terminates Ms. Wolf s employment other than for cause (as determined in the sole discretion of the Company), or if Ms. Wolf terminates her employment for good reason, (as described below), she will be deemed to have fully vested in all her benefits under the 2007 Omnibus Equity Compensation Plan and the deferred compensation plan so long as such vesting is permitted by applicable law. Good reason is defined as (i) a diminishment in Ms. Wolf s authority that is substantially and materially inconsistent with her position as Senior Vice President and Chief Financial Officer of a public company or (ii) the assignment to Ms. Wolf of duties that are substantially and materially inconsistent with her position as Senior Vice President and Chief Financial Officer of a public company.

Dietrich Firnhaber. Mr. Firnhaber was seconded from RWE to work at American Water pursuant to a secondment agreement. His secondment began on January 1, 2003, and was scheduled to end on October 31, 2006, although it was extended beyond such date. The secondment agreement provided for an annual base salary of 125,000 Euros, an annual allowance of 70,000 Euros for serving as member of the board of directors of American Water and a monthly foreign service allowance of 2,500 Euros. The agreement provided for Mr. Firnhaber s participation in the annual incentive plan and the Beat program.

During the secondment, Mr. Firnhaber was entitled to private health care coverage from RWE. He was entitled to reimbursement for school fees for his children in an amount up to $7,600 per child, adjusted annually. American Water paid for Mr. Firnhaber s costs of housing, less $1,000 per month, for which Mr. Firnhaber was responsible. American Water also agreed to provide Mr. Firnhaber with 9,000 Euros annually for home visit accommodations. Mr. Firnhaber had an annual budget for homeward journeys for himself and his family of 18,200 Euros. He was also provided with a company car.

Table of Contents

According to the secondment agreement, RWE was entitled to recall Mr. Firnhaber at any time upon three months notice. Any costs incurred due to the early termination of the secondment contract were to be reimbursed.

Mr. Firnhaber has resigned from RWE effective August 1, 2007. Previously, Mr. Firnhaber and RWE had entered into a separation agreement. For a description of the amounts Mr. Firnhaber received under the separation agreement, see Potential Payments on Termination or Change in Control.

2007 Outstanding Equity Awards at Fiscal Year-End

Name	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)(1)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested ($)(2)
Dietrich Firnhaber	2,228(2006)	$ 116,759
	1,441(2007)	$ 52,565
Volker Heischkamp	2,860(2006)	$ 145,949
	1,441(2007)	$ 52,565

(1) Awards in this column represent performance shares granted for the 2006-2008 and 2007-2009 performance periods under the RWE Beat program. For further information on RWE s Beat program, see Compensation Discussion and Analysis Long-Term Equity Incentive Compensation.

(2) The amounts in this column represent the values (assuming maximum performance for 2006-2008 awards and target performance for 2007-2009 awards) of the outstanding performance shares on December 31, 2007 (converted from Euros using an exchange rate of 1.4597 (the average exchange rate for the last 20 days of 2007)).

2007 Stock Vested

	Stock Awards(1)	
Name	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)
John S. Young	5,438	$ 443,408
Walter J. Lynch	4,894	$ 399,051
Paul G. Townsley	4,894	$ 399,051
Dietrich Firnhaber	1,882	$ 153,456
Volker Heischkamp	2,680	$ 218,524

(1) The amounts in this table represent performance shares granted for the 2005-2007 performance period under the RWE Beat program, which vested on December 31, 2007. Since Mr. Correll and Ms. Wolf were not hired until 2006, they were not granted any performance shares for the 2005-2007 cycle. For further information on RWE s Beat program, see Compensation Discussion and Analysis Long-Term Equity Incentive Compensation.

(2) The value realized was calculated by multiplying the number of performance shares granted by the final value of a performance share. The value of a performance share was the maximum value permitted under the plan, or $81.538842 (converted from Euros using an exchange rate of 1.4597 (the average exchange rate for the last 20 days of the performance period)) since the value determined pursuant to the formula under the plan exceeded this maximum.

126

Table of Contents

2007 Pension Benefits(1)

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)(5)	Payments During Last Fiscal Year ($)
Ellen C. Wolf(6)	AWW Co. Pension Plan(2)	4.52	$ 95,825	
John S. Young	AWW Inc. Executive Retirement Plan(3)	30.33	$ 648,194	
	AWW Co. Pension Plan(2)	30.33	$ 856,663	
Walter J. Lynch	AWW Inc. Executive Retirement Plan(3)	3.03	$ 27,176	
	AWW Co. Pension Plan(2)	3.03	$ 45,177	
Paul G. Townsley	AWW Inc. Executive Retirement Plan(3)	5.96	$ 177,207	
	AWW Co. Pension Plan (1)	5.96	$ 137,447	
Dietrich Firnhaber	I Lahmeyer AG(4)	12	$ 101,587	
Volker Heischkamp	VO2003(4)	5.33	$ 353,042	

(1) Since Mr. Correll was hired after 2005, he does not participate in any of our defined benefit pension plans.

(2) The AWW Co. Pension Plan, which we refer to as the AWWPP, is a qualified pension plan that provides for a pension benefit equal to 1.6% of final average pay multiplied by years of service. Final average pay is defined for purposes of the plan as the average sum of base pay plus annual incentive payout for the highest 60 months out of the final 120 months of employment. For executives hired prior to July 1, 2001, a grandfathered benefit is provided. Normal retirement is defined as age 65, and early retirement eligibility is satisfied when an employee s combined age and service total 70 years or more, provided the employee is at least age 55. The normal form of payment is a single life annuity for single participants and a 50% joint and survivor annuity for married participants, determined on an actuarially equivalent basis as the single life annuity. There is a reduction in benefits for early retirement for participants other than those who retire at age 62 or older with specified service levels, such as 20 years of service for someone who is age 62.

(3) The AWW Inc. Executive Retirement Plan, which we refer to as the ERP, is a nonqualified defined benefit pension plan that provides benefits under the same formula as the AWWPP, but without the pay and benefit payment limitations that are applicable to the AWWPP under the Internal Revenue Code. The ERP also provides a minimum benefit in accordance with provisions of former executive retirement plans that American Water sponsored, (a) the AWW Co., Inc. Supplemental Executive Retirement Plan, which we refer to as the SERP, (b) the AWW Co., Inc. Supplemental Retirement Plan, which we refer to as the SRP, (c) the NEI Supplemental Pension Plan, and (d) the Elizabethtown Water Company Supplemental Executive Retirement Plan. Executives who were participants in one of the former American Water nonqualified pension plans are entitled to the greater of the benefits determined pursuant to the restoration formula under the ERP and the benefits determined pursuant to their respective prior nonqualified plan formulas. Mr. Young participated in the former SRP. Mr. Lynch participates in the ERISA restoration provisions of the ERP. Mr. Townsley participated in the former SERP and SRP. Benefits vest in the AWWPP and the ERP upon completion of five years of service. In addition, individuals who participated in the SERP or the SRP became vested in those plans benefits upon the acquisition of American Water by RWE. Upon retirement, nonqualified plan benefits are payable as lump sums unless the participant has elected an alternate form of payment pursuant to the Internal Revenue Code regulations under Section 409A. Messers Young and Lynch have elected to receive ERP benefits as annuities at their date of retirement. Upon voluntary termination of employment prior to eligibility for retirement, all nonqualified benefits are payable as either lump sums or immediate annuity equivalents of lump sums. Mr. Townsley s SERP lump sum benefit includes an unreduced 50% joint and survivor annuity. All other nonqualified plan lump sums are based on single life annuities.

(4) The German pension plans are hybrid contribution plans. The normal retirement benefit is 4% of pensionable salary for I Lahmeyer AG and 2% of pensionable salary up to the social security ceiling plus 10% of pensionable salary above the social security ceiling for VO 2003, in each case multiplied by an age-dependent factor. Retirement age is determined by law. There are no reductions for early retirement for I Lahmeyer AG but there are reductions for early retirement for VO 2003. Upon disability, a pension is provided similar to normal retirement if a participant has a minimum of 13 years of pensionable service. If a participant does not have 13 years of pensionable service, additional service credit will be provided upon disability. Upon death, the spouse is provided with 60% of the normal pension. Participants vest in their benefits after reaching age 30 with a minimum of five years of pensionable service. Pension benefits are indexed 1% per year.

(5) Amounts shown reflect the present value of the accumulated benefit of the named executive officer as of December 31, 2007. All amounts for United States pension plans were determined using the same interest and mortality assumptions as those used for financial reporting purposes. The following assumptions were used to calculate United States pension values at the following measurement dates: 2006 (for purposes of the column titled Change in Pension Value and Nonqualified Deferred Compensation Earnings in the 2007 Summary Compensation Table) discount rate of 5.90%, lump sum conversion rate of 4.90% and mortality based on the Society of Actuaries RP 2000 table (for discounting annuity payments) and the 1994 Group Annuity Reserving mortality table (for calculating lump sums), and 2007 discount rate of 6.27%, lump sum conversion rate of 5.27% and the same mortality tables used for 2006.

Table of Contents

Amounts for the German pension plans reflect an interest rate of 5.5% and an exchange rate of 1.4721 (the December 31 rate) for 2007 and an interest rate of 4.5% and an exchange rate of 1.32027 (the December 31 rate) for 2006. All executives are vested in their pension benefits.

(6) Ms. Wolf is entitled to receive a benefit from the AWWPP attributable to her prior period of employment from May 24, 1999 through December 1, 2003. This benefit is payable as a life annuity beginning at age 65. The fixed annual benefit amount of $17,748 will not increase or be affected in any way by Ms. Wolf s current period of employment.

For further information on American Water s defined benefit pension plans, see Potential Payments on Termination or Change in Control.

2007 Nonqualified Deferred Compensation

Name	Plan	Executive Contributions in Last FY ($)	Registrant Contributions in Last FY ($)(3)	Aggregate Earnings in Last FY ($)(4)	Aggregate Balance at Last FYE ($)
Donald L. Correll	Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries(1)		$ 38,109	$ 972	$ 54,626
Ellen C. Wolf	Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries(1)		$ 30,885	$ 896	$ 46,119
John S. Young	Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries(1)		$ 4,594	$ 281	$ 9,376
Walter J. Lynch	Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries(1)		$ 2,200	$ 100	$ 3,900
Paul G. Townsley	Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and its Designated Subsidiaries(1)		$ 1,271	$ 78	$ 2,599
Volker Heischkamp	RWE Executive Deferred Compensation Plan (A)(2)				$ 523,553(6)
	RWE Executive Deferred Compensation Plan (B)(2)	$ 133,180(5)		$ 3,503	$ 435,990(6)
	Total	$ 133,180	$ 77,059	$ 5,830	$ 1,076,163

(1) Different groups of employees participate in different portions of our deferred compensation plan. For the named executive officers, the deferred compensation plan permits the deferral of up to 20% of base salary and up to 100% of bonus each year on a tax-favored basis. It also provides for annual matching contributions determined by the following formula for named executive officers hired on or after January 1, 2006 (Mr. Correll and Ms. Wolf): (a) the sum of (i) 100% of a participant s voluntary deferrals for the year, up to a maximum of 3% of the sum of the participant s base salary and bonus and (ii) 50% of a participant s voluntary deferrals for the year, up to a maximum of the next 2% of the sum of the participant s base salary and bonus, less (b) the maximum amount of matching contributions that the participant is eligible to receive under the 401(k) plan for the year. For named executive officers hired before January 1, 2006 (Messrs. Young, Lynch and Townsley), the matching contribution formula is: (a) 50% of a participant s base salary deferrals for the year, up to a maximum of 5% of the participant s base salary, less (b) the maximum amount of matching contributions that the participant is eligible to receive under the 401(k) plan for the year. In addition, the Company makes additional annual contributions for named executive officers hired on or after January 1, 2006, equal to the sum of (a) 5.25% of the participant s base salary in excess of the dollar limitation in effect under Section 401(a)(17) of the Internal Revenue

Code with respect to the year and (b) 5.25% of the participant s bonus. The Company also made a one-time contribution to the accounts of named executive officers hired on or after January 1, 2006,

Table of Contents

equal in value to the amount of the Company contribution that would have been contributed to the plan pursuant to the formula in the preceding sentence for the period between the later of January 1, 2006 and the date the officer qualified for the plan, and December 31, 2007, plus an additional amount to reflect an assumed rate of earnings on such contribution. The named executive officers also received certain one-time special contributions from the Company. Participants deferred compensation accounts are credited with returns in accordance with the deemed investment options elected by the participant. Participants are immediately vested in all contributions to the plan, except for the 5.25% annual contributions made for Mr. Correll and Ms. Wolf, which vest at the earliest of (i) completion of five years of service, (ii) attainment of age 65, (iii) death and (iv) a change in control. Participants may elect to receive their account balances at any of the following times: (i) separation from service, (ii) a specified distribution date, (iii) the earlier of separation from service or a specified distribution date or (iv) the later of separation from service or a specified distribution date, and may elect any of the following forms for distribution of their accounts: (i) lump sum or (ii) annual installments paid over a period of between two and ten years. None of the named executive officers had any withdrawals or distributions from the plan in 2007.

(2) Dr. Heischkamp participates in two deferred compensation plans. The RWE Executive Deferred Compensation Plan (A) allowed executives to contribute their bonus payments in a minimum amount of 2,500 Euros per year and a maximum amount of one full bonus payment per year. No further contributions can be made to this plan, and none were made in 2007. The RWE Executive Deferred Compensation Plan (B) allows executives to make pre-tax contributions of fixed and variable compensation elements, such as salary, bonus and long-term incentive compensation, in amounts of at least 2,000 Euros per year. The amounts contributed to the plans are non-forfeitable. However, the amounts are not payable to Dr. Heischkamp until January 1, 2024.

(3) The amounts in this column are also included in the 2007 Summary Compensation Table in the All Other Compensation column.

(4) Amounts in the United States plans earned income at a rate of 6.25%. The calculation of earnings in the RWE Executive Deferred Compensation Plan (B) is based on the age of the participant at the time of the calculation and the maturity of the insurance. The actuarial interest rate of 2.75% and mortality are taken into account. The earnings also include an interest and risk surplus.

(5) This amount was converted from Euros using the March 1, 2007 (date of contribution) exchange rate of 1.3318.

(6) These amounts were converted from Euros using the December 31, 2007 exchange rate of 1.4721.

Potential Payments on Termination or Change in Control

This section describes the potential payments that would have been made upon various types of terminations of employment on December 31, 2007 to the named executive officers, and the actual payments made to Mr. Firnhaber on account of his termination. The initial public offering did not trigger any change in control provisions under our compensation plans and arrangements.

United States-based Named Executive Officers

American Water s employment agreements with its United States-based named executive officers do not provide for severance payments. However, the following plans and policies provide for payments upon various types of termination of employment. No plans or policies provide for payments upon a change in control of American Water that is not accompanied by a termination of employment, except that certain amounts may be paid with respect to long-term incentive awards upon such a change in control, as described below. In addition, certain amounts in our defined benefit and defined contribution retirement plans may vest upon a change in control, as described below.

Retention Bonuses. A retention bonus program was established in connection with American Water s initial public offering to retain employees in key leadership roles. For further description of the retention bonus program, see Compensation Discussion and Analysis Transaction-Related Bonuses Retention Bonuses. As explained in that section, RWE determined the retention bonus opportunities by doubling the target percentage opportunities that would have applied to the named executive officers long-term equity incentives (determined by RWE), had we granted such incentives in 2006, since the long-term equity incentives would have had the potential to pay out at levels significantly greater than target. Retention bonuses were payable to individuals who were involuntarily terminated without cause prior to the payment date under the program. American Water could, in its discretion, pay the retention bonuses upon death or disability of participants. Upon all other types of termination of employment, the retention bonuses would have been forfeited.

Executive Severance Policy. Our executive severance policy provides severance benefits to executives whose employment is involuntarily terminated by American Water for reasons other than cause. The determination of whether an executive s employment is terminated for cause will be made at the sole discretion

Table of Contents

of the board of directors of American Water. Under the policy, eligible executives will receive 12 or, in the case of Mr. Correll, 18, months of their base salary. Upon a termination of employment on December 31, 2007, the severance pay would have been paid in the form of base salary continuation or a lump sum payment, as elected by the executive. Executives are also entitled to receive a pro-rated annual incentive payment upon a termination under the executive severance policy. They are entitled to a number of months of continued health, dental, vision and life insurance coverage equal to the number of months of their severance benefits, 12 months of outplacement services and limited financial planning assistance As explained in Compensation Discussion and Analysis Elements of Compensation Executive Severance Policy, we decided upon the number of months of salary and continued health benefits to be paid as severance based on surveys that Towers Perrin has done and its experience in the general industry. In order to receive severance benefits under the executive severance policy, an executive must sign a release and waiver of any claims against American Water and agree to certain restrictive covenants. Any severance benefits payable under the severance policy will be offset and reduced by any other severance benefits payable under any employment agreement or otherwise.

Deferred Compensation Plans. Our deferred compensation plans are described under 2007 Nonqualified Deferred Compensation. This section describes the payments that would be made under those plans upon various types of termination. Since employees are immediately vested in all contributions to the plan other than the annual 5.25% Company contributions, they would receive their full account balances, minus such 5.25% contributions, upon any termination of employment other than for cause. Since participants do not vest in the 5.25% Company contributions until completion of five years of service, attainment of age 65, change in control or death, participants whose employment terminates before any such events would not receive amounts attributable to such contributions, and participants whose employment terminates after any such events would receive such amounts. The initial public offering was not considered a change in control for purposes of the plan. Upon a termination for cause, all Company contributions would be forfeited. Payments of vested amounts will be made at the time and in the form elected by the participant, except that a lump-sum distribution of vested amounts will be paid upon death. Amounts shown in the table assume commencement of benefits on December 31, 2007, and do not presume any potential delays due to Section 409A of the Internal Revenue Code.

Defined Benefit Plans.

Our retirement plans are described under 2007 Pension Benefits. This section describes the payments that would be made under the retirement plans upon various types of termination.

Voluntary termination Despite being ineligible for retirement, the executives would have been entitled to benefits from the ERP and AWWPP upon voluntary termination at December 31, 2007. Messrs. Young, Lynch and Townsley s ERP benefits are shown as payable as immediate lump sums upon voluntary termination. However, the executives could elect an immediate actuarial equivalent annuity of this lump sum. The annuity value of Mr. Young s AWWPP benefit payable as an unreduced age 62 66⅔% joint and survivor annuity is $110,699, which cannot be paid as a lump sum. The annuity value of Mr. Lynch s AWWPP benefit payable as an unreduced age 65 50% joint and survivor annuity is $9,610, which cannot be paid as a lump sum. The annuity value of Mr. Townsley s AWWPP benefit payable as an unreduced age 62 50% joint and survivor annuity is $21,836, which cannot be paid as a lump sum. Ms. Wolf s AWWPP benefit is payable as a single life annuity beginning at age 65. The life annuity benefit amount is $17,748. This benefit is not available as a lump sum.

Retirement None of the named executive officers were eligible for early or normal retirement on December 31, 2007.

Involuntary termination without cause Under the AWWPP, benefits payable upon a termination of employment without cause are in the same amount, have the same timing and are in the same form as those payable upon a voluntary termination. Under the nonqualified plans, upon an involuntary termination without cause, Messrs. Young, Lynch and Townsley would receive an additional 12 months of service credit for purposes of measuring eligibility for vesting, pursuant to the executive severance policy. However, they were already vested on December 31, 2007.

Table of Contents

Involuntary termination without cause following a change in control Upon an eligible termination of employment resulting from a change in control, nonqualified plan benefits may become vested at the discretion of our board of directors. For purposes of the tables, it has been assumed that our board of directors would have vested all nonqualified plan benefits if there had been a change in control on December 31, 2007. AWWPP benefits payable upon termination of employment resulting from a change in control are in the same amount, have the same timing and are in the same form as those payable upon a voluntary termination.

Termination for cause In the case of termination for cause, benefits payable from the AWWPP and from the nonqualified plans are in the same amount, have the same timing and are in the same form as those payable upon a voluntary termination.

Disability Benefits payable upon a termination of employment as a result of a disability are determined under the AWWPP and the nonqualified plans in the same manner as benefits payable upon voluntary termination except that disability benefits are payable immediately, without reduction for early commencement. AWWPP benefits are payable as annuities; nonqualified plan disability benefits are payable as lump sums unless the participant has elected an alternate form of payment. The named executive officers qualified for disability benefits on December 31, 2007, except for Mr. Lynch, who had not completed the required ten years of service and Ms. Wolf, who was not eligible due to her rehire status.

Death If Messrs. Young or Townsley had died on December 31, 2007, their surviving spouses or named beneficiaries would have received lifetime annuities equal to the benefits that would have been payable from the AWWPP and lump sums of the benefits that would have been payable from the ERP, calculated as if the executives had retired on the date of death and elected a 100% joint and survivor annuity. Messrs. Young and Townsley would have been treated as if they were age 55, and as if their spouses were the age that would produce the same age difference between them and their spouses as the actual age difference. The lump-sum value of the spouse s ERP benefit is based on the spouse s actual age at December 31, 2007. If Mr. Lynch had died on December 31, 2007, his surviving spouse or named beneficiary would have received benefits under the AWWPP and the ERP calculated as if he had survived to age 55, died on his 55th birthday and elected a 50% joint and survivor annuity. The benefit under the AWWPP would have been payable to Mr. Lynch as an annuity beginning at Mr. Lynch s 55th birthday based on the age 55 early retirement factor, the age 55 50% joint and survivor factor (where the survivor s age is what it would be on Mr. Lynch s 55th birthday) and using service as of the date of death. The benefit under the ERP would have been paid to Mr. Lynch as the immediate lump-sum equivalent of an annuity determined in the same manner as the AWWPP. Death benefits for Ms. Wolf s surviving spouse or named beneficiary under the AWWPP would have been calculated as if she had survived to age 55 and elected a 50% joint and survivor annuity. The benefit under the AWWPP would have been payable as an annuity beginning at Ms. Wolf s 55th birthday based on the age 55 early retirement factor, the age 55 50% joint and survivor factor (where the survivor s age is what it would be on Ms. Wolf s 55th birthday) and using service as of Ms. Wolf s termination date in 2003. For purposes of reporting these benefits on the termination tables, we assumed that the participants were all married with spouses the same ages as the participant.

Long-term Incentive Plan Payments. If a participant s employment is terminated for cause prior to the payment date of RWE s 2006-2008 or 2007-2009 long-term incentive plans, his or her performance shares will lapse without substitution or compensation. If a participant s employment is terminated without cause or due to retirement or disability prior to the payment date, his or her performance shares will pay out on the normal payment date. If a participant voluntarily terminates his or her employment, his or her performance shares will lapse without substitution or compensation. If a participant dies before the end of the vesting period, his or her performance shares will lapse and a compensatory payment equal to the grant value of 17.48 Euros per share for the 2006-2008 plan and 24.99 Euros per share for the 2007-2009 plan, pro-rated for service until death, will be provided.

Table of Contents

Germany-based Named Executive Officers

There is no formal severance policy for the Germany-based named executive officers. However, Mr. Firnhaber entered into a separation agreement with RWE that provided for the payment of certain severance benefits.

Mr. Firnhaber resigned effective August 1, 2007. He had previously entered into a separation agreement with RWE that provided that his employment with RWE, and his secondment to American Water, would officially have ended on June 30, 2008. However, it provided that he was entitled to end his employment prior to June 30, 2008 upon two weeks notice prior to a month s end, in which case his severance payment of 350,000 Euros (payable at the time of his last salary payment) would be increased by 20,354.17 Euros for each full month his employment was ended prior to June 30, 2008. Since Mr. Firnhaber s resignation was effective August 1, 2007, his severance payments were so increased. Mr. Firnhaber was entitled to a full short-term bonus for 2007 and a prorated bonus for 2008. For purposes of both bonuses, 100% of target was assumed to have been achieved. Mr. Firnhaber will be required to repay certain amounts of his severance payment if he becomes re-employed by a company majority-owned by the RWE group. Mr. Firnhaber was also entitled to reimbursement for outplacement consulting costs, including a lump-sum payment of 6,000 Euros for overnight expenses related to his outplacement and professional reorientation. He was entitled to his pension benefit, as provided under 2007 Pension Benefits.

Following a termination of employment on December 31, 2007, Dr. Heischkamp would have been entitled to receive his pension benefits, which are summarized above under 2007 Pension Benefits, his nonqualified deferred compensation benefits, as shown in the table below, and certain insurance benefits described below.

Deferred Compensation Plans. The RWE Executive Deferred Compensation Plan (A) allowed executives to contribute their bonus payments in a minimum amount of 2,500 Euros per year and a maximum amount of one full bonus payment per year. No further contributions can be made to this plan. The RWE Executive Deferred Compensation Plan (B) allows executives to make pre-tax contributions of fixed and variable compensation elements, such as salary, bonus and long-term incentive compensation, in amounts of at least 2,000 Euros per year. The amounts contributed to the plans are non-forfeitable by Dr. Heischkamp. However, the amounts are not payable to Dr. Heischkamp until January 1, 2024. No amounts are shown in the Early/Normal Retirement column in the table below for Dr. Heischkamp because Dr. Heischkamp was not eligible to retire on December 31, 2007. In the case of disability, the values in the table represent the redemption value, at December 31, 2007, of liability insurance that would have been payable to Dr. Heischkamp in the future. Amounts were converted from Euros to United States dollars based on the December 31, 2007 exchange rate of 1.4721.

Table of Contents

Quantifications of Potential Payments on Termination or Change in Control

The following table quantifies the potential payments and benefits to which the named executive officers would have been entitled upon a termination of employment on December 31, 2007. The amounts shown in the table do not include certain payments and benefits to the extent they are provided on a non-discriminatory basis to non-union employees generally upon a termination of employment, including the prorated annual incentive plan payment to which employees would be entitled upon certain terminations and, for United States-based employees, accrued salary and vacation pay, 401(k) plan benefits and continued welfare coverage under the Consolidated Omnibus Budget Reconciliation Act, which we refer to as COBRA. Retirement-eligible United States-based employees would be entitled to continued coverage under American Water s retiree welfare benefit plans. All United States-based employees are also entitled to life insurance benefits of up to 1.5 times base salary, up to a maximum amount of $200,000, if death occurs while actively employed. Germany-based employees are entitled to certain payments pursuant to a tax favorable direct insurance plan. Please see the 2007 Summary Compensation Table for further information on the 401(k) plan benefits to which the named executive officers are entitled and the 2007 Grants of Plan-Based Awards table for further information on 2007 annual incentive plan amounts with respect to the named executive officers. Long-term incentive plan amounts are also not included in the table below, but are described in the 2007 Summary Compensation Table, the 2007 Grants of Plan-Based Awards table, the 2007 Outstanding Equity Awards at Fiscal Year-End table and the 2007 Stock Vested table.

Name	Benefit	Voluntary Termination	Early/ Normal Retirement	Involuntary Termination without Cause	Involuntary Termination for Cause	Involuntary Termination without Cause following a Change in Control	Disability	Death
Donald L. Correll	Retention bonus			$ 660,005		$ 660,005	Subject to company discretion	Subject to company discretion
	Cash severance			$ 849,750		$ 849,750		
	Deferred compensation benefits	$ 23,622		$ 23,622		$ 54,626	$ 23,622	$ 54,626
	Health, welfare and life insurance benefits			$ 2,178		$ 2,178		
	Total	$ 23,622	$	$ 1,535,555	$	$ 1,566,559	$ 23,622	$ 54,626
Ellen C. Wolf	Retention bonus			$ 450,000		$ 450,000	Subject to company discretion	Subject to company discretion
	Cash severance			$ 463,500		$ 463,500		
	Deferred compensation benefits	$ 19,943		$ 19,943		$ 46,119	$ 19,943	$ 46,119
	Qualified pension benefits	$ 95,763		$ 95,763	$ 95,763	$ 95,763		$ 40,262
	Health, welfare and life insurance benefits			$ 7,236		$ 7,236		
	Total	$ 115,706	$	$ 1,036,442	$ 95,763	$ 1,062,618	$ 19,943	$ 86,381

Table of Contents

Name	Benefit	Voluntary Termination	Early/ Normal Retirement	Involuntary Termination without Cause	Involuntary Termination for Cause	Involuntary Termination without Cause following a Change in Control	Disability	Death
John S. Young	Retention bonus			$ 370,000		$ 370,000	Subject to company discretion	Subject to company discretion
	Cash severance			$ 412,000		$ 412,000		
	Deferred compensation benefits	$ 9,376		$ 9,376		$ 9,376	$ 9,376	$ 9,376
	Qualified pension benefits	$ 831,456		$ 831,456	$ 831,456	$ 831,456	$ 1,607,957	$ 1,027,944
	Nonqualified pension benefits	$ 627,655		$ 627,655	$ 627,655	$ 627,655	$ 1,213,826	$ 839,060
	Health, welfare and life insurance benefits			$ 14,688		$ 14,688		
	Total	$ 1,468,487	$	$ 2,265,175	$ 1,459,111	$ 2,265,175	$ 2,831,159	$ 1,876,380
Walter J. Lynch	Retention bonus			$ 216,000		$ 216,000		
	Cash severance			$ 350,000		$ 350,000		
	Deferred compensation benefits	$ 3,900		$ 3,900		$ 3,900	$ 3,900	$ 3,900
	Qualified pension benefits	$ 32,766		$ 32,766	$ 32,766	$ 32,766		$ 14,568
	Nonqualified pension benefits	$ 19,710		$ 19,710	$ 19,710	$ 19,710		$ 21,052
	Health, welfare and life insurance benefits			$ 14,688		$ 14,688		
	Total	$ 56,376	$	$ 637,064	$ 52,476	$ 637,064	$ 3,900	$ 39,520
Paul G. Townsley	Retention bonus			$ 208,000		$ 208,000		
	Cash severance			$ 278,000		$ 278,000		
	Deferred compensation benefits	$ 2,599		$ 2,599		$ 2,599	$ 2,599	$ 2,599
	Qualified pension benefits	$ 132,300		$ 132,300	$ 132,300	$ 132,300	$ 321,024	$ 181,081
	Nonqualified pension benefits	$ 188,192		$ 188,192	$ 188,192	$ 188,192	$ 420,208	$ 232,392
	Health, welfare and life insurance benefits			$ 14,688		$ 14,688		
	Total	$ 323,091	$	$ 823,779	$ 320,492	$ 823,779	$ 743,831	$ 416,072
Volker Heischkamp	RWE Executive Deferred Compensation Plan A	$ 469,555		$ 469,555	$ 469,555	$ 469,555	$ 261,948	$ 371,294
	RWE Executive Deferred Compensation Plan B	$ 391,023		$ 391,023	$ 391,023	$ 391,023	$ 264,965	$ 387,881

Total	$ 860,578	$	$ 860,578	$ 860,578	$ 860,578	$ 526,913	$ 759,175

Table of Contents

2007 Director Compensation

Name	Fees Earned or Paid in Cash ($)	Total ($)
Martha Clark Goss	$ 77,500	$ 77,500
George MacKenzie, Jr.	$ 164,500(1)	$ 164,500
William J. Marrazzo	$ 78,500	$ 78,500

(1) This amount includes an additional fee of $5,000 per month paid to Mr. MacKenzie for assisting in the search for additional members for our board of directors, as well as $19,592 paid to Mr. MacKenzie for his services as a director and Audit Committee member of the board of directors of Pennsylvania-American Water Company, a wholly owned subsidiary of the Company.

Our non-employee directors receive an annual retainer of $40,000 per year, payable in quarterly installments of $10,000, for their service to our board of directors, plus a fee of $2,000 for each board of directors meeting attended. Additionally, effective as of March 31, 2007, directors are paid $1,000 for each interim telephonic board meeting attended. Each member of the Audit Committee receives a fee of $1,500 for each Audit Committee meeting attended. On September 14, 2007, our board of directors designated a Nominating/Corporate Governance Committee and a Compensation Committee. Each member of either of these committees receives a fee of $1,500 for each meeting of the applicable committee attended. The non-employee directors are reimbursed for expenses incurred in attending board and committee meetings. Directors who are employees of the Company or one of its subsidiaries do not receive retainers or attendance fees. Our non-employee director remuneration policy will be revised in the future. The annual retainer for non-employee directors will decrease to $35,000. The Chairman of the board of directors will receive an additional annual retainer of $25,000, and the Chairman of the Audit Committee will receive an additional annual retainer of $10,000. The Chairman of the Nominating/Corporate Governance Committee and the Compensation Committee will receive an additional annual retainer of $5,000.

During 2007, there were eight meetings of our board of directors, nine interim telephonic board meetings, eight Audit Committee meetings, one Nominating/Corporate Governance Committee meeting and one Compensation Committee meeting.

The Company has recently established a deferred compensation plan for non-employee directors pursuant to which they may defer up to 100% of their fees on a tax-deferred basis. Directors may elect to receive their deferrals upon (i) separation from service, (ii) a specified date, (iii) the earlier of separation from service, a specified date, a change in control or any combination of these events or (iv) the later of separation from service or a specified date or, if earlier, a change in control, and may elect to receive their deferrals in the form of a lump sum or annual installments paid over a period of between two and ten years. Amounts will be paid earlier upon death of a director. Directors are immediately vested in their contributions to the plan. Accounts of directors are credited with returns in accordance with the deemed investment options elected by the director.

In connection with the initial public offering, each of our non-employee directors was granted awards under the 2007 Omnibus Equity Compensation Plan with a total value of $40,000, 60% of which were in the form of stock options and 40% of which were in the form of restricted stock units. The Chairman of the board of directors was granted additional awards under the plan with a total value of $30,000, 60% of which were in the form of stock options and 40% of which were in the form of restricted stock units. The awards will vest on January 1, 2011 if the director remains on the board of directors until such time, or earlier upon death or disability. A prorated portion of the awards will vest upon retirement. Directors will be required to hold the shares underlying their awards until they own shares equal in value to 300% of their annual retainer.

2007 Omnibus Equity Compensation Plan

American Water has adopted a new equity incentive compensation plan in connection with its initial public offering, the American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan, which we refer to as the 2007 Plan. The following is a summary of the material terms of the 2007 Plan, but does not include all

Table of Contents

of the provisions of the 2007 Plan. For further information about the 2007 Plan, we refer you to the complete copy of the 2007 Plan, which we have filed as an exhibit to the registration statement of which this prospectus is a part.

Purpose. The purpose of the 2007 Plan is to provide designated employees of American Water and its subsidiaries and non-employee members of the board of directors of American Water with the opportunity to receive grants of equity-based awards. American Water believes that the 2007 Plan will encourage participants to contribute materially to the growth of the company, thereby benefiting American Water s stockholders, and will align the economic interests of the participants with those of the stockholders.

Administration. The 2007 Plan is administered and interpreted by the Committee. For purposes of the 2007 Plan, Committee means: (i) with respect to grants to employees, the compensation committee of our board of directors or another committee appointed by our board of directors to administer the plan, (ii) with respect to grants to non-employee directors, our board of directors and (iii) with respect to grants that are intended to be qualified performance-based compensation under section 162(m) of the Internal Revenue Code, a committee that consists of two or more persons appointed by our board of directors, all of whom must be outside directors as defined under section 162(m) of the Internal Revenue Code and related Treasury regulations.

The Committee has the sole authority to (i) determine participants, (ii) determine the type, size and terms and conditions of the grants, (iii) determine the date of grant and the duration of any applicable exercise or restriction period, including the criteria for exercisability and acceleration of exercisability, (iv) amend the terms and conditions of any previously issued grant and (v) deal with any other matters arising under the 2007 Plan.

Grants. Grants under the 2007 Plan may consist of stock options, stock units, stock awards, stock appreciation rights, which we refer to as SARs, and other stock-based awards.

Shares Subject to Plan. The total aggregate number of shares of common stock that may be issued under the 2007 Plan is 6,000,000, subject to adjustment as described below.

Shares issued under the 2007 Plan may be authorized but unissued shares of American Water common stock or reacquired shares of American Water common stock, including shares purchased by American Water on the open market for purposes of the 2007 Plan. If any options or SARs granted under the 2007 Plan terminate, expire or are canceled, forfeited, exchanged or surrendered without having been exercised, and if any stock awards, stock units or other stock-based awards are forfeited or terminated, or otherwise are not paid in full, the shares reserved for such grants will again be available for purposes of the 2007 Plan. Shares of stock surrendered in payment of the exercise price of an option, and shares withheld or surrendered for payment of taxes, will not be available for re-issuance under the 2007 Plan. If SARs are granted, the full number of shares subject to the SARs will be considered issued under the 2007 Plan, without regard to the number of shares issued upon exercise of the SARs and without regard to any cash settlement of the SARs. To the extent that a grant of stock units is designated in the grant agreement to be paid in cash, such grants will not count against the 2007 Plan s share limitations.

The maximum aggregate number of shares of American Water common stock with respect to which all grants may be made under the 2007 Plan to any individual during any calendar year will be 500,000 shares, subject to adjustment as described below. The individual limit will apply without regard to whether the grants are to be paid in stock or cash. For purposes of applying the limit, all cash payments (other than with respect to dividend equivalents) will be converted into a number of shares based on the fair market value of the shares to which the cash payments relate. A participant may not accrue dividend equivalents during any calendar year in excess of $750,000.

If there is any change in the number or kind of shares of American Water common stock outstanding (i) by reason of a stock dividend, spinoff, recapitalization, stock split, or combination or exchange of shares, (ii) by

Table of Contents

reason of a merger, reorganization or consolidation, (iii) by reason of a reclassification or change in par value or (iv) by reason of any other extraordinary or unusual event affecting the outstanding stock as a class without American Water s receipt of consideration, or if the value of outstanding shares of American Water common stock is substantially reduced as a result of a spinoff or American Water s payment of an extraordinary dividend or distribution, the maximum number of shares of common stock available for issuance under the 2007 Plan, the maximum number of shares of common stock for which any individual may receive grants in any year, the kind and number of shares covered by outstanding grants, the kind and number of shares issued and to be issued under the 2007 Plan, and the price per share or the applicable market value of such grants will be equitably adjusted by the Committee to reflect any increase or decrease in the number of, or change in the kind or value of, the issued shares of American Water common stock to preclude, to the extent practicable, the enlargement or dilution of rights and benefits under the 2007 Plan and such outstanding grants; provided, however, that any fractional shares resulting from such adjustment will be eliminated. Any adjustments to outstanding grants will be consistent with Section 409A or 422 of the Internal Revenue Code, to the extent applicable. Any adjustments determined by the Committee will be final, binding and conclusive.

Eligibility for Participation. Certain employees and non-employee directors are eligible to participate in the 2007 Plan. The Committee will select the participants to receive grants and will determine the number of shares subject to each grant.

Options. The Committee may grant incentive stock options, which we refer to as ISOs, or nonqualified stock options, which we refer to as NSOs, or any combination of the two. ISOs may be granted only to employees of American Water or its parents or subsidiaries. NSOs may be granted to employees or non-employee directors. The exercise price per share of common stock subject to an option may be equal to or greater than the fair market value of a share of common stock on the date the option is granted. However, an ISO may not be granted to an employee who, at the time of grant, owns stock possessing more than 10% of the total combined voting power of all classes of common stock of American Water or any parent or subsidiary, unless the exercise price per share is not less than 110% of the fair market value per share of American Water stock on the grant date. The term of each option will not exceed ten years from the date of grant. However, an ISO that is granted to an employee who, at the time of grant, owns stock possessing more than 10% of the total combined voting power of all classes of common stock of American Water or any parent or subsidiary, may not have a term that exceeds five years from the date of grant.

Options will become exercisable in accordance with the terms and conditions specified in the grant agreement. Options may be granted that are subject to achievement of performance goals or other conditions. The Committee may accelerate the exercisability of any or all outstanding options at any time for any reason.

The Committee may provide in a grant instrument that the participant may elect to exercise part or all of an option before it otherwise has become exercisable. Any shares so purchased will be restricted shares and will be subject to a repurchase right in favor of American Water during a specified restriction period, with the repurchase price equal to the lesser of (a) the exercise price or (b) the fair market of such shares at the time of repurchase, or such other restrictions as the Committee deems appropriate.

The participant may pay the exercise price for the option (i) in cash, (ii) if permitted by the Committee, by delivering shares of common stock having a fair market value equal to the exercise price, (iii) by payment through a broker or (iv) by such other method as the Committee may approve.

If the aggregate fair market value on the date of grant of the stock with respect to which ISOs are exercisable for the first time by a participant during any calendar year, under any stock option plan of American Water or a parent or subsidiary, exceeds $100,000, then the option, as to the excess, will be treated as a NSO.

The Committee has not formalized any procedures regarding grants of stock options.

Table of Contents

Stock Units. The Committee may grant stock units that are payable on terms and conditions determined by the Committee, which may include payment based on achievement of performance goals. Payment with respect to stock units may be made in cash, in common stock or in a combination of the two. Stock units may be paid at the end of a specified vesting or performance period, or payment may be deferred to a date authorized by the Committee. The Committee may grant dividend equivalents in connection with stock units.

Stock Awards. Shares of common stock issued pursuant to stock awards may be issued for cash consideration or for no cash consideration, and subject to restrictions or no restrictions. Any restrictions may lapse over a specified vesting or performance period. While stock awards are subject to restrictions, a participant may not sell, assign, transfer, pledge or otherwise dispose of the shares of a stock award except upon death subject to certain conditions. The Committee will determine whether participants will have the right to vote shares of stock awards and to receive any dividends or other distributions paid on such shares during the restriction period.

Stock Appreciation Rights. An SAR is the right to receive an amount equal to the amount by which the fair market value of the American Water common stock underlying the SAR on the date of exercise of the SAR exceeds the base amount of the SAR, or the stock appreciation for the SAR. The base amount of each SAR will not be less than the fair market value of a share of common stock as of the grant date. SARs may be subject to achievement of performance goals or other conditions. The Committee may accelerate the exercisability of any or all outstanding SARs at any time for any reason. SARs may be granted separately or in tandem with an option. A tandem SAR is only exercisable while the option to which it is related is exercisable. The stock appreciation for an SAR may be paid in the form of shares of common stock, cash or a combination of the two.

Other Stock-Based Awards. Other stock-based awards may be granted subject to achievement of performance goals or other conditions and may be payable in common stock or cash, or in a combination of the two, as determined in the grant agreement.

Qualified Performance-Based Compensation. The Committee may determine that awards are intended to qualify as qualified performance-based compensation for purposes of Section 162(m) of the Internal Revenue Code. If an award is intended to so qualify, the Committee will establish in writing (i) the objective performance goals that must be met, (ii) the period during which performance will be measured, (iii) the maximum amounts that may be paid if the performance goals are met and (iv) any other conditions that the Committee deems appropriate. The performance goals will satisfy the requirements for qualified performance-based compensation under Section 162(m) of the Internal Revenue Code. The Committee will use objectively determinable performance goals based on one or more of the following criteria: stock price, earnings per share, price-earnings multiples, net earnings, operating earnings, revenue, number of days sales outstanding in accounts receivable, productivity, margin, EBITDA (earnings before interest, taxes depreciation and amortization), net capital employed, return on assets, stockholder return, return on equity, return on capital employed, growth in assets, unit volume, sales, cash flow, market share, relative performance to a comparison group designated by the Committee, or strategic business criteria consisting of one or more objectives based on meeting specified revenue goals, market penetration goals, customer growth, geographic business expansion goals, cost targets or goals relating to acquisitions or divestitures. The performance goals may relate to one or more business units or the performance of American Water and its subsidiaries as a whole, or any combination of the foregoing. The Committee will certify the performance results for the performance period specified in the grant agreement after the performance period ends, and will determine the amount, if any, to be paid pursuant to each grant based on the achievement of the performance goals and the satisfaction of all other terms and conditions of the grant agreement.

The Committee may provide in the grant agreement that grants will be payable, in whole or in part, in the event of the participant s death or disability, a change in control or other circumstances consistent with the Treasury regulations and rulings under section 162(m) of the Internal Revenue Code.

Table of Contents

Deferrals. A participant may be permitted or required to defer receipt of the payment of cash or the delivery of shares that would otherwise be due to the participant in connection with any grant.

Withholding of Taxes. All grants under the 2007 Plan will be subject to applicable federal, state and local tax withholding requirements. If the Committee so permits, shares of common stock may be withheld to satisfy the Company s tax withholding obligation with respect to grants paid in common stock, at the time such grants become taxable, up to an amount that does not exceed the minimum applicable withholding tax rate for federal, state and local tax liabilities.

Transferability of Grants. A participant may not transfer exercise rights under a grant except by will or by the laws of descent and distribution. However, a participant may transfer NSOs to family members, or one or more trusts or other entities for the benefit of or owned by family members, consistent with applicable securities laws; provided that the participant receives no consideration for the transfer of an NSO and the transferred NSO will continue to be subject to the same terms and conditions as were applicable immediately before the transfer.

Consequences of a Change in Control. In the event of a change in control, the Committee may take any one or more of the following actions with respect to any or all outstanding grants, without the consent of any participant: (i) determine that outstanding options and SARs will become fully exercisable, and restrictions on outstanding stock awards and stock units will lapse, (ii) require that participants surrender their outstanding options and SARs in exchange for one or more payments by the Company, in cash or common stock, in an amount equal to the amount, if any, by which the then fair market value of the shares of common stock subject to the options and SARs exceeds the exercise price, (iii) after giving participants an opportunity to exercise their outstanding options and SARs, terminate any or all unexercised options and SARs, (iv) with respect to participants holding stock units and other stock-based awards, determine that such participants will receive one or more payments in settlement of such stock units and other stock-based awards, in such amount and form and on such terms as may be determined by the Committee, or (v) determine that all outstanding options and SARs that are not exercised will be assumed by, or replaced with comparable options or rights of, the surviving corporation (or a parent or subsidiary of the surviving corporation), and other outstanding grants that remain in effect after the change in control will be converted to similar grants of the surviving corporation (or a parent or subsidiary of the surviving corporation). Such acceleration, surrender, termination, settlement or conversion will take place as of the date of the change in control or such other date as the Committee may specify. The Committee may provide in a grant agreement that a sale or other transaction involving a subsidiary or other business unit of the Company will be considered a change in control for purposes of a grant.

A change in control will generally be deemed to have occurred for purposes of the 2007 Plan upon any person becoming the beneficial owner of securities representing more than 50% of the voting power of the then outstanding securities of American Water; the consummation of a merger or consolidation of American Water with another corporation where the stockholders of American Water immediately prior to the merger or consolidation do not beneficially own, immediately after the merger or consolidation, shares entitling such stockholders to more than 50% of all votes to which all stockholders would be entitled in the election of directors; a sale or disposition of all or substantially all the assets of American Water; a liquidation or dissolution of American Water; or the election of directors of American Water such that a majority of the members of the board of directors will have been on the board of directors for less than one year, unless the election or nomination for election of each new director who was not a director at the beginning of such one-year period was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of such period. A change in control was not deemed to have occurred as a result of American Water s initial public offering.

Requirements for Issuance of Shares. No common stock will be issued in connection with any grant unless and until all legal requirements applicable to the issuance of such common stock have been complied with to the satisfaction of the Committee.

Table of Contents

Amendment and Termination. Our board of directors may amend or terminate the 2007 Plan at any time; provided, however, that our board of directors will not amend the 2007 Plan without approval of our stockholders if such approval is required in order to comply with the Internal Revenue Code or applicable laws, or to comply with applicable stock exchange requirements. No amendment or termination of the 2007 Plan will, without the consent of the applicable participant, materially impair any rights or obligations under any grant previously made to a participant under the 2007 Plan, unless such right has been reserved in the 2007 Plan or the grant agreement.

Notwithstanding anything in the 2007 Plan to the contrary, the Committee may not reprice options or SARs, nor may our board of directors amend the 2007 Plan to permit repricing of options or SARs, unless the stockholders of the Company provide prior approval for such repricing.

The 2007 Plan will terminate on the day immediately preceding the tenth anniversary of its effective date, unless it is terminated earlier by our board of directors or is extended by our board of directors with the approval of our stockholders.

Nonqualified Employee Stock Purchase Plan

American Water has recently adopted a new employee stock purchase plan, the American Water Works Company, Inc. Nonqualified Employee Stock Purchase Plan, which we refer to as the ESPP. No purchase periods have begun under the ESPP. The ESPP is not intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. The following is a summary of the material terms of the ESPP, but does not include all of the provisions of the ESPP. For further information about the ESPP, we refer you to the complete copy of the ESPP, which we have filed as an exhibit to the registration statement of which this prospectus is a part.

Purpose. The purpose of the ESPP is to encourage employee stock ownership by allowing employees to purchase shares of the Company s common stock at a discount from the fair market value.

Administration. The ESPP will be administered by a committee appointed by the Board of Directors. The committee will have the express discretionary authority and power to administer the ESPP and to make, adopt, construe and enforce rules and regulations not inconsistent with the provisions of the ESPP. The committee will have the fullest discretion permissible under law in the discharge of its duties. The committee s interpretations and decisions with respect to the ESPP will be final and conclusive.

Eligibility. Each employee of the Company, including part-time employees, but other than employees who are members of a collective bargaining unit, employees of non-U.S. subsidiaries (unless the committee specifically designates otherwise) and employees who terminate employment, die or become disabled prior to the end of a purchase period, is eligible to participate in the ESPP.

Purchase Periods. Purchase periods under the ESPP will consist of three-month periods corresponding to the calendar quarter, or such other periods as specified by the committee administering the ESPP.

Participation. An eligible employee may elect to participate in the ESPP by properly executing a purchase agreement and filing it with the committee. The purchase agreement will authorize after-tax payroll deductions from the participant s compensation (which is defined as base wages, exclusive of overtime pay, commissions, cash bonuses, premium pay, shift differential pay, any compensation reductions made in connection with plans described in Section 401(k), 125 or 132(f)(4) of the Internal Revenue Code, and any other extraordinary remuneration, as determined by the committee in its sole and absolute discretion) for the purpose of funding the purchase of stock. Each participant will authorize the withholding of a percentage of each payment of compensation during the purchase period, which will be in one percent increments. The committee administering the plan may also allow participants to deposit funds with the Company to be used for the purpose of purchasing stock, in addition to payroll deductions. The committee will designate the dates by which any such deposits must be made for a purchase period.

Table of Contents

Maximum Deduction Amount. The total amount that a participant may contribute to the ESPP during a purchase period (through payroll deductions and deposits) may not exceed, unless otherwise adjusted by the committee administering the ESPP, the lesser of: (i) 10% of each payment of compensation paid to the participant during the purchase period and (ii) $25,000.

Purchase Price of Shares. Unless the committee determines otherwise, the purchase price per share of stock to be sold to participants under the ESPP will be the lesser of: (i) 90% of the market value of a share of the Company s common stock on the purchase date (the last trading day of a purchase period) and (ii) 90% of the market value of a share of the Company s common stock on the first trading date of the purchase period. Market value is defined as the last price for the Company s common stock as reported on the New York Stock Exchange for the applicable date. If there was no such price reported for the applicable date, market value means the last reported price for the stock on the day next preceding the applicable date for which such price was reported or, if there was no such reported price the fair market value of a share of stock as determined by the committee administering the plan.

Purchases. As of the first day of each purchase period, each participant will be granted an option to purchase shares of Company common stock at the purchase price described above. The option will continue in effect through the purchase date for the purchase period. On each purchase date, the participant will automatically be deemed to have exercised his or her option to purchase shares of stock, unless he or she notifies the committee or its delegate, in such manner and at such time in advance of the purchase date as the committee will prescribe, of his or her desire to forfeit such option and, subject to any restrictions that may be imposed by the committee, to receive a refund of any outstanding amounts that have been deducted pursuant to the participant s purchase agreement or contributed for the purchase of stock. On each purchase date, there will be purchased for the participant, at the purchase price for the purchase period, the largest number of shares of stock as can be purchased with the participant s accumulated payroll deductions or additional deposits, subject to the plan maximums described below. In the event that any amounts that are attributable to a participant s deductions or contributions remain after the purchase of shares of stock on a purchase date, such amounts will be returned to the participant, as soon as administratively practicable.

Holding Period. Participants are required to hold stock purchased under the ESPP for six months following each purchase date. The holding period will be deemed satisfied as of the date of a participant s death.

Cessation of Participation. A participant may voluntarily cease participating in the ESPP and stop payroll deductions at any time by filing a notice of cessation of participation on such form and at such time in advance of the purchase date as the committee will prescribe. A participant who ceases contributions during a purchase period may not make additional contributions to the plan during the purchase period and may request payment of any funds held for the participant under the ESPP on such form and at such time in advance of the purchase date as the committee will prescribe.

Shares Subject to Plan. There are 2.0 million shares of stock reserved for issuance or transfer under the ESPP, subject to adjustment as described below. The committee may increase the number of shares of stock available for issuance under the ESPP by up to 2.0 million shares annually, subject to adjustment.

Limitation on Shares to be Purchased. The maximum number of shares of stock that may be purchased for each participant on a purchase date is the least of: (i) the number of shares of stock that can be purchased by applying the full balance of the participant s deducted or deposited funds to the purchase of shares of stock at the purchase price, (ii) the participant s proportionate part of the maximum number of shares of stock available under the plan and (iii) 5,000 shares of stock. Before the beginning of a purchase period, the committee may increase or decrease the maximum share limit for the purchase period and subsequent purchase periods. The adjusted maximum share limit will continue in effect until again adjusted by the committee. Any amounts deducted from a participant s compensation that cannot be applied to the purchase of stock on a purchase date by reason of the foregoing limitations will be returned to the participant, as soon as administratively practicable.

Table of Contents

Issuance of Shares. The shares of stock purchased by a participant on a purchase date will, for all purposes, be deemed to have been issued or sold at the close of business on the purchase date. Prior to that time, none of the rights or privileges of a shareholder of the Company will inure to the participant with respect to such shares of stock. All the shares of stock purchased under the ESPP will be delivered by the Company in a manner as determined by the committee following the participant s satisfaction of the applicable holding period. The committee, in its sole discretion, may determine that shares of stock will be delivered by: (i) issuing and delivering the number of shares of stock purchased to a firm that is a member of the National Association of Securities Dealers, as selected by the committee from time to time, which shares will be maintained by such firm in a separate brokerage account for each participant or (ii) issuing and delivering the number of shares of stock purchased by participants to a bank or trust company or affiliate thereof, as selected by the committee from time to time, which shares may be held by such bank or trust company or affiliate in street name, but with a separate account maintained by such entity for each participant reflecting such participant s share interests in the stock. A participant may request a distribution of shares of stock purchased for the participant under the ESPP or order the sale of such shares following the participant s satisfaction of the applicable holding period, by making a request in such form and at such time as the committee will prescribe. If a participant terminates his or her employment with the Company or otherwise ceases to be an eligible employee, following the participant s satisfaction of the applicable holding period, the participant will receive a distribution of his or her shares of stock held in any shareholder account, which will be effectuated by the committee in any manner that it deems reasonable and appropriate, as determined by the committee in its sole and absolute discretion or, in lieu of the receipt of shares of stock, the participant may alternatively elect to instead have the shares of stock sold, in accordance with such procedures as the committee will prescribe. If a participant is to receive a distribution of shares of stock, or if shares are to be sold, the distribution or sale will be made in shares of stock. Any brokerage commissions resulting from a sale of stock will be deducted from amounts payable to the participant.

Shares Unavailable. If, on any purchase date, the aggregate funds available for the purchase of stock would otherwise permit the purchase of a number of shares stock in excess of the number then available for purchase under the ESPP, the following adjustments will be made: (i) the number of shares of stock that would otherwise be purchased by each participant will be proportionately reduced on the purchase date in order to eliminate such excess and (ii) the ESPP will automatically terminate immediately after the purchase date as of which the supply of available shares is exhausted, unless the board of directors of the Company determines otherwise.

Anti-Dilution Provisions. The aggregate number of shares of stock reserved for purchase under the ESPP, the maximum number of shares of stock that may be purchased by a participant and the calculation of the purchase price per share may be appropriately adjusted by the committee administering the plan to reflect any increase or decrease in the number of issued shares of stock resulting from a subdivision or consolidation of shares or other capital adjustment, the payment of a stock dividend or other increase or decrease in the shares, if effected without receipt of consideration by the Company.

Effect of Certain Transactions. Subject to any required action by the shareholders, if the Company is the surviving corporation in any merger or consolidation, any offering under the ESPP will continue to pertain to and apply to the shares of stock of the Company. However, in the event of a dissolution or liquidation of the Company, or a merger or consolidation in which the Company is not the surviving corporation, the ESPP and any offering under the ESPP will terminate upon the effective date of such dissolution, liquidation, merger or consolidation, unless the board of directors of the Company determines otherwise, and the balance of any amounts deducted from a participant s compensation or deposited to the ESPP by the participant that have not by such time been applied to the purchase of stock will be returned to the participant.

Withholding of Taxes. All acquisitions and sales of stock under the ESPP will be subject to applicable federal, state and local tax withholding requirements. The Company may require that participants pay to the Company (or make other arrangements satisfactory to the Company for the payment of) the amount of any federal, state or local taxes that the Company is required to withhold with respect to the purchase of stock or the sale of stock acquired under the ESPP, or instead deduct from the participant s wages or other compensation the amount of any withholding taxes due with respect to the purchase of stock or the sale of stock acquired under the ESPP.

Table of Contents

Amendment and Termination. The board of directors of the Company may, at any time and from time to time, amend the ESPP in any respect, except that any amendment that is required to be approved by the shareholders of the Company will be submitted to the shareholders for approval. The ESPP will continue in effect for ten years from its effective date, unless terminated prior to that date pursuant to the provisions of the ESPP or pursuant to action by the board of directors of the Company. The board of directors of the Company will have the right to terminate the ESPP at any time without prior notice to any participant and without liability to any participant. Upon the expiration or termination of the ESPP, the balance, if any, then standing to the credit of each participant from amounts deducted from the participant s compensation or deposited by the participant that has not, by such time, been applied to the purchase of stock will be refunded to the participant.

Table of Contents

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Relationships and Transactions with RWE and its Affiliates

American Water Works Company, Inc. was acquired in 2003 by RWE for approximately $4.6 billion as a stand-alone entity and has continued to operate as such during the period it has been owned by RWE. Since 2003 and prior to the initial public offering, the Company was an indirect wholly owned subsidiary of RWE. RWE has not historically provided any material central corporate functions to the Company.

RWE has provided certain financings for the Company and its subsidiaries primarily through AWCC. These financings have included short-term and long-term borrowings under credit facilities and other debt instruments. The largest aggregate principal amount of indebtedness owed to RWE since January 1, 2005 was $4,483.8 million. All such indebtedness was incurred at market rates and has been repaid in connection with the Transactions. Interest expense with regard to such indebtedness was $26.8 million in 2007, $131.1 million in 2006 and $93.9 million in 2005.

Thames Water Investments Luxembourg S.a r.l., a wholly owned subsidiary of RWE, was the holder of $1,750.0 million of the Company s preferred stock. Preferred dividends included in interest expense were $74.6 million in 2007, $103.3 million in 2006 and $103.3 million in 2005. The preferred stock has been redeemed at the price of $1,750.0 million in connection with the Transactions.

Thames Water, a former wholly owned subsidiary of RWE, has provided certain management services to the Company for which we paid $1.4 million in 2006 and $9.1 million in 2005. These management services have been terminated as a result of RWE s sale of Thames Water and no amounts were paid in 2007.

Thames Water International Services Limited, a former wholly owned subsidiary of RWE, has provided expatriate employees to the Company, for which we paid $1.8 million in 2006 and $5.0 million in 2005. These arrangements have been terminated as a result of RWE s sale of Thames Water and no amounts were paid in 2007.

Consulting services provided by KPMG LLP to the Company were paid by RWE in the amount of $1.1 million and $0.1 million in 2006 and 2007, respectively.

RWE Systems AG, a wholly owned subsidiary of RWE, is a party to a Microsoft Enterprise Agreement for the benefit of RWE s subsidiaries, including the Company. The Company paid 1,569 Euros in 2005, 860,016 Euros in 2006 and 989,271 Euros in 2007 to RWE Systems AG for licenses and software assurance provided under the agreement.

The Company believes that the transactions and agreements set forth above were on terms comparable to those the Company could have obtained from unaffiliated third parties.

Agreements Between RWE and the Company

This section provides a summary description of agreements entered into between RWE and the Company upon the consummation of the initial public offering. Each of these agreements has been filed as an exhibit to the registration statement of which this prospectus is a part. The description of these agreements is not complete and, with respect to each such agreement, is qualified by reference to the terms of such agreement. We encourage you to read the full text of these agreements.

Table of Contents

The Company negotiated the separation agreement and registration rights agreement with RWE while it was a wholly owned subsidiary of RWE. The terms of these agreements may be less favorable to the Company than those we could have obtained in arm s length negotiations of similar agreements with unaffiliated third parties.

Separation Agreement

The separation agreement contains the key provisions relating to our separation from RWE. The separation agreement provides that the Company and RWE, subject to certain limited exceptions, are each responsible only for their own businesses and operations and any liabilities arising in connection therewith. Accordingly, the separation agreement provides, among other things, that:

- subject to certain exceptions, the Company assumed all liabilities of RWE and its affiliates related to the Company s business;
- subject to certain exceptions, all agreements, arrangements, commitments or understandings between the Company and its affiliates, on the one hand, and RWE and its affiliates, on the other, were terminated;
- the Company and RWE released each other from certain pre-separation liabilities and will indemnify each other against certain liabilities;
- the Company and RWE provided each other with certain information and documents and, in particular, the Company provided RWE with certain financial statements and reports, including specified quarterly and monthly reports, and will do so for so long as RWE holds specified percentages of the Company s voting power; and
- the Company and RWE will cooperate with each other with respect to certain matters following the separation and, in particular, the Company will perform certain regulatory obligations of RWE.

Registration Rights Agreement

The registration rights agreement provides RWE with certain registration rights relating to the remaining shares of our common stock held by RWE after the consummation of the initial public offering. The registration rights agreement provides RWE with priority in registering and selling its shares of the Company s stock in any future issuance and sale of stock by the Company, except that the Company will have the rights to issue and sell an agreed amount of stock and equity units sufficient to meet the Company s currently expected equity needs. Accordingly, the registration rights agreement provides that:

- subject to certain restrictions and limitations, RWE may at any time require the Company at its own expense to register for offer and sale all or a portion of the shares held by RWE;
- subject to certain restrictions and limitations, RWE may require the Company at its own expense to include all or a portion of the shares held by RWE under a registration statement to be filed by the Company;
- other than with respect to an agreed amount of stock sufficient to meet the Company s currently expected equity needs that may be issued and sold by the Company, the Company will not file any registration statement relating to the sale of the Company s stock without RWE s consent; and

the Company and RWE will indemnify each other against certain liabilities related to such registrations.

Relationships and Transactions with Current or Former Officers of the Company

The Company maintains agreements with both public and private water providers for the purchase of water to supplement its water supply, particularly during periods of peak demand. Donald L. Correll, our President and Chief Executive Officer, is a Commissioner of the New Jersey Water Supply Authority. The Company paid

Table of Contents

approximately $16.8 million in 2007, $16.4 million in 2006 and $16.7 million in 2005 to the New Jersey Water Supply Authority for purchased water. The estimated minimum commitment to purchase water under this agreement is $14.9 million for 2008.

Walter Howard, who was our Senior Vice President, Sales and Business Development from October 2005 to March 2008, served as the chief executive officer of Poseidon Resources Corporation, which we refer to as Poseidon Corp., until 2001. Pursuant to the terms of a settlement agreement entered into by Mr. Howard, Poseidon Corp. and Poseidon Resources, LLC, which we refer to as Poseidon, in 2004, Mr. Howard agreed to surrender all of his outstanding shares of Poseidon Corp. stock in exchange for, among other things, a contingent cash payment in the amount of $300,726. The contingent payment is payable at such time as Poseidon has distributable proceeds equal to or in excess of $300,726. Distributable proceeds consist of any amount (from any source) that is available for distribution to the holders of preferred units or common units in Poseidon on account of their ownership of such units.

American Water, together with certain other parties, has signed a contract with Poseidon pursuant to which each will provide funds to Poseidon to complete the development of its desalination plant in Carlsbad, California. Although the funds that will be provided by American Water will be used solely for the development of the Carlsbad facility, the transaction may indirectly result in distributable proceeds for Poseidon and subsequent payment to Mr. Howard if the facility is profitable.

The Company believes that the transactions and agreements set forth above were on terms comparable to those the Company could have obtained from unaffiliated third parties.

Procedure for Approval of Related Person Transactions

We have adopted a written procedure for approving and ratifying related person transactions. The procedure covers transactions or series of transactions between directors, nominees, executives, shareholders who own more than 5% of any class of voting securities and immediate family members of any such person described above and the Company where any of these classes of persons described above has a direct or indirect material interest.

Permission for a related person transaction may only be granted in writing in advance by the following:

- the audit committee of the board of directors in the case of transactions involving officers, directors and/or employees in certain senior grade levels;
- the ethics committee of the board of directors in the case of all other employees; and
- in any case, the board of directors, acting through its disinterested members only.

Transactions involving compensation of executive officers shall be reviewed and, if appropriate, approved by the compensation committee of the board of directors (or a group of independent directors of the Company performing a similar function) in the manner specified in the charter of the compensation committee.

Before any related person transaction is permitted, the following factors are to be considered:

- the related person s interest in the transaction;
- the dollar value of the amount involved in the transaction;
- the dollar value of the related person s interest in the transaction without regard to the amount of any profit or loss;

whether the transaction is to be undertaken in the ordinary course of business of the Company;

whether the transaction with the related person is proposed to be entered into on terms more favorable to the Company than terms that could have been reached with an unrelated third party;

Table of Contents

the purpose of, and the potential benefits to the Company of, the transaction; and

any other information regarding the transaction or the related person that are material in light of the circumstances of the particular transaction.

Approval of a related person transaction will only be granted if it is determined that, under all of the circumstances, the transaction is in the best interests of the Company and only so long as those interests outweigh any negative effects that may arise from permitting it to occur.

Table of Contents

PRINCIPAL STOCKHOLDERS

The following table sets forth, as of April 30, 2008, information regarding the beneficial ownership of our common stock by:

- each person known by us to beneficially own more than 5% of the outstanding shares of our common stock;
- each of our current directors;
- each of our named executive officers; and
- our directors and named executive officers as a group.

Beneficial ownership is determined in accordance with SEC rules and includes voting or investment power with respect to the securities. Shares of common stock subject to options that are currently exercisable or exercisable within 60 days are deemed to be outstanding and beneficially owned by the person holding such options. Such shares, however, are not deemed to be outstanding for the purposes of computing the percentage ownership of any other person.

Percentage of beneficial ownership is based on 160.0 million shares of our common stock outstanding as of April 30, 2008. Unless otherwise indicated, the address for all beneficial owners is c/o American Water Works Company, Inc., 1025 Laurel Oak Road, Voorhees, NJ 08043.

Table of Contents

Beneficial Owner	Shares of Common Stock Beneficially Owned Number	%
RWE Aqua Holdings GmbH	101,910,079	63.7%
Directors and Officers:		
Donald L. Correll	25,100	*
John S. Young	16,000	*
Ellen C. Wolf	10,500	*
Laura L. Monica	3,480	*
George W. Patrick	100	*
Sean G. Burke	2,780	*
James M. Kalinovich	2,400	*
Mark Chesla	1,000	*
Terry L. Gloriod	2,500	*
Walter J. Lynch	2,000	*
Mark F. Strauss	2,750	*
Paul G. Townsley	200	*
George MacKenzie	1,100	*
Martha Clark Goss		*
William J. Marrazzo	744	*
Dr. Manfred Döss		*
Dr. Rolf Pohlig		*
Andreas G. Zetzsche		*
Directors and executive officers as a group (20 persons)	**70,654**	*****
Total:	**101,980,733**	**63.7%**

* Shares represent less than 1% of common stock outstanding.

Table of Contents

DESCRIPTION OF OTHER INDEBTEDNESS

Revolving Credit Facility

Overview

On September 15, 2006, AWCC, our finance subsidiary, entered into a senior unsecured credit agreement syndicated among a group of ten banks with JPMorgan Chase Bank, N.A., or JPMCB, as administrative agent. The following description is only a summary of certain material provisions of the senior unsecured credit agreement, does not purport to be complete and is qualified in its entirety by reference to the provisions of that agreement.

The senior unsecured credit agreement provides AWCC with an $800.0 million revolving credit facility, of which up to $150.0 million is available in the form of letters of credit and $25.0 million is available in the form of swingline loans. With the consent of the applicable existing lender and new lenders, AWCC may increase the commitments under the revolving credit facility by up to $200.0 million, none of which may increase the availability of letters of credit thereunder. The proceeds of loans made and letters of credit issued under the senior unsecured credit agreement will be used to support our working capital needs and for other general purposes. The commitments of the lenders under the senior unsecured credit agreement, which originally terminated on September 15, 2011, but may be extended at the request of AWCC with the consent of a majority of the lenders for up to two additional one-year periods. On September 14, 2007, this revolving credit facility was extended for an additional year by the facility bank group, making the new termination dated September 15, 2012. As of December 31, 2007, AWCC had no revolving credit loans and $89.3 million of letters of credit outstanding under the senior unsecured credit agreement.

Interest rates and fees

Borrowings under the senior unsecured credit agreement will bear interest at an applicable margin plus, at AWCC s option, a base rate determined by reference to the higher of either (a) the prime rate of JPMCB and the federal funds rate plus $^{1}/_{2}$ of 1% or (b) a LIBOR rate determined by reference to the cost of funds for deposit in dollars for the interest period relevant to such borrowing adjusted for certain additional costs. In the case of borrowings bearing interest based on a base rate, the applicable margin is 0.00% and in the case of borrowings bearing interest based on a LIBOR rate, the applicable margin may be adjusted from time to time depending on our ratings from S&P and Moody s, but will not exceed 0.55%, except as described in the next sentences. In the case of both base rate borrowings and LIBOR borrowings, the applicable margin shall be increased by 0.05% for any period during which the aggregate principal amount of outstanding revolving credit borrowings, swingline borrowings and letters of credit exceeds 50% of the total commitments under the senior unsecured credit agreement. In addition, any principal and interest amounts not paid when due shall bear additional interest of 2.00% until paid.

In addition to paying interest on the outstanding principal under the senior unsecured credit agreement, AWCC is required to pay a commitment fee with respect to (a) unused revolving credit commitments, which may be adjusted from time to time depending on our ratings from S&P and Moody s, but shall not exceed 0.15%, and (b) outstanding letters of credit, which may be adjusted from time to time depending on our ratings from S&P and Moody s, but shall not exceed 0.55%. AWCC is also obligated to pay customary fees with respect to the issuance and maintenance of letters of credit and the administration of the facilities under the senior unsecured credit agreement.

Prepayments

The senior unsecured credit agreement requires AWCC to prepay outstanding revolving credit and swingline borrowings and to fund a cash collateral account with respect to letters of credit to the extent that (a) the aggregate

Table of Contents

principal amount of revolving credit and swingline loans and letters of credit outstanding exceeds the lenders aggregate commitment under the senior unsecured credit agreement or (b) the aggregate principal amount of swingline loans outstanding exceeds the lenders aggregate swingline commitment as then reduced.

Support Agreement

Pursuant to a support agreement with AWCC, American Water has agreed to pay to any debt investor or lenders of AWCC any principal or interest amounts owed by AWCC to such debt investor or lender that AWCC fails to pay on a timely basis. The lenders under the senior unsecured credit agreement may proceed directly against American Water to the extent AWCC fails to make any principal or interest payment required thereunder on a timely basis.

Certain covenants and events of default

The senior unsecured credit agreement contains a number of covenants that, among other things, restrict, subject to certain exceptions, AWCC s ability to:

- incur additional indebtedness secured by any lien;
- create liens on assets;
- engage in mergers or consolidations;
- pay dividends and distributions or repurchase its common stock;
- make investments, loans or advances;
- engage in certain transactions with affiliates;
- terminate or make certain amendments to the support agreement between AWCC and American Water;
- cause or permit American Water to incur additional debt;
- change its lines of business; and
- sell assets.

In addition, the senior unsecured credit agreement requires American Water to maintain a ratio of consolidated total indebtedness to consolidated total capitalization of not more than 0.70 to 1.00.

The senior unsecured credit agreement contains certain customary affirmative covenants and events of default, including reporting covenants.

Privately Placed Senior Unsecured Notes

Overview

Since December 21, 2006, AWCC has issued six series of senior unsecured notes in private placements to certain institutional accredited investors with interest rates per annum payable semi-annually, aggregate principal amounts, issue dates and maturity dates as follows:

Series	Interest Rate per Annum	Aggregate Principal Amount Issued	Aggregate Principal Amount Outstanding	Maturity Date
A	5.39%	$ 101.0 million	$ 101.0 million	December 21, 2013
B	5.52%	$ 37.5 million	$ 37.5 million	December 21, 2016
C	5.62%	$ 329.5 million	$ 329.5 million	December 21, 2018
D	5.77%	$ 432.0 million	$ 432.0 million	December 21, 2021
E	5.62%	$ 100.0 million	$ 100.0 million	March 29, 2019
F	5.77%	$ 100.0 million	$ 100.0 million	March 29, 2022

Table of Contents

The following description is only a summary of certain material provisions of the senior unsecured notes, does not purport to be complete and is qualified in its entirety by reference to the note purchase agreements pursuant to which the senior unsecured notes were issued.

The senior unsecured notes rank *pari passu* in right of payment with all current and future unsubordinated, unsecured indebtedness of AWCC. The net proceeds from the sale of the senior unsecured notes were used to refinance inter-company indebtedness and for our general corporate purposes.

Prepayment

The senior unsecured notes are callable at any time at the greater of par and a make whole discount rate of the then current market standard for United States treasury bills plus 0.50%. AWCC is required to offer to prepay the senior unsecured notes upon certain changes in control and dispositions of assets (excluding the initial public offering).

Support Agreements

Pursuant to a support agreement with AWCC, American Water has agreed to pay to any debt investor or lenders of AWCC any principal or interest amounts owed by AWCC to such debt investor or lender that AWCC fails to pay on a timely basis. The holders of the senior unsecured notes may proceed directly against American Water to the extent AWCC fails to make any principal or interest payment required thereon on a timely basis.

Certain covenants and events of default

The senior unsecured indenture contains a number of covenants that, among other things, restrict, subject to certain exceptions, AWCC, American Water and Thames US Holdings ability to:

- engage in certain transactions with affiliates;
- engage in mergers or consolidations;
- change its lines of business;
- incur additional indebtedness secured by any lien;
- create liens on assets;
- pay dividends and distributions or repurchase its common stock;
- terminate or make certain amendments to the support agreement between AWCC and American Water;
- sell assets; and
- incur certain other indebtedness, which is secured and senior to the subject notes.

In addition, the senior unsecured notes require American Water to maintain a ratio of consolidated total indebtedness to consolidated total capitalization of not more than 0.70 to 1.00.

The senior unsecured notes contain certain customary affirmative covenants and events of default.

Other Debt

The debt of AWCC totaled $2,798.9 million as of December 31, 2007. As of December 31, 2007, these obligations had interest rates ranging between 3.20% and 6.87% and maturity dates ranging from 2011 to 2037.

Debt of the subsidiaries of American Water other than AWCC totaled $1,924.0 million as of December 31, 2007. As of December 31, 2007, these obligations had interest rates ranging between 0.00% and 9.75% and maturity dates ranging from 2008 to 2038.

Table of Contents

Capital lease obligations of the subsidiaries of American Water totaled $2.0 million as of December 31, 2007.

Consolidated debt included unamortized debt discount premium and a fair market adjustment of $70.7 million as of December 31, 2007.

On January 26, 2007, AWCC entered into a $10.0 million revolving line of credit with PNC Bank, N.A., or PNC. Commitments under this revolving credit facility were scheduled to expire on December 31, 2007 unless extended. Borrowings under this line of credit will bear interest at PNC s prime rate or the applicable LIBOR rate plus 0.25% and will be used primarily for our short-term working capital needs. As of December 31, 2007, AWCC had $9.0 million drawn against this facility. As of December 31, 2007, the PNC line of credit was extended one year to December 31, 2008.

Table of Contents

DESCRIPTION OF THE NOTES

The following description is a summary of the material provisions of the indenture. It does not restate that agreement in its entirety. We urge you to read the indenture because it, and not this description, defines your rights as holders of the notes. A copy of the indenture is filed as an exhibit to the registration statement of which this prospectus forms a part. Unless the context otherwise requires, for the purposes of this Description of the Notes, the term notes refers to both the original notes and the new notes that will be issued in exchange for original notes in the exchange offer. Unless the context otherwise requires, for purposes of this Description of the Notes, American Water, our, us, we or the Company refers to American Water Works Company, Inc. and not to any of its subsidiaries.

General

The original notes were issued and the new notes will be issued under the indenture dated as of October 22, 2007 between the issuer and Wells Fargo Bank, National Association, as indenture trustee, a copy of which has been filed as an exhibit to the registration statement of which this prospectus forms a part.

The aggregate principal amount of the 2017 Notes is U.S. $750,000,000 and the aggregate principal amount of the 2037 Notes is U.S. $750,000,000.

The notes have the benefit of a support agreement from us described below.

The notes are the issuer s unsecured senior obligations and:

- rank equal in right of payment to all of the issuer s existing and future unsecured obligations that are not, by their terms, expressly subordinated in right of payment to the notes;
- rank senior in right of payment to all of the issuer s future obligations that are, by their terms, expressly subordinated in right of payment to the notes; and
- rank effectively junior in right of payment to all of the issuer s future secured indebtedness to the extent of the value of the assets securing such indebtedness.

Similarly, our obligations as support provider under the support agreement are unsecured senior obligations of ours and:

- rank equal in right of payment to all of our existing and future unsecured obligations that are not, by their terms, expressly subordinated in right of payment to such obligations;
- rank senior in right of payment to any of our future obligations that are, by their terms, expressly subordinated in right of payment so such obligations; and
- rank (i) effectively junior in right of payment to any of our secured indebtedness to the extent of the value of the assets securing such indebtedness and (ii) structurally junior in right of payment to any liabilities of our subsidiaries.

The notes are not subject to a sinking fund provision.

The indenture trustee is initially the security registrar and the paying agent for the notes. Notes have been issued in registered global form and will be in denominations of $2,000 and integral multiples of $1,000, without coupons, in excess thereof and may be transferred or exchanged, without service charge but upon payment of any taxes or other governmental charges payable in connection with the transfer or exchange, at the office described below. Payments on notes issued as a global security will be made to the depositary or a successor depositary. Principal and

interest with respect to certificated notes will be payable, the transfer of the notes will be registrable and notes will be exchangeable for notes of a like aggregate principal amount in denominations of $2,000, and integral multiples of $1,000 in excess thereof, at the office or agency maintained by the issuer for

Table of Contents

this purpose in the City of New York. The issuer has initially designated the corporate trust office of the indenture trustee as that office. However, at the issuer s option, payment of interest may be made by check mailed to the address of the holder entitled to payment or by wire transfer to an account appropriately designated by the holder entitled to payment.

The indenture does not limit our ability or the ability of the issuer, to issue or incur other unsecured debt or issue preferred stock.

Support Agreement

The issuer s debt (including the notes) is supported by a support agreement, dated June 22, 2000, and amended on July 26, 2000, between the issuer and us; referred to as the support agreement. The support agreement provides, among other things, that:

- we own, and during the term of the support agreement shall continue to own, all of the voting stock of the issuer free and clear of any lien, security interest or other charge or encumbrance;
- we will provide to the issuer, at its request or the request of any lender (including any holder of notes), funds in the form of cash or liquid assets (as equity or, if we and the issuer agree, as a loan subordinated to any and all indebtedness, whether or not that indebtedness is outstanding at the time of the loan) as required if the issuer is unable to make timely payment of interest, principal or premium, if any, on any indebtedness issued by it;
- we will cause the issuer to have at all times a positive tangible net worth (net assets less intangible assets), as determined in accordance with generally accepted accounting principles; and
- if the issuer fails or refuses to take timely action to enforce certain rights under the support agreement or if the issuer defaults in the timely payment of interest, principal or premium, if any, owed to a lender (including any holder of notes) when due, that lender may proceed directly against us to enforce such rights or to obtain payment of the defaulted interest, principal or premium, if any, owed to that lender.

No amendment to the support agreement that adversely affects the rights of any lender (including any holder of notes) and no termination of the support agreement will be effective until such time as all indebtedness of the issuer shall have been irrevocably paid in full and all commitments for indebtedness have been terminated, unless the lenders holding all of the aggregate principal amount of debt outstanding and (to the extent not outstanding) committed to consent in writing thereto. Notwithstanding the foregoing sentence, any amendment to the support agreement for the purposes of (i) increasing the minimum net worth as provided in the support agreement, (ii) establishing or increasing a minimum interest coverage ratio, (iii) establishing or reducing a maximum amount of debt leverage, (iv) increasing the aggregate principal amount of debt outstanding whose holders are required to consent to the termination or amendment of the support agreement, or (v) any combination of clause (i), (ii), (iii) and (iv) of this sentence, shall be effective without the consent of any lender. In addition, nothing in the prior two sentences shall derogate from, or override, any provision in an instrument, indenture, agreement or other document pursuant to which indebtedness is or will be issued that requires the written consent of the holders of a specified amount or percentage of that indebtedness to consent to an amendment or termination of the support agreement.

Principal, Maturity and Interest

The 2017 notes and the 2037 notes were each issued in an initial aggregate principal amount of U.S. $750,000,000. The 2017 Notes mature on October 15, 2017 and the 2037 Notes mature on October 15, 2037.

The 2017 notes bear interest at 6.085% per annum from the most recent date to which interest on the original 2017 notes has been paid or, if no interest has been paid, from October 22, 2007. The 2037 notes bear interest at 6.593% per annum from the most recent date to which interest on the original 2037 notes has been paid or, if no interest has been paid, from October 22, 2007.

Table of Contents

Interest on the new notes will be paid semiannually to holders of record at the close of business on April 1 and October 1 immediately preceding the interest payment date on April 15 and October 15 of each year, commencing on April 15, 2008 or, if the exchange offer is not consummated by such date, October 15, 2008.

The amount of interest payable on the notes for any period will be computed on the basis of a 360-day year of twelve 30-day months. In the event that any date on which interest is payable on the notes is not a business day, then payment of the interest payable on such date will be made on the next day that is a business day (and without any interest or other payment in respect of any such delay).

Change of Control

If a change of control triggering event (as defined below) occurs at any time, unless the issuer has exercised its right to redeem the notes as described below under Optional Redemption by the Issuer, holders of notes will have the right to require the issuer to repurchase all or any part (equal to $2,000 or an integral multiple of $1,000 in excess thereof) of their notes pursuant to the offer described below, referred to as the change of control offer, on the terms set forth in the notes. In the change of control offer, the issuer will be required to offer payment in cash equal to 101% of the aggregate principal amount of notes repurchased plus accrued and unpaid interest, if any, on the notes repurchased, to the date of purchase, referred to as the change of control payment. Within 30 days following any change of control triggering event, the issuer will be required to mail a notice to holders of notes describing the transaction or transactions that constitute the change of control triggering event and offering to repurchase the notes on the date specified in the notice, which date will be no earlier than 30 days and no later than 60 days from the date such notice is mailed, referred to as the change of control payment date, pursuant to the procedures required by the notes and described in the notice. The issuer must comply with the requirements of Rule 14e-1 under the Exchange Act and any other securities laws and regulations thereunder to the extent those laws and regulations are applicable in connection with the repurchase of the notes as a result of a change of control triggering event. To the extent that the provisions of any securities laws or regulations conflict with the change of control provisions of the notes, the issuer will be required to comply with the applicable securities laws and regulations and will not be deemed to have breached its obligations under the change of control provisions of the notes by virtue of such conflicts.

On the change of control payment date, the issuer will be required, to the extent lawful, to:

- accept for payment all notes or portions of notes properly tendered pursuant to the change of control offer;
- deposit with the paying agent an amount equal to the change of control payment in respect of all notes or portions of notes properly tendered; and
- deliver or cause to be delivered to the trustee the notes properly accepted together with an officers certificate stating the aggregate principal amount of notes or portions of notes being purchased.

The paying agent will promptly pay to each holder of notes properly tendered the purchase price for the notes, and the trustee will promptly authenticate and mail (or cause to be transferred by book-entry) to each holder a new note equal in principal amount to any unpurchased portion of any notes surrendered; provided that each new note will be in a principal amount of $2,000 or an integral multiple of $1,000 in excess thereof.

The issuer will not be required to make an offer to repurchase the notes upon a change of control triggering event if a third party makes such an offer in the manner, at the times and otherwise in compliance with the requirements for an offer made by the issuer and that third party purchases all notes properly tendered and not withdrawn under its offer.

Table of Contents

For purposes of the foregoing discussion of a repurchase at the option of holders, the following definitions apply:

Below investment grade rating event means the notes are rated below an investment grade rating by each of the rating agencies (as defined below) on any date from the date of the public notice of an arrangement that could result in a change of control until the end of the 60-day period following public notice of the occurrence of the change of control (which 60-day period shall be extended so long as the rating of the notes is under publicly announced consideration for possible downgrade by any of the rating agencies); provided that a below investment grade rating event otherwise arising by virtue of a particular reduction in rating shall not be deemed to have occurred in respect to a particular change of control (and thus shall not be deemed a below investment grade rating event for purposes of the definition of change of control triggering event hereunder), if the rating agencies making the reduction in rating to which this definition would otherwise apply do not announce or publicly confirm that the reduction was the result, in whole or in part, of any event or circumstance comprised of or arising as a result of, or in respect of, the applicable change of control (whether or not the applicable change of control shall have occurred at the time of the below investment grade rating event).

Change of control means the occurrence of any of the following: (1) the direct or indirect sale, transfer, conveyance or other disposition (other than by way of merger or consolidation), in one or a series of related transactions, of all or substantially all of our properties or assets and those of our subsidiaries taken as a whole to any person or group of related persons for purposes of Section 13(d) of the Exchange Act, referred to as a group, other than us or one of our subsidiaries; (2) the approval by the holders of our common stock of any plan or proposal for the liquidation or dissolution of us (whether or not otherwise in compliance with the provisions of the indenture); (3) the consummation of any transaction (including, without limitation, any merger or consolidation) the result of which is that any person or group becomes the beneficial owner, directly or indirectly, of more than 50% of the voting power of the then outstanding voting stock of the Company; or (4) the first day on which a majority of the members of our board of directors are not continuing directors.

The definition of change of control includes a phrase relating to the direct or indirect sale, lease, transfer, conveyance or other disposition of all or substantially all of our properties or assets and those of our subsidiaries taken as a whole. Although there is a limited body of case law interpreting the phrase substantially all , there is no precise established definition of the phrase under applicable law. Accordingly, the ability of a holder of notes to require the issuer to repurchase its notes as a result of a sale, lease, transfer, conveyance or other disposition of less than all of our assets and our subsidiaries taken as a whole to another person or group may be uncertain.

Change of control triggering event means the occurrence of both a change of control and a below investment grade rating event.

Continuing directors means, as of any date of determination, any member of our board of directors who (1) was a member of our board of directors on the date of the issuance of the notes; or (2) was nominated for election or elected to our board of directors with the approval of a majority of the continuing directors who were members of our board of directors at the time of such nomination or election (either by a specific vote or by approval of our proxy statement in which such member was named as a nominee for election as a director, without objection to such nomination).

Investment grade rating means a rating equal to or higher than Baa3 (or the equivalent) by Moody s and BBB (or the equivalent) by S&P, respectively.

Moody s means Moody s Investors Service, Inc.

Person has the meaning set forth in the indenture and includes a person as used in Section 13(d)(3) of the Exchange Act.

Table of Contents

Rating agencies means (1) each of Moody s and S&P; and (2) if either of Moody s or S&P ceases to rate the notes or fails to make a rating of the notes publicly available for reasons outside of our control, a nationally recognized statistical rating organization within the meaning of Rule 15c3-1(c)(2)(vi)(F) under the Exchange Act, selected by us (as certified by a resolution of our board of directors) as a replacement agency for Moody s or S&P, or both of them, as the case may be.

S&P means Standard & Poor s Ratings Services, a division of The McGraw-Hill Companies, Inc.

Events of Default

Each of the following is an event of default with respect to each series of notes:

(1) default for 30 days in the payment when due of interest on the notes of that series;

(2) default in payment when due of the principal of, or premium, if any, on the notes of that series;

(3) failure by the issuer or us to comply with the provisions described under the caption Certain Covenants Merger, Consolidation or Sale of Assets ;

(4) failure by the issuer or us to comply for 60 days after receipt of notice with any of the other agreements in the indenture or the support agreement; provided, however, that except with respect to defaults under or breaches of the covenant described under Certain covenants Restrictions on Liens, holders of the notes will be deemed to have agreed to an extension of such 60-day period to 120 days so long as corrective action is initiated by the issuer or us within such 60-day period unless such corrective action is no longer being diligently pursued;

(5) default under any mortgage, indenture or instrument under which there may be issued or by which there may be secured or evidenced any indebtedness for money borrowed by the issuer or us (or the payment of which is guaranteed by the issuer or us), if that default is caused by a failure to pay principal at its stated maturity after giving effect to any applicable grace period, or results in the acceleration of such indebtedness prior to its stated maturity and, in each case, the principal amount of any such indebtedness, together with the principal amount of any other indebtedness under which there has been a payment default after stated maturity or the maturity of which has been so accelerated, aggregates $100 million or more, referred to as the cross acceleration provision;

(6) failure by the issuer or us to pay final judgments aggregating (to the extent not paid or insured) in excess of $100 million, which judgments are not paid, within 60 days after the entry thereof, bonded, discharged or stayed pending appeal, or are not discharged within 60 days after the expiration of such stay; referred to as the judgment default provision;

(7) except as permitted by the indenture the support agreement shall cease for any reason to be in full force and effect or us, or any person acting on behalf of us, shall deny or disaffirm our obligations under the support agreement; and

(8) certain events of bankruptcy or insolvency described in the indenture with respect to the issuer or us, referred to as the bankruptcy provision.

However, a default under clause (4) will not constitute an event of default with respect to a series of notes until the trustee or the holders of 25% in aggregate principal amount of the outstanding notes of that series notify the issuer of the default and the issuer does not cure the default within the time specified after receipt of that notice. In the case of an event of default arising from certain events of bankruptcy or insolvency, with respect to the issuer or us, all outstanding notes will become due and payable immediately without further action or notice. If any other event of default with respect to a series of notes occurs and is continuing, the trustee or the holders of at least 25% in aggregate principal amount of the

then outstanding notes of that series may declare all the notes of that series to be due and payable immediately. Unless as otherwise provided herein, after any such acceleration, but before a judgment or decree based on acceleration is obtained by the trustee, the registered

Table of Contents

holders of a majority in aggregate principal amount of outstanding notes of the affected series may, under certain circumstances, rescind and annul such acceleration and waive such event of default with respect to the notes of that series if all events of default, other than the nonpayment of accelerated principal, premium or interest with respect to the notes of that series, have been cured or waived as provided in the indenture.

Holders of the notes may not enforce the indenture or the notes except as provided in the indenture. Subject to certain limitations with respect to any series of notes, holders of a majority in principal amount of the then outstanding notes of that series may direct the trustee in its exercise of any trust or power. The trustee may withhold from holders of the notes notice of any continuing default if it determines that withholding notice is in their interest, except a default relating to the payment of principal or interest.

Subject to the provisions of the indenture relating to the duties of the trustee, in case an event of default shall occur and be continuing, the trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any of the holders of the notes, unless such holders shall have offered to the trustee reasonable indemnity or security against any loss, liability or expense. Subject to such provisions for indemnification of the trustee, the holders of a majority in aggregate principal amount of the notes then outstanding will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee or exercising any trust or power conferred on the trustee with respect to the notes.

With respect to any series of notes, the holders of a majority in aggregate principal amount of the notes of that series then outstanding by notice to the trustee may on behalf of the holders of all of the notes of that series waive any existing default and its consequences under the indenture except a continuing default in the payment of interest on, or the principal of, the notes of that series (other than the non-payment of principal of or interest on the notes that became due solely because of the acceleration of the notes of that series).

The issuer is required to deliver to the trustee within 90 days after the end of each fiscal year a statement regarding compliance with the indenture during that fiscal year. Promptly (and in any event within 5 business days) upon a responsible officer of the issuer becoming aware of any default or event of default, the issuer is required to deliver to the trustee a statement specifying that default.

Responsible officer means the chief executive officer, chief operating officer, general counsel, any senior financial officer and any other officer of the issuer with responsibility for the administration of the indenture.

Senior financial officer means the chief financial officer, principal accounting officer, treasurer or controller of the issuer.

Optional Redemption by the Issuer

The issuer will have the right at its option to redeem any of the notes in whole or in part, at any time or from time to time prior to their maturity, on at least 30 days, but not more than 60 days notice, at a redemption price equal to the greater of (i) 100% of the principal amount of such notes and (ii) the sum of the present values of each remaining scheduled payment of principal and interest thereon (exclusive of interest accrued to the date of redemption) discounted to the redemption date on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the treasury rate plus 20 basis points (in the case of the 2017 Notes) or 25 basis points (in the case of the 2037 Notes), referred to as the make-whole amount, plus in each case accrued interest on the principal amount of the notes to the date of redemption.

Treasury rate means, with respect to any redemption date, the rate per annum equal to the semiannual equivalent yield to maturity or interpolated maturity (on a day count basis) of the comparable treasury issue, assuming a price for the comparable treasury issue (expressed as a percentage of its principal amount) equal to the comparable treasury price for such redemption date.

Comparable treasury issue means the United States treasury security or securities selected by an independent investment banker as having an actual or interpolated maturity comparable to the remaining term of

Table of Contents

the notes to be redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of a comparable maturity to the remaining term of such notes.

Independent investment banker means one of the reference treasury dealers appointed by the issuer.

Comparable treasury price means, with respect to any redemption date the average of the reference treasury dealer quotations for such redemption date.

Reference treasury dealer means each of Citigroup Global Markets Inc., Goldman, Sachs & Co., Merrill Lynch, Pierce, Fenner & Smith Incorporated and Credit Suisse Securities (USA) LLC or their affiliates which are primary United States government securities dealers, and their respective successors; *provided*, *however*, that if any of the foregoing shall cease to be a primary United States government securities dealer in the City of New York, referred to as a primary treasury dealer, the issuer will substitute therefor another primary treasury dealer.

Reference treasury dealer quotation means, with respect to each reference treasury dealer and any redemption date, the average, as determined by the issuer, of the bid and asked prices for the comparable treasury issue (expressed in each case as a percentage of its principal amount) quoted in writing to the issuer by such reference treasury dealer at 3:30 pm New York time on the third business day preceding such redemption date.

On and after the redemption date, interest will cease to accrue on the notes or any portion of the notes called for redemption (unless the issuer defaults in the payment of the redemption price and accrued interest). On or before the redemption date, the issuer will deposit with the trustee money sufficient to pay the redemption price of and (unless the redemption date shall be an interest payment date) accrued interest to the redemption date on the notes to be redeemed on such date.

Selection and Notice

If less than all of the notes of any series are to be redeemed in connection with any redemption, the trustee will select notes (or portions of notes) for redemption as follows:

(a) if the notes of that series are listed on any national securities exchange, in compliance with the requirements of the principal national securities exchange on which such notes are listed; or

(b) if the notes of that series are not listed on any national securities exchange, on a pro rata basis, by lot or by such method as the trustee deems fair and appropriate.

No notes of $2,000 or less can be redeemed in part. Notices of redemption will be mailed by first class mail at least 30 but not more than 60 days before the redemption date to each holder of notes of any series to be redeemed at its registered address, except that redemption notices may be mailed more than 60 days prior to a redemption date if the notice is issued in connection with a satisfaction and discharge of the indenture. Notices of redemption may not be conditional.

If any note is to be redeemed in part only, the notice of redemption that relates to that note will state the portion of the principal amount of that note that is to be redeemed. A new note in principal amount equal to the unredeemed portion of the original note will be issued in the name of the holder of notes upon cancellation of the original note. Notes called for redemption become due on the date fixed for redemption. On and after the redemption date, interest will cease to accrue on notes or portions of them called for redemption.

Table of Contents

Certain Covenants

The indenture contains, among others, the following covenants:

Restrictions on Liens

The issuer will not, and will not allow us, as the support provider, or any of our subsidiaries to, create, incur, issue or assume any liens on our or their respective property to secure debt where the debt secured by those liens would exceed an amount equal to 15% of our consolidated tangible total assets, as defined below (calculated to exclude debt secured by Permitted Liens). This restriction does not apply to permitted liens, which is defined to include:

(a) liens existing, or created pursuant to the terms of agreements existing, on the date of the indenture;

(b) liens consisting of (i) pledges or deposits in the ordinary course of business to secure obligations under workmen s compensation laws or similar legislation, (ii) deposits in the ordinary course of business to secure or in lieu of surety, appeal or customs bonds to which the issuer, we or any of our subsidiaries is a party, (iii) liens created by or resulting from any litigation or legal proceeding which is currently being contested in good faith by appropriate proceedings diligently conducted, (iv) pledges or deposits in the ordinary course of business to secure performance in connection with bids, tenders or contracts (other than contracts for the payment of money) or (v) materialmen s mechanics , carriers , workmen s repairmen s or other like liens incurred in the ordinary course of business for sums not yet due or currently being contested in good faith by appropriate proceedings diligently conducted;

(c) liens created to secure tax-exempt debt, in connection with the financing or refinancing of the purchase, lease or construction of properties;

(d) any lien on any asset of any person existing at the time the person is merged or consolidated with or into, or such asset is acquired by the issuer, us or any of our subsidiaries and not created in contemplation of such event;

(e) liens created to secure sales of accounts receivable and other receivables;

(f) licenses of intellectual property granted by the issuer, us or any of our subsidiaries in the ordinary course of business and not interfering in any material respect with the ordinary conduct of business;

(g) liens of landlords arising under real property leases to the extent those liens arise in the ordinary course of business and do not secure any past due obligation for the payment of money;

(h) any interest or title of a lessor or sublessor under any lease permitted by the indenture;

(i) liens securing debt which has neither been assumed by the issuer, us or any of our subsidiaries nor upon which it customarily pays interest charges, existing upon real property, or rights in or relating thereto, which real property or rights were acquired for right-of-way purposes;

(j) zoning laws and ordinances;

(k) any leases required to be capitalized on a balance sheet of the lessee in accordance with generally accepted accounting principles;

(l) easements, rights-of-way, restrictions, conditions and other similar encumbrances, minor defects or irregularities of title, and alleys, streets and highways, which in the aggregate do not materially impair the usefulness of the mortgaged property in the present business of the issuer, us or any of our subsidiaries;

(m) leases of the properties of the issuer, us or any of our subsidiaries, in each case entered into in the ordinary course of business and that do not, individually or in the aggregate, (i) interfere in any material respect with the ordinary course of business or (ii) materially impair the value of the property subject thereto;

Table of Contents

(n) liens arising out of conditional sale, title retention, consignment or similar arrangements for the sale of goods entered into by the issuer, us or any of our subsidiaries in the ordinary course of business in accordance with the past practices of the issuer, us or such subsidiary;

(o) bankers liens, right of setoff and other similar liens (including deposits required by interest rate swap agreements) existing solely with respect to cash and cash equivalents on deposit in one or more accounts maintained by the issuer, us or any of our subsidiaries, in each case granted in the ordinary course of business in favor of the financial institutions with which such accounts are maintained, securing amounts owing to such financial institutions with respect to cash management and operating account arrangements, including those involving pooled accounts and netting arrangements; provided that, unless such liens are non-consensual and arise by operation of law, in no case shall any such liens secure (either directly or indirectly) the repayment of any debt;

(p) liens for taxes, assessments or governmental charges or levies not yet delinquent and which may subsequently be paid without interest or penalties and liens for taxes, assessments or governmental charges or levies which are being contested in good faith by appropriate proceedings for which reserves have been established to the extent required by GAAP;

(q) any lien on any property of the issuer, us or any of our subsidiaries securing obligations not exceeding in the aggregate $100 million outstanding any time;

(r) liens on any property, acquired, constructed or improved by the issuer, us or any of our subsidiaries after the date of the indenture, and any improvements thereon, accessions thereto or other property acquired or constructed for use in connection therewith or related thereto, which are created or assumed prior to or contemporaneously with, or within 180 days after, such acquisition or completion of such construction or improvement, or within one year thereafter pursuant to a firm commitment for financing arranged with a lender or investor within such 180-day period, to secure or provide for the payment of all or any part of the purchase price of such property or the cost of such construction or improvement incurred after the date of the indenture or liens on any property existing at the time of acquisition thereof; *provided*, that the liens shall not extend to any property theretofore owned by the issuer, us or any of our subsidiaries other than, in the case of any such construction or improvement, (i) unimproved real property on which the property so constructed or the improvement is located, (ii) other property (or improvement thereon) which is an improvement to or is acquired or constructed for use in connection therewith or related thereto, (iii) any right and interest under any agreement or other documents relating to the property being so constructed or improved or such other property and (iv) the stock of any subsidiary of ours created or maintained for the primary purpose of owning the property so constructed or improved;

(s) liens on property securing debt if, prior to or concurrently with the issuance, assumption or guarantee of such debt, the notes (together with, if the issuer shall so determine, (i) any other debt of or guaranteed by the issuer ranking equally with the notes or (ii) any debt of us or any of our subsidiaries then existing or thereafter created) are secured by such property equally and ratably with (or prior to) such debt (for so long as such debt is secured by such liens);

(t) liens securing the notes;

(u) liens securing debt owed to the issuer, us or any of our subsidiaries; and

(v) liens created for the sole purpose of refinancing, extending, renewing or replacing in whole or in part debt or other obligations secured by any lien referred to in the foregoing subsections (a) through (t); *provided*, *however*, that the principal amount of debt or obligations secured thereby shall not exceed the principal amount of debt or obligations so secured at the time of such refinancing, extension, renewal or replacement *plus* the amount of any premiums required to be paid thereon and reasonable fees and expenses associated therewith and that such refinancing, extension, renewal or replacement, as the case may be, shall be limited to all or a part of the property that secured the lien or mortgage so refinanced, extended, renewed or replaced (and any improvements on such property).

Table of Contents

Debt means, for any person (without duplication), all (i) indebtedness for borrowed money, (ii) obligations evidence by bonds, debentures, notes or other similar instruments, (iii) obligations to pay the deferred purchase price of property or service (other than trade payables not overdue by more than 90 days incurred in the ordinary course of business and long term water purchase contracts), (iv) obligations under capital leases, (v) indebtedness of the type referred to in clauses (i) through (iv) above secured by (or for which the holder of such indebtedness has an existing right, contingent or otherwise, to be secured by), any lien or encumbrance on, or security interest in, property (including, without limitation, accounts and contract rights) owned by such person, even though such person has not assumed or become liable for payment of such indebtedness, and (vi) all obligations of others of the kinds referred to in clauses (i) through (iv) above under direct or indirect guarantees, excluding, in all cases, (i) advances for construction and contributions in aid of construction as set forth on the consolidated balance sheet of American Water and its subsidiaries, (ii) reimbursement obligations (contingent or otherwise) in respect of outstanding letters of credit and (iii) attributable debt in respect of sale and leaseback transactions.

Restrictions on Sales and Leasebacks

The issuer will not, and will not allow us or any of our subsidiaries to, enter into any sale and leaseback transaction without effectively providing that the notes will be secured equally and ratably with or prior to the sale and leaseback transaction, unless:

- the aggregate amount of the attributable debt of the issuer, us and our subsidiaries in respect of sale and leaseback transactions then outstanding would not exceed an amount equal to 15% of our consolidated tangible total assets, or

- the issuer, we or any of our subsidiaries, within 12 months of the sale and leaseback transaction, retire an amount of secured debt which is not subordinate to the notes in an amount equal to the greater of (1) the net proceeds of the sale or transfer of the property or other assets that are the subject of the sale and leaseback transaction or (2) the fair market value of the property leased.

A sale and leaseback transaction for purposes of this subsection is an arrangement between the issuer, us or any of our subsidiaries and a bank, insurance company or other lender or investor where the issuer, we or any of our subsidiaries leases property for an initial term of three years or more that was or will be sold by the issuer, us, or such subsidiary to that lender or investor for a sale price of U.S.$1,000,000 or its equivalent or more.

Attributable debt means the lesser of (1) the fair market value of the asset subject to the sale and leaseback transaction and (2) the present value, determined in accordance with GAAP (discounted at a rate equal to the rate of interest implicit in such transaction), of the obligations of the lessee for the net rental payments (excluding amounts on account of maintenance and repairs, insurance, taxes, assessments and similar charges and contingent rents) during the term of the lease.

Consolidated tangible total assets means, as at any applicable time of determination, consolidated total assets *less*, without duplication, all intangible assets such as goodwill, trademarks, trade names, patents and unamortized debt discount and expense carried as an asset, in each case as set forth in our most recent consolidated balance sheet.

Consolidated total assets means, as at any applicable time of determination, our consolidated total assets as set forth in our most recent consolidated financial statements.

Merger, Consolidation or Sale of Assets

(a) Neither the issuer nor we will consolidate with or merge into any other person or convey, transfer or lease its properties and assets substantially as an entirety to any person, unless:

(i) the successor formed by a consolidation or the survivor of a merger or the person that acquires by conveyance, transfer or lease all or substantially all of the assets of the issuer or us as an entirety, as the case

Table of Contents

may be, is a person organized and existing under the laws of the United States or any State thereof (including the District of Columbia), and expressly assumes, in the case of the issuer, the due and punctual payment of the principal of and any premium and interest on all the notes and the performance or observance of every covenant of the indenture on the part of the issuer to be performed or observed, and, in the case of us, all the obligations under the support agreement to be performed or observed, and such person shall have caused to be delivered to the trustee an officer s certificate and an opinion of counsel to the effect that such consolidation, merger, conveyance, transfer or lease complies in all material respects with this covenant; and

(ii) immediately before and immediately after giving effect to such transaction, no event of default, and no event which, after notice or lapse of time or both, would become an event of default, has occurred and is continuing.

(b) Upon any consolidation by the issuer us with or merger by the issuer or us into any other person or any conveyance, transfer or lease of either the issuer s or our properties and assets substantially as an entirety in accordance with this covenant, the successor person formed by such consolidation or into which it is merged or to which such conveyance, transfer or lease is made will succeed to, and be substituted for, and may exercise every right and power of, the issuer or us, as applicable, under the indenture and the support agreement with the same effect as if such successor person had been named as the issuer or the support provider, as applicable, therein, and thereafter, except in the case of a lease, the predecessor person will be relieved of all obligations and covenants, in the case of the issuer under the indenture, the notes and, in the case of us, under the support agreement.

Support Agreement

The issuer will not permit us to (a) cancel or terminate the support agreement or (b) amend or otherwise modify the terms of the support agreement, except for amendments and modifications that do not adversely affect the rights of the holders of notes, in each case, without the prior written consent of holders of at least 51% of the outstanding principal amount of all outstanding notes of each series.

Assumption

We may directly assume the due and punctual payment of the principal of (premium, if any) and interest on all the notes and any coupons appertaining thereto and the performance of every covenant of the indenture on the part of the issuer to be performed or observed. Upon any such assumption, we will succeed to and be substituted for and may exercise every right and power of the issuer under the indenture with the same effect as if we had been named as the issuer in the indenture and the issuer will be released from its liability as obligor on the notes. No such assumption shall be permitted unless we have delivered to the indenture trustee an officers certificate of us and an opinion of counsel for us, each stating that such assumption and supplemental indenture comply with this covenant and that all conditions precedent in the indenture relating to such transaction have been complied with.

Modification or Waiver

Except as provided below, the issuer and the trustee may supplement and amend the indenture or the notes with the consent of the holders of not less than a majority in principal amount of the outstanding notes of each affected series. The consent of the holder of each outstanding note affected is required to:

change the stated maturity of or the stated amount of the principal of, or any installment of interest on, the notes of any series;

reduce the principal amount or the rate of interest on, or any premium payable upon the redemption of the notes of any series;

change the place or currency of payment of principal of, or interest on, the notes of any series;

Table of Contents

impair the right to institute suit for the enforcement of any such payment on or after the stated maturity of the notes or any redemption date for the notes of any series;

reduce the percentage of holders of outstanding notes necessary to modify or amend the indenture or to consent to any waiver under the indenture;

reduce the percentage of outstanding notes necessary to waive any past default; or

modify any of the above requirements.

The issuer and the trustee may supplement and amend the indenture or the notes of any series without the consent of any holder for the following purposes:

to evidence the succession of another entity to the issuer as obligor under an indenture;

to provide for the acceptance of appointment by a successor trustee;

to effect the assumption of the indenture by us or one of our subsidiaries;

to cure any ambiguity, defect or inconsistency in the indenture;

to provide for uncertificated notes in addition to or in place of certificated notes (provided that the uncertificated notes are issued in registered form for purposes of Section 163(f) of the Internal Revenue Code, or in a manner such that the uncertificated notes are described in Section 163(f)(2)(B) of the Internal Revenue Code);

to add guarantees with respect to the notes or to secure the notes of any series;

to establish the form or terms of notes of any series as permitted by the indenture;

to add to the covenants of us, the issuer or our other subsidiaries for the benefit of the holders of the notes or to surrender any right or power conferred upon us, the issuer or our other subsidiaries;

to make any change that does not adversely affect the rights of any holder of the notes;

to comply with any requirement of the SEC in connection with the qualification of the indenture under the Trust Indenture Act;

to make any amendment to the provisions of the indenture relating to the transfer and legending of notes; *provided, however,* that (a) compliance with the indenture as so amended would not result in notes being transferred in violation of the Securities Act or any

other applicable securities law and (b) such amendment does not materially and adversely affect the rights of holders to transfer notes.

The consent of the holders of the notes is not necessary under the indenture to approve the particular form of any proposed amendment or supplemental indenture. It is sufficient if such consent approves the substance of the proposed amendment or supplemental indenture.

Further Issues

The issuer may issue additional notes of either series, referred to as additional notes, under the indenture from time to time with the same CUSIP number as such series of notes if such additional notes are fungible with such series of notes for United States federal income tax purposes. The notes and any additional notes subsequently issued under the indenture will rank equally and will be treated as a single class for all purposes under the indenture, including, without limitation, waivers, amendments, redemptions and offers to purchase.

The period of the resale restrictions applicable to any notes previously offered and sold in reliance on Rule 144A under the Securities Act shall automatically be extended to the last day of the period of any resale restrictions imposed on any such additional notes.

Table of Contents

Prescription Period

Any money that the issuer deposits with the trustee or any paying agent for the payment of principal or interest on any global note that remains unclaimed for two years after the date upon which the principal and interest are due and payable will be repaid to the issuer upon the issuer s request unless otherwise required by mandatory provisions of any applicable unclaimed property law. After that time, unless otherwise required by mandatory provisions of any unclaimed property law, the holder of any note will be able to seek any payment to which that holder may be entitled to collect only from the issuer.

No Personal Liability of Directors, Officers, Employees and Stockholders

No director, officer, employee, incorporator or stockholder of the issuer or us, will have any liability for any obligations of the issuer or us under the notes, the indenture, the support agreement, or for any claim based on, in respect of, or by reason of, such obligations or their creation. Each holder of notes by accepting a note waives and releases all such liability. The waiver and release are part of the consideration for issuance of the notes. The waiver may not be effective to waive liabilities under the federal securities law and it is the view of the SEC that such waiver is against public policy.

Defeasance

At any time, the issuer may terminate all its obligations under the notes and the indenture, referred to as legal defeasance, except for certain obligations, including those respecting the defeasance trust and obligations to register the transfer or exchange of the notes, to replace mutilated, destroyed, lost or stolen notes and to maintain a registrar and paying agent in respect of the notes.

In addition, at any time the issuer may terminate its obligations under Change of Control and under the covenants described under Certain Covenants (other than the covenant described under Merger, Consolidation or Sale of Assets), the operation of the cross acceleration provision, the bankruptcy provision and the judgment default provision described under Events of Default, referred to as covenant defeasance.

The issuer may exercise its legal defeasance option notwithstanding its prior exercise of its covenant defeasance option. If the issuer exercises its legal defeasance option, payment of the notes may not be accelerated because of an event of default with respect thereto. If the issuer exercises its covenant defeasance option, payment of the notes may not be accelerated because of a default specified in clause (4), (5), (6) or (7) under Events of Default .

In order to exercise either of its defeasance options, the issuer must irrevocably deposit in trust, referred to as the defeasance trust, with the trustee money or U.S. Government obligations for the payment of principal and interest on the notes to redemption or maturity, as the case may be, and must comply with certain other conditions, including delivery to the trustee of an opinion of counsel to the effect that holders of the notes will not recognize income, gain or loss for Federal income tax purposes as a result of such deposit and defeasance and will be subject to Federal income tax on the same amounts and in the same manner and at the same times as would have been the case if such deposit and defeasance had not occurred (and, in the case of legal defeasance only, such opinion of counsel must be based on a ruling of the Internal Revenue Service or other change in applicable Federal income tax law).

Discharge

When (i) the issuer delivers to the trustee all outstanding notes (other than notes replaced because of mutilation, loss, destruction or wrongful taking) for cancellation or (ii) all outstanding notes have become due and payable, or are by their terms due and payable within one year whether at maturity or are to be called for redemption within one year under arrangements reasonably satisfactory to the trustee, and in the case of clause

Table of Contents

(ii) the issuer irrevocably deposits with the trustee funds sufficient to pay at maturity or upon redemption all outstanding notes, including interest thereon, and if in either case the issuer pays all other sums related to the notes payable under the indenture by the issuer, then the indenture shall, subject to certain surviving provisions cease to be of further effect. The trustee shall acknowledge satisfaction and discharge of the indenture with respect to the notes on demand of the issuer accompanied by an officers certificate and an opinion of counsel of the issuer.

Governing Law

The indenture and the notes are governed by, and construed in accordance with, the laws of the State of New York.

Book-Entry, Delivery and Form

The new 2012 notes and the new 2037 notes will each be represented by a note in registered, global form without interest coupons, which we refer to as the global notes. The global notes will be deposited upon issuance with the trustee as custodian for DTC, in New York, New York, and registered in the name of DTC or its nominee, in each case for credit to an account of a direct or indirect participant in DTC as described below.

Except as set forth below, the global notes may be transferred, in whole and not in part, only to another nominee of DTC or to a successor of DTC or its nominee. Except in the limited circumstances described below, owners of beneficial interests in the global notes will not be entitled to receive physical delivery of notes in certificated form. Transfers of beneficial interests in the global notes will be subject to the applicable rules and procedures of DTC and its direct or indirect participants, which may change from time to time.

Exchanges of Book-Entry Notes for Certificated Notes

A beneficial interest in a global note of any series may not be exchanged for a note in certificated form for that series unless (i) DTC (x) notifies the issuer that it is unwilling or unable to continue as depository for such global note or (y) has ceased to be a clearing agency registered under the Exchange Act, (ii) in the case of a global note held for an account of Euroclear or Clearstream, as the case may be, Euroclear or Clearstream, as the case may be, (A) is closed for business for a continuous period of 14 days (other than by reason of statutory or other holidays) or (B) announces an intention permanently to cease business or does in fact do so, or (iii) there shall have occurred and be continuing an event of default with respect to the notes. In all cases, certificated notes of any series delivered in exchange for any global note for that series or beneficial interests therein will be registered in the names, and issued in approved denominations, requested by or on behalf of DTC (in accordance with its customary procedures). Any certificated notes of any series issued in exchange for an interest in a global note for that series will bear the legend restricting transfers that is borne by such global note. Any such exchange will be effected only through the DWAC system and an appropriate adjustment will be made in the records of the security register to reflect a decrease in the principal amount of the relevant global note.

Global Notes

The following description of the operations and procedures of DTC, is provided solely as a matter of convenience. These operations and procedures are solely within the control of the respective settlement systems and are subject to changes by them from time to time. We and the issuer take no responsibility for these operations and procedures and urge investors to contact the system or their participants directly to discuss these matters.

Upon the issuance of the global notes, DTC will credit, on its internal system, the respective principal amount of the individual beneficial interests represented by such global notes of that series to the accounts with DTC, referred to as participants, or persons who hold interests through participants. Ownership or beneficial

Table of Contents

interests in the global notes of that series will be shown on, and the transfer of that ownership will be effected only through, records maintained by DTC or its nominee (with respect to interests of participants) and the records of participants (with respect to interest of persons other than participants).

As long as DTC, or its nominee, is the registered holder of a global note of any series, DTC or such nominee, as the case may be, will be considered the sole owner and holder of the notes of that series represented by such global note for all purposes under the indenture and the notes for that series. Except in the limited circumstances described above under Exchanges of Book-Entry Notes for Certificated Notes, owners of beneficial interests in a global note of any series will not be entitled to have portions of such global note registered in their names, will not receive or be entitled to receive physical delivery of notes of that series in definitive form and will not be considered the owners or holders of the global note for that series (or any notes presented thereby) under the indenture or the notes. In addition, no beneficial owner of an interest in a global note of any series will be able to transfer that interest except in accordance with DTC s applicable procedures. In the event that owners of beneficial interests in a global note of any series become entitled to receive notes of that series in definitive form, such notes will be issued only in registered form in denominations of U.S. $2,000 and integral multiples of $1,000 in excess thereof.

The laws of some states require that certain persons take physical delivery in definitive form of securities that they own. Consequently, the ability to transfer beneficial interests in a global note of any series to such persons may be limited to that extent. Because DTC can act only on behalf of participants, which in turn act on behalf of indirect participants and certain banks, the ability of a person having beneficial interests in a global note of any series to pledge such interests to persons or entities that do not participate in the DTC system, or otherwise take action in respect of such interests, may be affected by the lack of a physical certificate evidencing such interests.

Payments of the principal of and interest on global notes of any series will be made to DTC or its nominee as the registered owner thereof. Neither the issuer, the trustee nor any of their respective agents will have any responsibility or liability for any aspect of the records relating to or payments made on account of beneficial ownership interests in the global notes for that series or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests.

Beneficial interests in the global notes of any series will trade in DTC s Same-Day Funds Settlement System, and secondary market trading activity in such interests will therefore settle in immediately available funds. The issuer expects that DTC or its nominee, upon receipt of any payment of principal or interest in respect of a global note of any series representing any Notes of that series held by it or its nominee, will immediately credit participants accounts with payment in amounts proportionate to their respective beneficial interests in the principal amount of such notes of that series as shown on the records of DTC or its nominee. The issuer also expects that payments by participants to owners of beneficial interests in such global notes held through such participants will be governed by standing instructions and customary practices, as is now the case with securities held for the accounts of customers registered in street name. Such payments will be the responsibility of such participants.

Transfers between participants in DTC will be effected in accordance with DTC s procedures, and will be settled in same-day funds.

DTC has advised the issuer that it will take any action permitted to be taken by a holder of notes of any series (including the presentation of notes for exchange as described below) only at the direction of one or more participants to whose account with DTC interests in the global notes for that series are credited and only in respect of such portion of the aggregate principal amount of the notes of that series as to which such participant or participants has or have given such direction. However, if there is an event of default (as defined above) under the notes of any series, DTC reserves the right to exchange the global notes for that series for legended notes of that series in certificated form, and to distribute such notes to its participants.

Table of Contents

DTC has advised the issuer as follows: DTC is

a limited purpose trust company organized under the laws of the State of New York,

a banking organization within the meaning of New York Banking law,

a member of the Federal Reserve System,

a clearing corporation within the meaning of the Uniform Commercial Code, as amended, and

a Clearing Agency registered pursuant to the provisions of Section 17A of the Exchange Act.

DTC was created to hold securities for its participants and facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes in accounts of its participants, thereby eliminating the need for physical transfer and delivery of certificates. Participants include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. DTC is partially owned by some of these participants or their representatives. Indirect access to the DTC system is available to other entities such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly, referred to as indirect participants.

Although DTC, has agreed to the foregoing procedures in order to facilitate transfers of beneficial ownership interests in the global notes for any series among participants of DTC, it is under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the issuer, the trustee nor any of their respective agents will have any responsibility for the performance by DTC, its participants or indirect participants of their respective obligations under the rules and procedures governing their operations, including maintaining, supervising or reviewing the records relating to, or payments made on account of, beneficial ownership interests in global notes of any series.

Same Day Settlement and Payment

The issuer will make payments in respect of the notes of any series represented by the global notes for that series (including principal, premium, if any, interest and special interest, if any) by wire transfer of immediately available funds to the accounts specified by the global note holder for that series. The issuer will make all payments of principal, interest and premium and special interest, if any, with respect to Certificated Notes of any series by wire transfer of immediately available funds to the accounts specified by the holders of the Certificated Notes of that series or, if no such account is specified, by mailing a check to each such holder s registered address. The notes of any series represented by the global notes for that series are expected to be eligible to trade in DTC s Same-Day Funds Settlement System, and any permitted secondary market trading activity in such notes will, therefore, be required by DTC to be settled in immediately available funds. The issuer expects that secondary trading in any Certificated Notes of any series will also be settled in immediately available funds.

Table of Contents

UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

General

This section summarizes the material U.S. Federal income tax consequences to holders associated with an exchange of original notes for new notes. However, the discussion is limited in the following ways:

- This discussion only covers you if you purchased original notes in the initial offering and you exchange such original notes for new notes pursuant to the exchange offer.
- This discussion only covers you if you have always held your original notes, and will only hold New Notes received pursuant to the exchange offer, as a capital asset (that is, for investment purposes), and if you do not have a special tax status.
- The discussion does not cover tax consequences that depend upon your particular tax situation in addition to your ownership of original notes or new notes. We suggest that you consult your tax advisor about the consequences of holding original notes or new notes in your particular situation.
- The discussion is based on current U.S. Federal tax law. Changes in the law may change the tax treatment of the original notes or new notes.
- The discussion does not cover state, local or foreign law.
- The discussion does not apply to you if you are a Non-U.S. Holder , as defined below, of notes and you (a) own 10% or more of our voting stock, (b) are a controlled foreign corporation with respect to us, or (c) are a bank making a loan in the ordinary course of its business.
- We have not requested a ruling from the Internal Revenue Service, which we refer to as the IRS, on the tax consequences of the exchange offer or owning the new notes. As a result, the IRS could disagree with any portion of this discussion.

IF YOU ARE CONSIDERING EXCHANGING ORIGINAL NOTES FOR NEW NOTES PURSUANT TO THE EXCHANGE OFFER, WE SUGGEST THAT YOU CONSULT YOUR TAX ADVISOR ABOUT THE TAX CONSEQUENCES OF SUCH AN EXCHANGE AND HOLDING THE NEW NOTES IN YOUR PARTICULAR SITUATION.

For purposes of this summary, a U.S. Holder is:

- an individual U.S. citizen or resident alien;
- a corporation or other entity taxable as a corporation for U.S. Federal income tax purposes that was created under U.S. law (Federal or state); or
- an estate or trust whose world-wide income is subject to U.S. Federal income tax.

If a partnership holds original notes or new notes, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. If you are a partner of a partnership holding original notes or new notes, we suggest that you consult your tax advisor.

For purposes of this summary, a Non-U.S. Holder is:

- an individual that is a nonresident alien;
- a corporation or other entity taxable as a corporation for U.S. Federal income tax purposes that was created under non-U.S. law (Federal or state); or
- an estate or trust that is not taxable in the U.S. on its worldwide income.

Exchange Offer

The consummation of the exchange offer will not be a taxable event for U.S. Federal income tax purposes. Accordingly, holders will not recognize any income, gain or loss in connection with an exchange of original notes for new notes pursuant to the exchange offer, and any such holder will have the same adjusted tax basis and holding period in the new notes as it had in the original notes, as measured immediately before the exchange.

Table of Contents

PLAN OF DISTRIBUTION

Unless the context otherwise requires, for purposes of this section entitled Plan of Distribution, the terms our, us or we refer to American Water Capital Corp.

Each broker-dealer that receives new notes for its own account pursuant to the exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of such new notes. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of new notes received in exchange for original notes where such original notes were acquired as a result of market-making activities or other trading activities. We have agreed that, starting on the expiration date and for a period ending upon the earlier of the 180th day after the expiration of the exchange offer or such time as such broker-dealers no longer own any original notes, we will make this prospectus, as amended or supplemented, available to any broker-dealer for use in connection with any such resale. In addition, until August 10, 2008 all dealers effecting transactions in the new notes may be required to deliver a prospectus.

We will not receive any proceeds from any sale of new notes by broker-dealers. New notes received by broker-dealers for their own account pursuant to the exchange offer may be sold from time to time in one or more transactions in the over-the-counter market, in negotiated transactions, through the writing of options on the new notes or a combination of such methods of resale, at market prices prevailing at the time of resale, at prices related to such prevailing market prices or negotiated prices. Any such resale may be made directly to purchasers or to or through brokers or dealers who may receive compensation in the form of commissions or concessions from any such broker-dealer or the purchasers of any such new notes. Any broker-dealer that resells new notes that were received by it for its own account pursuant to the exchange offer and any broker or dealer that participates in a distribution of such new notes may be deemed to be an underwriter within the meaning of the Securities Act and any profit on any such resale of new notes and any commission or concessions received by any such persons may be deemed to be underwriting compensation under the Securities Act. The letter of transmittal states that, by acknowledging that it will deliver and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act.

For a period ending upon the earlier of the 180th day after the expiration of the exchange offer or such time as such broker-dealers no longer own any original notes, we will promptly send additional copies of this prospectus and any amendment or supplement to this prospectus to any broker-dealer that requests such documents in the letter of transmittal. We have agreed to pay all expenses incident to the exchange offer other than commissions or concessions of any brokers or dealers and to indemnify the holders of the original notes (including any broker-dealers) against certain liabilities, including liabilities under the Securities Act as set forth in the exchange and registration rights agreement.

Table of Contents

LEGAL MATTERS

Certain legal matters in connection with the new notes and the support agreement, will be passed upon for us by Cravath, Swaine & Moore LLP, New York, New York.

EXPERTS

The consolidated financial statements of American Water Works Company, Inc. and Subsidiary Companies (formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies) as of December 31, 2007 and 2006 and for the three years ended December 31, 2007, included in this prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in accounting and auditing.

Table of Contents

GLOSSARY

authorized area refers to a geographic area in which we provide water and wastewater services pursuant to a certificate of public convenience and necessity (or similar authorizations).

c*ertificate of public convenience and necessity* refers to a certificate issued by a state PUC granting an exclusive right with respect to investor-owned utilities to provide service within a designated service area, and which provides limited protection from competition within that area from other investor-owned utilities.

customer typically means a connection to our water or wastewater networks; as in the case of apartment complexes, businesses and many homes, multiple individuals may be served by a single connection.

DBO refers to services provided pursuant to a contract to design, build and operate a water or wastewater system.

forward-looking test year is a device employed by state PUCs that takes account of current or projected costs or current or projected invested capital and other known and measurable changes in our business, in the rate setting process, as opposed to relying strictly on historical data.

infrastructure surcharge is a device employed by a state PUC that allows for adjustment of our basic rates and charges for specified portions of capital expenditures, generally related to replacement of aging infrastructure, outside the context of a general rate proceeding.

O&M refers to services provided pursuant to a contract to operate and maintain a water or wastewater system.

population means the estimated number of people served by our water and wastewater services; see Industry and Market Data for the methodology we employ to estimate population served.

rate case means the process to obtain approval for a change in rates that involves filing a petition with a state PUC on a periodic basis as determined by our capital expenditures needs and our operating costs.

single tariff is a policy employed by a state PUC pursuant to which all customers in a state or a region within a state are charged utilizing a single rate structure, regardless of which individual water and/or wastewater system serves them.

state PUC means a state commission or other entity engaged in economic regulation of public utilities.

test year is a device employed by a state PUC to determine costs and revenues for regulated utilities for the purposes of setting rates.

tuck-in means an acquisition of a small water and/or wastewater system, typically serving fewer than 10,000 customers, in close geographic proximity to locations where we operate our Regulated Businesses.

Table of Contents

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page Number
Audited Consolidated Financial Statements	
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets as of December 31, 2006 and 2007	F-3
Consolidated Statements of Operations for the years ended December 31, 2005, 2006, 2007	F-5
Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2006, 2007	F-6
Consolidated Statements of Changes in Common Stockholder s Equity and Comprehensive Income (Loss) for the years ended December 31, 2005, 2006, 2007	F-7
Notes to Consolidated Financial Statements	F-8

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholder of

American Water Works Company, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in common stockholder s equity and comprehensive income (loss) and of consolidated cash flows present fairly, in all material respects, the financial position of American Water Works Company, Inc. and Subsidiary Companies (formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies) at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company changed the manner in which it accounts for its defined benefit pension and other postretirement benefit plans effective December 31, 2006.

/s/ PricewaterhouseCoopers LLP

Philadelphia, Pennsylvania

February 28, 2008

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)

Consolidated Balance Sheets

(In thousands, except per share data)

	December 31, 2007	2006
ASSETS		
Property, plant and equipment		
Utility plant at original cost, net of accumulated depreciation	$ 9,199,909	$ 8,605,341
Nonutility property, net of accumulated depreciation	118,052	115,216
Total property, plant and equipment	9,317,961	8,720,557
Current assets		
Cash and cash equivalents	13,481	29,754
Restricted funds	3,258	2,100
Utility customer accounts receivable	147,640	153,583
Allowance for uncollectible accounts	(20,923)	(23,061)
Unbilled utility revenues	134,326	123,180
Non-regulated trade and other receivables, net	66,540	54,463
Taxes receivable, including federal income	23,111	
Materials and supplies	27,458	23,012
Assets of discontinued operations		12,834
Other	35,463	36,576
Total current assets	430,354	412,441
Regulatory and other long-term assets		
Regulatory assets	628,039	587,157
Restricted funds	10,252	17,239
Goodwill	2,456,952	2,962,493
Other	90,514	83,172
Total regulatory and other long-term assets	3,185,757	3,650,061
TOTAL ASSETS	$ 12,934,072	$ 12,783,059

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)

Consolidated Balance Sheets (Continued)

(In thousands, except per share data)

	December 31, 2007	2006
CAPITALIZATION AND LIABILITIES		
Capitalization		
Common stockholder s equity	$ 4,542,046	$ 3,817,397
Preferred stock without mandatory redemption requirements	4,568	4,568
Long-term debt		
Long-term debt	4,674,837	3,096,404
Redeemable preferred stock at redemption value	24,296	1,774,475
Total capitalization	9,245,747	8,692,844
Current liabilities		
Short-term debt	220,514	719,745
Current portion of long-term debt	96,455	287,383
Accounts payable	168,886	140,691
Taxes accrued, including federal income	56,002	28,115
Interest accrued	50,867	34,775
Liabilities of discontinued operations		2,478
Other	181,765	150,475
Total current liabilities	774,489	1,363,662
Regulatory and other long-term liabilities		
Advances for construction	655,375	615,671
Deferred income taxes	638,918	583,403
Deferred investment tax credits	35,361	36,533
Regulatory liability cost of removal	192,650	166,867
Accrued pension expense	290,722	314,577
Accrued postretirement benefit expense	158,552	144,904
Other	123,871	110,354
Total regulatory and other long-term liabilities	2,095,449	1,972,309
Contributions in aid of construction	818,387	754,244
Commitments and contingencies		
TOTAL CAPITALIZATION AND LIABILITIES	$ 12,934,072	$ 12,783,059

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)

Consolidated Statements of Operations

(In thousands, except per share data)

	Years Ended December 31,		
	2007	2006	2005
Operating revenues	$ 2,214,215	$ 2,093,067	$ 2,136,746
Operating expenses			
Operation and maintenance	1,246,479	1,174,544	1,201,566
Depreciation and amortization	267,335	259,181	261,364
General taxes	183,253	185,065	183,324
Loss (gain) on sales of assets	(7,326)	79	(6,517)
Impairment charges	509,345	221,685	385,434
Total operating expenses, net	2,199,086	1,840,554	2,025,171
Operating income	15,129	252,513	111,575
Other income (deductions)			
Interest, net	(283,165)	(365,970)	(345,257)
Allowance for other funds used during construction	7,759	5,980	5,810
Allowance for borrowed funds used during construction	3,449	2,652	2,420
Amortization of debt expense	(4,867)	(5,062)	(4,367)
Preferred dividends of subsidiaries	(225)	(215)	(227)
Other, net	6,401	1,164	5,895
Total other income (deductions)	(270,648)	(361,451)	(335,726)
Loss from continuing operations before income taxes	(255,519)	(108,938)	(224,151)
Provision for income taxes	86,756	46,912	50,979
Loss from continuing operations	(342,275)	(155,850)	(275,130)
Loss from discontinued operations, net of tax	(551)	(6,393)	(49,910)
Net loss	$ (342,826)	$ (162,243)	$ (325,040)
Basic earnings per common share			
Loss from continuing operations	$ (2.14)	$ (0.97)	$ (1.72)
Loss from discontinued operations, net of tax	$ (0.00)	$ (0.04)	$ (0.31)
Net loss	$ (2.14)	$ (1.01)	$ (2.03)
Diluted earnings per common share			
Loss from continuing operations	$ (2.14)	$ (0.97)	$ (1.72)
Loss from discontinued operations, net of tax	$ (0.00)	$ (0.04)	$ (0.31)

Net loss	$ (2.14)	$ (1.01)	$ (2.03)
Average common shares outstanding during the period:			
Basic	160,000	160,000	160,000
Diluted	160,000	160,000	160,000

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)

Consolidated Statements of Cash Flows

(In thousands, except per share data)

	Years Ended December 31,		
	2007	**2006**	**2005**
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	$ (342,826)	$ (162,243)	$ (325,040)
Adjustments			
Loss on sale of discontinued businesses		1,001	15,407
Depreciation and amortization	267,335	259,181	261,364
Impairment charges	509,345	227,802	420,370
Removal costs net of salvage	38,442	34,627	32,196
Provision for deferred income taxes	41,918	34,464	26,861
Amortization of deferred investment tax credits	(1,510)	(1,306)	(1,612)
Provision for losses on utility accounts receivable	17,553	26,706	27,485
Allowance for other funds used during construction	(7,759)	(5,980)	(5,810)
(Gain) loss on sale of assets	(7,326)	79	(6,517)
Gain on early extinguishment of debt	(13,113)	(3,739)	
Other, net	(45,117)	9,734	29,383
Changes in assets and liabilities			
Receivables and unbilled utility revenues	(35,097)	3,094	4,589
Taxes receivable, including federal income	(23,111)		
Other current assets	(1,171)	326	20,060
Accounts payable	6,860	7,214	23,100
Taxes accrued, including federal income	42,430	(56,970)	4,193
Interest accrued	16,092	(18,131)	4,564
Other current liabilities	10,767	(32,111)	(5,158)
Net cash provided by operating activities	473,712	323,748	525,435
CASH FLOWS FROM INVESTING ACTIVITIES			
Construction expenditures	(758,569)	(688,843)	(558,446)
Allowance for other funds used during construction	7,759	5,980	5,810
Acquisitions	(15,877)	(12,534)	(4,979)
Proceeds from sale of assets and securities	16,346	3,665	1,528
Proceeds from sale of discontinued operations	9,660	30,151	15,336
Removal costs from property, plant and equipment retirements	(9,852)	(20,446)	(17,928)
Receivable from affiliates			562
Net funds (restricted) released	5,829	(9,411)	27,952
Investment in equity investee	(1,874)		
Net cash used in investing activities	(746,578)	(691,438)	(530,165)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	3,869,109	582,498	494,322
Repayment of long-term debt	(2,350,725)	(637,479)	(66,039)
Net borrowings (repayments) under short-term debt agreements	(541,623)	345,682	(485,334)
Advances and contributions for construction, net of refunds	35,846	47,446	51,985
Change in cash overdraft position	42,198		
Capital contributions	967,092		
Debt issuance costs	(14,916)	(5,239)	(3,347)
Redemption of preferred stocks	(1,750,388)	(541)	(636)
Net cash provided by financing activities	256,593	332,367	(9,049)

Net decrease in cash and cash equivalents	(16,273)	(35,323)	(13,779)
Cash and cash equivalents at beginning of period	29,754	65,077	78,856
Cash and cash equivalents at end of period	$ 13,481	$ 29,754	$ 65,077
Cash paid during the year for:			
Interest, net of capitalized amount	$ 295,707	$ 402,370	$ 349,084
Income taxes, net of refunds	$ 17,823	$ 11,633	$ 43,694
Non-cash investing activity			
Capital expenditures acquired on account but unpaid as of year-end	$ 94,930	$ 73,595	$ 85,703
Non-cash financing activity			
Advances and contributions	$ 101,226	$ 72,892	$ 85,818
Capital contribution (See Note 10)	$ 100,000	$ 1,194,454	$

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)

Consolidated Statements of Changes in Common Stockholder s Equity and Comprehensive Income (Loss)

(In thousands, except per share data)

	Common Stock			Retained Earnings	Accumulated Other	Common	
	Shares	Par Value	Paid-in Capital	(Accumulated Deficit)	Comprehensive Income (Loss)	Stockholder s Equity	Comprehensive Income (Loss)
Balance at December 31, 2004	160,000	$ 1,600	3,376,401	(249,009)	563	3,129,555	
Net loss				(325,040)		(325,040)	$ (325,040)
Market value adjustments for investments, net of tax of $125					(233)	(233)	(233)
Additional minimum pension liability, net of tax of $302					(472)	(472)	(472)
Foreign currency translation					906	906	906
Dividends on preferred stock							
Total comprehensive loss							$ (324,839)
Balance at December 31, 2005	160,000	$ 1,600	$ 3,376,401	$ (574,049)	$ 764	$ 2,804,716	
Net loss				(162,243)		(162,243)	$ (162,243)
Equity investment by RWE			1,194,454			1,194,454	
Market value adjustments for investments, net of tax of $254					471	471	471
Additional minimum pension liability, net of tax of $1,115					1,744	1,744	1,744
Recognition of employee benefit plan underfunded status					(21,919)	(21,919)	
Foreign currency translation					174	174	174
Dividends on preferred stock							
Total comprehensive loss							$ (159,854)
Balance at December 31, 2006	160,000	$ 1,600	$ 4,570,855	$ (736,292)	$ (18,766)	$ 3,817,397	
Net loss				(342,826)		(342,826)	$ (342,826)
Equity investment by RWE			1,067,092			1,067,092	
Change in employee benefit plan funded status					924	924	
Pension plan amortized to periodic benefit cost:							
Prior service cost					36	36	36
Actuarial loss					72	72	72
Foreign currency translation					(649)	(649)	(649)
Total comprehensive loss							$ (343,367)
Balance at December 31, 2007	160,000	$ 1,600	$ 5,637,947	$ (1,079,118)	$ (18,383)	$ 4,542,046	

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents

American Water Works Company, Inc. and Subsidiary Companies

(formerly Thames Water Aqua US Holdings, Inc. and Subsidiary Companies)

Notes to Consolidated Financial Statements

(In thousands, except per share data)

Note 1: Organization and Operation

American Water Works Company, Inc. (AWW) and its subsidiaries (collectively referred to herein as the Company), formerly Thames Water Aqua US Holdings, Inc. (TWAUSHI) and a wholly owned subsidiary of RWE Aktiengesellschaft (RWE), is the holding company for regulated and non-regulated subsidiaries throughout the United States of America and Ontario, Canada. The regulated subsidiaries provide water and wastewater services and, as public utilities, function under rules and regulations prescribed by state regulators. These regulated subsidiaries have similar long-term economic characteristics and are operationally segregated into the 20 U.S. states in which the Company operates regulated utilities. The non-regulated subsidiaries include distinctive lines of business including Homeowner Services, which provides water and sewer line protection plans for homeowners, the Operations and Maintenance contracts group, which conducts operation and maintenance of water and wastewater facilities for municipalities and the U.S. Military, among others, and Carbon Regeneration, which sells granular activated carbon technologies to help remove contaminants and improve the quality of drinking water.

RWE has announced its intention to divest the Company through an initial public offering (IPO). These consolidated financial statements represent the consolidated results of the Company, formerly issued under the name of TWAUSHI. On September 28, 2007, TWAUSHI, formerly the parent company of AWW, merged with and into AWW (the Merger). The IPO required filing of a registration statement with the U.S. Securities and Exchange Commission, which was filed on August 27, 2007 and subsequently amended on October 11, 2007 and January 29, 2008.

Prior to the merger, AWW was a wholly-owned subsidiary of TWAUSHI. As a result of the Merger, TWAUSHI, at the time an indirect wholly-owned subsidiary of RWE, was dissolved and AWW is the surviving entity. As the merger parties were each part of a group of entities under the common control of RWE, AWW recognized the transfer of the assets and liabilities of TWAUSHI at their respective carrying amounts as of the effective date of the Merger in accordance with Statement of Financial Accounting Standards No. 141, Accounting for Business Combinations (SFAS 141). In accordance with SFAS 141, as the merger parties were each part of a group of entities under common control of RWE, the Merger did not constitute a business combination and the method used by the Company to account for the merger was similar to the pooling method and was performed retroactively in these consolidated financial statements as if they had historically been a combined entity. Accordingly, the consolidated financial statements of AWW as of and at December 31, 2007, 2006 and 2005 include the accounts of TWAUSHI.

Note 2: Significant Accounting Policies

Principles of Consolidation

As a result of the Merger, the accompanying consolidated financial statements include the accounts of AWW and its subsidiaries, which include the accounts of the former TWAUSHI entity and its subsidiaries. The Company s results of operations are comprised of the combination of the formerly separate entities and their subsidiaries. Intercompany balances and transactions between subsidiaries have been eliminated. The Company uses the equity method to report its investments in two joint venture investments in each of which the Company holds a 50% voting interest and cannot exercise control over the operations and policies of the investments. Under the equity method, the Company records its interests as an investment and its percentage share of earnings as earnings or losses of investee.

Table of Contents

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The Company considers benefit plan assumptions, the carrying values of goodwill and other long-lived assets, including regulatory assets, revenue recognition and accounting for income taxes to be its critical accounting estimates. The Company s significant estimates that are particularly sensitive to change in the near term are amounts reported for pension and other postemployment benefits, contingency-related obligations and goodwill.

Regulation

The Company s regulated utilities are subject to regulation by the public utility commissions and the local governments of the states in which they operate (the Regulators). These Regulators have allowed recovery of costs and credits which the Company has recorded as regulatory assets and liabilities. Accounting for future recovery of costs and credits as regulatory assets and liabilities is in accordance with Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation (SFAS 71). This statement sets forth the application of generally accepted accounting principles for those companies whose rates are established by or are subject to approval by an independent third-party regulator. Under SFAS 71, regulated utilities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the rate making process in a period different from the period in which they would have been reflected in operations by an non-regulated company. These deferred regulatory assets and liabilities are then reflected in the statement of operations in the period in which the costs and credits are reflected in the rates charged for service.

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction. The costs incurred to acquire and internally develop computer software for internal use are capitalized as a unit of property. The carrying value of these costs amounted to $29,103 and $44,652 at December 31, 2007 and 2006, respectively. The cost of repairs, maintenance, including planned major maintenance activities, and minor replacements of property is charged to maintenance expense as incurred.

When units of property are replaced, retired or abandoned, the recorded value thereof is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates, until the costs to retire those assets are incurred.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method.

Nonutility property consists primarily of buildings and equipment utilized by the Company for internal operations. This property is stated at cost, net of accumulated depreciation calculated using the straight-line method over the estimated useful lives of the assets, ranging from three to forty years.

Table of Contents

Cash and Cash Equivalents

Substantially all cash is invested in interest-bearing accounts. All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

The Company had book overdrafts for certain of its disbursement accounts of $42,198 and $0 at December 31, 2007 and 2006, respectively. A book overdraft represents transactions that have not cleared the bank accounts at the end of the period. The Company transfers cash on an as-needed basis to fund these items as they clear the bank. The balance of the book overdraft is reported as short-term debt and the change in the book overdraft balance is reported as cash flows from financing activities.

Restricted Funds

Restricted funds represent proceeds received from financings for the construction and capital improvement of utility facilities. The proceeds of these financings are held in escrow until the capital expenditures are incurred. Restricted funds expected to be released within 12 months subsequent to year-end are classified as current.

Utility Customer Accounts Receivable

Regulated utility customer accounts receivable represent amounts billed to water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable Regulators and generally, collateral is not required.

Allowance for Uncollectible Accounts

Allowances for uncollectible accounts are maintained for estimated probable losses resulting from the Company s inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company writes-off accounts when they become uncollectible. (See Note 5)

Non-regulated Trade and Other Receivables, Net

Non-regulated trade and other receivables, net consists of non-regulated trade accounts receivable and non-regulated unbilled revenues, net of a reserve for doubtful accounts and non-utility customer receivables of the regulated subsidiaries. In determining the reserve for uncollectible non-regulated accounts, the Company considers the length of time the trade accounts receivable are past due and the customer s current ability to pay their obligation. Unbilled receivables are accrued when service has been provided but has not been billed to customers. (See Note 6)

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Goodwill

The Company considers the carrying value of goodwill to be one of its critical accounting estimates. The Company believes the assumptions and other considerations used to value goodwill to be appropriate. However, if actual experience differs from the assumptions and considerations used in its analysis, the resulting change could have a material impact on the consolidated financial statements.

Table of Contents

Goodwill is primarily associated with the acquisitions of American Water Works Company, Inc. in 2003 and E town Corporation in 2001 (the Acquisitions) and has been assigned to reporting units based on the fair values at the date of the Acquisitions. The regulated utility subsidiaries have been aggregated and deemed a single reporting unit as they have similar economic characteristics. In the non-regulated segment, the business is organized into seven reporting units for its non-regulated services. In accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142), goodwill is reviewed annually, or more frequently if changes in circumstances indicate the carrying value may not be recoverable. To test for impairment, the Company utilizes discounted estimated future cash flows, comparable public company analyses and all other available relevant fair value information to measure fair value for each reporting unit. This calculation is highly sensitive to the estimated future cash flows of each reporting unit, the discount rate assumed in these calculations, the market multiples of comparable companies and the estimated price per share of the Company s stock assumed in these calculations. Annual impairment reviews are performed in the fourth quarter of the calendar year, in conjunction with the timing of the completion of the Company s annual strategic business plan.

For each of the years ended December 31, 2007, 2006 and 2005, the Company determined that its goodwill, including goodwill of discontinued operations, was impaired and recorded impairments of $509,345, $227,802 and $396,348 respectively. (See Note 8)

Impairment of Long-Lived Assets

The Company considers the carrying value of long-lived assets to be one of its critical accounting estimates. The Company believes the assumptions and other considerations used to evaluate the carrying value of long-lived assets to be appropriate. However, if actual experience differs from the assumptions and considerations used in its estimates, the resulting change could have a material adverse impact on the consolidated financial statements.

Long-lived assets, other than goodwill, include land, buildings, equipment and long-term investments. Long-lived assets, other than investments and land, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market value of a long-lived asset, a significant adverse change in the manner the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, the Company estimates the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets and compares that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recorded.

The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the assets carrying value exceeds its fair value.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

The Company considered the results of the goodwill impairment analysis as indicators that the carrying value of long-lived assets may not be recoverable and performed impairment analyses for long-lived assets, other than investments, in accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment of disposal of Long-Lived Assets (SFAS 144). As a result of SFAS 144 impairment analyses, the Company recorded pre-tax charges of $0, $0, and $24,022 for the years ended December 2007, 2006 and 2005,

Table of Contents

respectively. The non-regulated impairment in 2005 primarily resulted from lower than expected growth, slower development compared with original expectations, and a building with a carrying value that exceeded its fair value. These charges are included in impairment charges in the statements of operations. The carrying values as of December 31, 2007, 2006 and 2005 were determined to be appropriate.

The Company holds other investments including investments in privately held companies and investments in joint ventures accounted for using the equity method. The Company s investments in privately held companies and joint ventures are classified as other long-term assets.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which the Company invests, as well as volatility inherent in the external markets. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset s carrying value exceeds its fair value. As a result of fair value analyses, the Company recorded pre-tax charges of $0 for the year ended December 31, 2007, $750 for the year ended December 31, 2006 and $0 for the year ended December 31, 2005.

Advances and Contributions in Aid of Construction

Regulated utility subsidiaries may receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Advances which are no longer refundable are reclassified to contributions in aid of construction. Contributions in aid of construction are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such contributions generally serves as a rate base reduction since they represent non-investor supplied funds. Non-cash utility property has been received, primarily from developers, as advances or contributions of $101,226, $72,892, and $85,818 for the years ended December 31, 2007, 2006 and 2005, respectively.

Generally, the Company depreciates utility plant funded by contributions and amortizes its contributions balance as a reduction to depreciation expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for the contributions. Certain of the Company s subsidiaries do not depreciate contributed property, based on regulatory guidelines. Amortization of contributions in aid of construction was $20,720, $16,697 and $14,960 for the years ended December 31, 2007, 2006 and 2005, respectively.

Recognition of Revenues

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are provided and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the latest meter reading to the end of the accounting period.

The Company has agreements with the United States Government to operate and maintain water and wastewater systems at various military bases pursuant to 50 year contracts (military agreements). The military agreements are subject to periodic price redetermination adjustments and modifications for changes in circumstance. Additionally, the Company has agreements ranging in length from one to 25 years with various municipalities to operate and maintain water and wastewater systems (O&M agreements). Revenue from these non-regulated operations is recognized as services are provided. (See Note 20)

Construction Contracts

In accordance with the American Institute of Certified Public Accountants Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production Type Contracts, the Consolidated Statements of Operations include revenues and operation and maintenance expenses related to agreements for the design and construction of water and waste water treatment plants. Revenues from these construction projects are

Table of Contents

recognized over the contract term based on the estimated percentage of completion during the period compared to the total estimated services to be provided over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Under these agreements, revenues were $32,141, $56,069 and $120,331 and operation and maintenance expenses were $34,543, $53,845 and $117,814 as of December 31, 2007, 2006 and 2005, respectively.

Taxes

The parent company and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

Investment tax credits have been deferred by the regulated utility subsidiaries and are being amortized to income over the average estimated service lives of the related assets.

The Company accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

Allowance for Funds Used During Construction (AFUDC)

AFUDC is a non-cash credit to income with a corresponding charge to utility plant which represents the cost of borrowed funds or a return on equity funds devoted to plant under construction. The regulated utility subsidiaries record AFUDC to the extent permitted by the Regulators.

Environmental Costs

Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to $6,600, $6,600 and $5,557 at December 31, 2007, 2006 and 2005, respectively. (See Note 7) The Company pursues recovery of incurred costs through all appropriate means, including regulatory recovery through customer rates.

New Accounting Standards

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards SFAS No. 160 (SFAS 160), Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51, which establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 is effective for the Company on January 1, 2009. The Company is currently evaluating the effect, if any, that the adoption of SFAS 160 will have on its results of operations, financial position and cash flows.

Table of Contents

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R) (SFAS 141(R)), Business Combinations, which will significantly change the accounting for business combinations. SFAS 141(R) is effective for the Company for business combinations finalized on or after January 1, 2009. The Company is currently evaluating the effect, if any, that the adoption of SFAS 141(R) will have on its results of operations, financial position and cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). This standard permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This standard will be effective for the Company on January 1, 2008. The Company does not believe the standard will have a significant effect on its results of operations, financial position or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R), (SFAS 158). This statement requires the recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, actuarial gains and losses, prior service costs or credits, and transition obligations and assets that have not been recognized in net periodic benefit cost under previous accounting standards will be recognized as a regulatory asset for the portion of the underfunded liability that meets the recovery criteria prescribed in SFAS 71 and as accumulated other comprehensive income, net of tax effects, for that portion of the underfunded liability that does not meet SFAS 71 regulatory accounting criteria. The Company adopted the recognition and disclosure requirements of the statement as of the end of fiscal year 2006.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position FAS 157-2 which allows a one-year deferral of adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The Company is currently evaluating the impact on its financial statements of adopting SFAS 157.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, (FIN 48) an Interpretation of SFAS No. 109, Accounting for Income Taxes. FIN 48 is intended to address inconsistencies among entities with the measurement and recognition in accounting for income tax deductions for financial statement purposes. Specifically, FIN 48 addresses the timing of the recognition of income tax benefits. FIN 48 requires the financial statement recognition of an income tax benefit when the Company determines that it is more -likely -than -not that the tax position will be sustained. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted as required on January 1, 2007 and it did not have a significant effect on the Company s results of operations, financial position or cash flows. The Company elected to recognize accrued interest and penalties related to tax positions as a component of income tax expense.

During 2006, the Emerging Issues Task Force of the FASB ratified EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) (EITF 06-3). The Task Force reached a consensus that the scope of EITF 06-3 includes any tax assessed by a governmental authority that is both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and that the presentation of such taxes is an accounting policy that should be disclosed. The Company s accounting policy is to present these taxes on a net basis (excluded from revenues).

Table of Contents

Note 3: Acquisitions

On November 1, 2007, the Company acquired all of the outstanding capital stock of S.J. Services, Inc. (SJS), for $13,000 in cash, which included the assumption of long-term debt totaling $3,541, and incurred acquisition costs of $458. The acquisition was accounted for as a business combination and in accordance with SFAS 141. Accordingly, operating results of SJS from November 1, 2007 through December 31, 2007 are included in the Company s results of operations. The purchase price was allocated to the net tangible and intangible assets based upon their estimated fair values at the date of acquisition. The following table shows the purchase price allocation:

Property, plant and equipment	$ 15,614
Current assets	2,162
Other long term assets	917
Goodwill	4,727
Total assets acquired	23,420
Current liabilities	491
Long term debt (including current portion)	2,791
Deferred taxes	1,114
Contributions in aid of construction	5,566
Total liabilities assumed	9,962
Net assets acquired	$ 13,458

In addition to SJS, during 2007, the Company closed on the acquisitions of eight other regulated water systems. These water systems were acquired for an aggregate purchase price of $2,419.

As of December 31, 2007, the Company has entered into agreement with the City of Trenton, New Jersey to purchase the assets of the City s water system located in the four surrounding townships. The acquisition would add approximately thirty-nine thousand customers to the Company s customer base with a proposed purchase price of $100,000. The proposed purchase has been approved by the Trenton City Council and is awaiting approval from the New Jersey Board of Public Utilities. Included in other current assets is a $10,000 refundable deposit the Company made in December 2007 which is being held in an interest bearing escrow account as required by the bidding process.

Note 4: Utility Plant

The components of utility plant by category at December 31 are as follows:

	Range of Remaining Useful Lives	2007	2006
Water plant			
Land and other non-depreciable assets		$ 144,909	$ 141,092
Sources of supply	7 to 93 Years	488,477	464,328
Treatment and pumping facilities	2 to 90 Years	2,273,501	2,201,989
Transmission and distribution facilities	5 to 101 Years	5,462,209	5,141,382
Services, meters and fire hydrants	5 to 100 Years	2,027,746	1,889,105
General structures and equipment	3 to 70 Years	774,051	612,462
Wastewater plant	4 to 100 Years	506,049	451,251
Construction work in progress		299,917	276,405
		11,976,859	11,178,014
Less accumulated depreciation		2,776,950	2,572,673

	$ 9,199,909	$ 8,605,341

Table of Contents

Utility plant depreciation expense amounted to $263,737 in 2007, $249,355 in 2006 and $249,524 in 2005. Included in the 2005 amount is $21,644 resulting from an information technology project that was abandoned.

Note 5: Allowance for Uncollectible Accounts

The following table summarizes the changes in the Company s allowances for uncollectible accounts:

	2007	2006	2005
Balance at January 1,	$ (23,061)	$ (15,051)	$ (9,748)
Amounts charged to expense	(17,553)	(26,706)	(27,485)
Amounts written off	22,192	21,538	24,677
Recoveries of amounts written off	(2,501)	(2,842)	(2,495)
Balance at December 31,	$ (20,923)	$ (23,061)	$ (15,051)

Note 6: Non-regulated Trade and Other Receivables, Net

Components of the Company s non-regulated trade and other receivables, net are as follows:

	2007	2006
Non-regulated trade accounts receivable	$ 28,028	$ 23,365
Allowance for doubtful accounts non-regulated trade accounts receivable	(5,567)	(8,663)
Non-regulated unbilled revenue	17,232	12,624
Other	26,847	27,137
	$ 66,540	$ 54,463

Note 7: Regulatory Assets

The regulatory assets represent costs that are expected to be fully recovered from customers in future rates. Except for income taxes, regulatory assets are excluded from the Company s rate base and do not earn a return. The components of regulatory assets are as follows:

	2007	2006
Income taxes recoverable through rates	$ 228,562	$ 230,860
Debt and preferred stock expense	76,070	66,021
Deferred pension expense	102,130	106,622
Deferred other postretirement benefit expense	45,683	23,721
Deferred security costs	16,853	21,089
Deferred business services project expense	17,037	21,368
Deferred tank painting costs	18,502	16,537
Deferred rate case expense	11,854	6,675
Purchase premium recoverable through rates	60,869	61,079
Environmental remediation recoverable through rates	6,600	6,600
Coastal water project costs	15,739	
Other	28,140	26,585
	$ 628,039	$ 587,157

The Company has recorded a regulatory asset for the additional revenues expected to be realized as the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the regulatory authorities of full normalization for rate making purposes. Full normalization requires no flow through of tax benefits to customers. The regulatory asset for income taxes recoverable through rates is

Table of Contents

net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates. Expenses of preferred stock issues without sinking fund provisions are amortized over 30 years from date of issue; expenses of issues with sinking fund provisions are charged to operations as shares are retired.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain subsidiaries. These costs will be recovered in future service rates as contributions are made to the pension plan. The Company has regulatory assets of $45,933 and $44,813 at December 31, 2007 and 2006 which is the portion of the underfunded status that is probable of recovery through rates in future periods.

Postretirement benefit expense in excess of the amount recovered in rates through 1997 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service and will be fully recovered over a 20-year period ending in 2012 as authorized by the regulatory authorities. The Company has regulatory assets of $40,012 and $16,687 at December 31, 2007 and 2006 which is the portion of the underfunded status that is probable of recovery through rates in future periods.

The cost of additional security measures that were implemented to protect facilities after the terrorist attacks on September 11, 2001 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service by certain subsidiaries.

Business services project expenses consist of reengineering and start-up activities for consolidated customer and shared administrative service centers that began operations in 2001. These costs are recognized in the rates charged for water service by certain subsidiaries.

Tank painting costs are generally deferred and amortized to current operations on a straight-line basis over periods ranging from 5 to 15 years, as authorized by the regulatory authorities in their determination of rates charged for service.

Purchase premium recoverable through rates is the recovery of the acquisition premium related to an asset acquisition by the Company s California subsidiary during 2002. As authorized for recovery by the California regulator, these costs are being amortized to operations based on an agreed schedule of mortgage style amortization. The recovery period is from May 2004 through December 2041.

Environmental remediation recoverable through rates is the recovery of costs incurred by the Company s California subsidiary under a settlement agreement entered into with the National Oceanic and Atmospheric Administration to improve habitat conditions in the Carmel River Watershed.

Coastal water project costs include certain preliminary costs associated with studying alternative projects to help solve water supply shortages in Monterey, California. In 2007, in accordance with the instructions of the California regulator, the Company reclassified $12,287 to Coastal water project costs that was included in construction work in progress at December 31, 2006. Coastal water project costs incurred through December 31, 2006 have been reviewed and approved for recovery. The Company believes it is probable that the costs incurred since the last rate review will also be recoverable.

Note 8: Goodwill

The Company reviews goodwill associated with its reporting units for impairment. The performance of the impairment test involves a two-step process. The first step of the impairment test involves comparing the fair value of a reporting unit with the reporting unit s carrying amount, including goodwill. If the carrying amount of the reporting

Table of Contents

unit exceeds its fair value, a second step is performed to determine the amount of the impairment loss. The impairment loss is determined by comparing the implied fair value of goodwill with the carrying amount of goodwill. The Company believes that the estimates of fair value are reasonable. The Company may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in the valuation multiples of comparable water utilities, a decline in the market value of the Company s common stock and its value relative to the Company s book equity at the consummation of the IPO or a decline over a period of time of the Company s stock price following consummation of the IPO. A decline in the Company s forecasted results in the Company s business plan, such as changes in rate case results or capital investment budgets or changes in the Company s interest rates may also result in an incremental impairment charge. Further recognition of impairments of a significant portion of goodwill would negatively affect the Company s results of operations and total capitalization, the effect of which could be material and could make it more difficult for the Company to secure financing on attractive terms and maintain compliance with the Company s debt covenants.

For the years ended December 31, 2007, 2006 and 2005, the Company recorded impairment charges for goodwill, including discontinued operations, in the amount of $509,345, $227,802, and $396,348, respectively.

During the third quarter of 2007, as a result of the Company s debt being placed on review for possible downgrades and the proposed sale of the Company in an IPO, management determined that it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and in the third quarter of 2007 the Company recorded an impairment charge to goodwill related to its Regulated Businesses in the amount of $243,345. The impairment charge was not due to any one significant event but represents the result of a decline in the estimated fair value of the Regulated Businesses from November 30, 2006. The decline was primarily due to slightly lower long-term earnings than previously forecasted caused by updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

The Company completed its scheduled annual impairment test in the fourth quarter of 2007 and determined that impairment had occurred based upon information regarding the Company s market value in connection with the IPO. Management determined that the indicative fair value of the Company based on estimates of the IPO price range was the best evidence of the Company s market value and incorporated this indicated market value into the Company s valuation methodology. Based on the results of the impairment test, an impairment of $266,000 to the Company s carrying value was recognized.

The 2006 impairment charge was attributable to higher interest rates in the regulated business and a change in the potential net realizable value of an unregulated business.

The 2005 impairment charge was primarily attributable to a change in the Company s strategic business plan for the unregulated business and lower margins than previously forecasted in the regulated business.

The change in the Company s goodwill assets, as allocated between the reporting units is as follows:

Reporting Unit	Balance as of Dec. 31, 2004	Goodwill reclassified to assets of discontinued operations	2005 Impairment Losses	Balance as of Dec. 31, 2005	Goodwill from Acquisitions	2006 Impairment Losses	Balance as of Dec. 31, 2006	Goodwill from Acquisitions	2007 Impairment Losses	Balance as of Dec. 31, 2007
Regulated	$ 3,387,071	$	$ (341,946)	$ 3,045,125	$ 2,608	$ (214,922)	$ 2,832,811	$ 3,804	$ (509,345)	$ 2,327,270
Operations & maintenance										
Residuals	34,678	(21,016)	(7,951)	5,711		(5,711)				
Underground	16,141	(16,141)								
Carbon	3,138		(1,386)	1,752			1,752			1,752
Engineering	1,052			1,052		(1,052)				
Homeowner services	121,800			121,800			121,800			121,800
Military	28,190		(22,060)	6,130			6,130			6,130
Total	$ 3,592,070	$ (37,157)	$ (373,343)	$ 3,181,570	$ 2,608	$ (221,685)	$ 2,962,493	$ 3,804	$ (509,345)	$ 2,456,952

Table of Contents

Note 9: Preferred Stock Without Mandatory Redemption Requirements

Certain preferred stock agreements do not require annual sinking fund payments or redemption except at the option of the subsidiaries and are as follows:

	Balance at December 31	
Dividend Yield	**2007**	**2006**
4.50%	$ 1,720	$ 1,720
5.00%	1,968	1,968
5.50%	488	488
5.75%	392	392
	$ 4,568	$ 4,568

Note 10: Long-Term Debt

The Company primarily incurs long-term debt to fund capital expenditures at the regulated subsidiaries. The components of long-term at December 31 are:

	Rate	Maturity Date	2007	2006
Long-term debt of American Water Works Company, Inc.				
Mandatory redeemable preferred stock (a)			$	$ 1,750,000
Long-term debt of American Water Capital Corp.				
Private activity bonds and government funded debt				
Floating rate (b)	3.20%-5.05%	2018-2032	86,860	86,860
Senior notes				
Fixed rate	5.39%-6.87%	2011-2037	2,712,000	623,000
RWE notes (c)				
Fixed rate				465,300
Long-term debt of other subsidiaries				
Private activity bonds and government funded debt				
Fixed rate	0%-6.88%	2009-2038	942,941	949,240
Floating rate (d)	3.65%-4.90%	2015-2032	178,145	178,145
Mortgage bonds				
Fixed rate	6.31%-9.71%	2008-2034	731,340	832,876
Senior debt				
Fixed rate	5.60%-9.10%	2008-2025	45,473	146,000
Mandatory redeemable preferred stock	4.60%-9.75%	2013-2036	24,644	25,032
Notes payable and other (e)	5.76%-11.77%	2008-2026	3,442	5,703
Long-term debt			$ 4,724,845	$ 5,062,156
Unamortized debt discount, net (f)			70,743	96,106
Total long-term debt			$ 4,795,588	$ 5,158,262

(a) Thames Water Investments Luxembourg (TWILUX), an affiliate and wholly owned subsidiary of RWE, was the holder of $1,750,000 of the Company s 5.9% preferred stock, par value $1, which was issued in connection with RWE s acquisition of American Water Works Company, Inc. One thousand seven hundred and fifty shares were authorized and outstanding at December 31, 2006.

Table of Contents

(b) Tax-exempt bonds which are remarketed as money market bonds for periods up to 270 days (1 to 127 days during 2007). These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption.
(c) Debt funded by RWE. (See Note 19)
(d) $169,585 of the total represents tax-exempt bonds which are sold at auction rates that are reset every 7 to 35 days. These bonds may be converted to other short-term variable-rate structures, a fixed-rate structure or subject to redemption. The remaining $8,560 represents tax-exempt bonds remarketed as money market bonds. See (b) above.
(e) Includes capital lease obligations of $1,982 and $2,191 at December 31, 2007 and 2006, respectively. Lease payments of $152, $171, $193, $215, $237 and $1,014 will be made in 2008, 2009, 2010, 2011, 2012 and thereafter, respectively.
(f) Includes fair value adjustments.

In 2007, the Company borrowed $1,750,000 from RWE and used the proceeds to redeem $1,750,000 of its 5.9% mandatory redeemable preferred stock.

Also during 2007, the Company issued senior notes in the principal amount of $2,117,000 and received equity contributions from RWE in the amount of $1,067,092. The Company used the proceeds from the senior notes and equity contributions to repay long-term and short-term RWE notes, repay outstanding commercial paper and for other corporate purposes amounting to $2,011,530, $624,446 and $548,116, respectively.

A portion of the RWE notes that were redeemed in 2007 were obtained for the use of certain of the Company s regulated subsidiaries. These notes were redeemed early resulting in a difference of $8,655 between the book value of the RWE notes and the cash consideration required to extinguish the notes. As agreed with the applicable Regulators, the difference on extinguishment was deferred as a regulatory liability by the Company s regulated subsidiaries and will be amortized to Interest, net over the remaining lives of the original RWE notes for periods ranging from 2014 to 2034.

The future sinking fund payments and maturities are as follows:

Year	Amount
2008	$ 96,455
2009	55,799
2010	45,158
2011	35,043
2012	32,254
Thereafter	4,460,136

The following long-term debt was issued in 2007:

Company	Type	Interest Rate	Maturity	Amount
American Water Capital Corp.	RWE notes variable rate	5.72%	2009	$ 1,750,000
American Water Capital Corp.	Senior notes	5.39%-6.59%	2013-2037	2,117,000
Other subsidiaries	State financing authority loans and other	1.00%-1.62%	2013-2025	2,109
Total issuances				$ 3,869,109

In 2007, the Company assumed $3,347 of long-term debt consisting of senior notes and state financing authority loans with interest rates ranging from 0.00% to 9.10% and maturities ranging from 2008 to 2025 associated with the acquisition of SJS. This debt was recognized at fair value in the purchase accounting at $2,791. (See Note 3)

Table of Contents

The following debt and preferred stock with mandatory redemption requirements were retired through optional redemption or payment at maturity during 2007:

Company	Type	Interest Rate	Maturity	Amount
Long-term debt				
American Water Capital Corp.	Senior notes fixed rate	6.87%	2011	$ 28,000
American Water Capital Corp.	RWE notes fixed rate	4.00%-6.05%	2007-2034	465,300
American Water Capital Corp.	RWE notes variable rate	5.72%	2009	1,750,000
Other subsidiaries	Senior notes fixed rate	7.25%-8.75%	2007-2028	101,531
Other subsidiaries		0%-10.06%	2007-2034	114,340
Preferred stock with mandatory redemption requirements				
American Water Works Company	RWE preferred stock fixed rate	5.90%	2012	1,750,000
Other subsidiaries		4.60%-8.88%	2007-2019	388
Total retirements & redemptions				$ 4,209,559

Gains from early extinguishment of debt included in Interest, net amounted to $13,113, $3,739 and $0 in 2007, 2006 and 2005, respectively.

Interest, net includes interest income of approximately $10,985, $4,254 and $3,300 at December 31, 2007, 2006 and 2005, respectively.

Note 11: Short-Term Debt

The components of short-term debt at December 31 are as follows:

	2007	2006
RWE short-term notes	$	$ 398,230
Commercial paper, net of $680 and $1,395 discount at 12/31/07 and 12/31/06, respectively	169,267	321,339
Book overdraft	42,198	
Other short-term debt	9,049	176
Total short-term debt	$ 220,514	$ 719,745

American Water Capital Corp. (AWCC) had the following available capacity under its commercial paper program at December 31:

	2007	2006
Commercial paper program	$ 700,000	$ 700,000
Commercial paper program available capacity	530,053	377,266

On September 15, 2006, AWCC entered into an $800,000 unsecured revolving credit facility syndicated among a group of ten banks. This revolving credit facility, which terminates on September 15, 2012, is principally used to support the commercial paper program at AWCC and to provide up to $150,000 in letters of credit.

At December 31, AWCC had the following sub-limits and available capacity under the credit facility.

	2007	2006
Letter of credit sublimit	$ 150,000	$ 150,000

Letter of credit available capacity	60,659	85,986

Table of Contents

The following table presents the short-term borrowing activity for AWCC for 2007 and 2006:

	2007	2006
Average borrowings	$ 207,210	$ 726,894
Maximum borrowings outstanding	720,964	2,222,500
Weighted average interest rates, computed on a daily basis	5.49%	5.30%
Weighted average interest rates, at December 31	5.62%	5.41%

Interest rates on advances under the credit facility are based on either prime or the London Interbank Offering Rate (LIBOR) plus an applicable margin based upon credit ratings of the Company, as well as total outstanding amounts under the agreement at the time of the borrowing. The maximum LIBOR margin is 55 basis points.

The credit facility requires the Company to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00.

At December 31, 2007, the Company had $96,211 of outstanding letters of credit, $89,341 of which was issued under the revolving credit facility noted above.

AWCC has entered into a one year $10,000 committed revolving line of credit with a financial institution. This line of credit will terminate on December 31, 2008 unless extended and is used primarily for short-term working capital needs. Interest rates on advances under this line of credit are based on either the prime rate of the financial institution or the applicable LIBOR rate for the term selected plus 25 basis points.

Note 12: General Taxes

Components of general tax expense from continuing operations for the years presented are as follows:

	2007	2006	2005
Gross receipts and franchise	$ 71,360	$ 71,629	$ 69,237
Property and capital stock	75,172	75,132	77,535
Payroll	28,406	27,853	26,897
Other general	8,315	10,451	9,655
	$ 183,253	$ 185,065	$ 183,324

Note 13: Income Taxes

Components of income tax expense from continuing operations for the years presented are as follows:

	2007	2006	2005
State income taxes			
Current	$ 16,135	$ 13,808	$ 8,456
Deferred			
Current	2,079	(977)	590
Non-current	(11)	4,950	3,731
	18,203	17,781	12,777
Federal income taxes			
Current	30,213		17,274
Deferred			

Current	9,382	(15,213)	(7,431)
Non-current	30,468	45,704	29,971
Amortization of deferred investment tax credits	(1,510)	(1,360)	(1,612)
	68,553	29,131	38,202
	$ 86,756	$ 46,912	$ 50,979

Table of Contents

A reconciliation of income tax expense from continuing operations at the statutory federal income tax rate to actual income tax expense is as follows:

	2007	2006	2005
Income tax at statutory rate	$ (89,432)	$ (38,128)	$ (78,453)
Increases (decreases) resulting from			
State taxes, net of federal taxes	11,832	11,558	8,305
Change in valuation allowance	(4,727)	(3,870)	
Flow through differences	2,780	2,363	2,655
Amortization of deferred investment tax credits	(1,510)	(1,360)	(1,612)
Subsidiary preferred dividends	799	707	745
Impairment charges	171,247	74,177	121,375
Other, net	(4,233)	1,465	(2,036)
Actual income tax expense	$ 86,756	$ 46,912	$ 50,979

The following table provides the components of the net deferred tax liability from continuing operations at December 31:

	2007	2006
Deferred tax assets:		
Advances and contributions	$ 521,323	$ 483,525
Deferred investment tax credits	13,495	13,936
Other postretirement benefits	71,124	63,155
Tax losses and credits	90,725	112,916
Pension benefits	119,523	130,897
Long-term debt	29,569	36,600
Capital loss not utilized	6,992	7,686
Other	82,000	82,327
	934,751	931,042
Valuation allowance	(29,021)	(37,746)
	905,730	893,296
Deferred tax liabilities:		
Utility plant, principally due to depreciation differences	1,370,241	1,297,602
Income taxes recoverable through rates	76,998	78,574
Security costs	6,980	8,861
Business services project expenses	2,158	4,248
Deferred other postretirement benefits	17,637	9,001
Deferred pension benefits	40,308	46,284
Other	30,326	32,129
	1,544,648	1,476,699
	$ (638,918)	$ (583,403)

At December 31, 2007 and 2006, the Company recorded federal net operating loss (NOL) carryforwards of $91,554 and $175,266, respectively. The Company believes the federal NOL carryforwards are more likely than not to be recovered and require no valuation allowance. The federal NOL carryforwards will begin to expire in 2024. In addition, at December 31, 2007 and 2006, the Company recorded state NOL s of $381,623

and $358,556, respectively, the majority of which are offset by a valuation allowance because the Company does not believe these NOL s are more likely than not to be realized. The state NOL carryforwards will begin to expire in 2008.

Table of Contents

At December 31, 2007 and 2006, the Company had Canadian NOL carryforwards of $20,155 and $21,930, respectively. The majority of these carryforwards are offset by a valuation allowance because the Company does not believe these NOL s are more likely than not to be realized. The Canadian NOL carryforwards will begin to expire in 2008.

At December 31, 2007 and 2006, the Company had capital loss carryforwards for federal income tax purposes of $19,977 and $21,960 respectively. The Company has recognized a full valuation allowance for the capital loss carryforwards because the Company does not believe these losses are more likely than not to be recovered.

The Company files income tax returns in the United States federal jurisdiction, and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local or non-U.S income tax examinations by tax authorities for years before 2001.

In December 2006, the Internal Revenue Service (IRS) completed its examination of the 2003 and 2004 tax years. No material findings or adjustments were proposed and a Form 4549, Examination No Change Report was issued.

During the course of the audit, the Company filed refund claims of $30,306. The majority of the refund claims are attributable to the carry back of NOL s generated in 2003. These claims procedurally require approval by the Joint Committee of Taxation (JCT). In March 2007, the IRS notified the Company that additional audit procedures were necessary to support the filing of the JCT report. The Company anticipates receipt of a significant portion of the refund by December 31, 2008 and has reclassed the amount expected to be received to current income tax receivable.

The Company has state income tax examinations in progress and does not expect material adjustments to result.

The Company adopted FIN 48 effective January 1, 2007. The adoption did not have any impact to the Company s opening balance of retained earnings in 2007 because the positions taken were adequately reserved. The Company s gross FIN 48 liability, excluding interest and penalties, for unrecognized tax benefits decreased during 2007 as follows:

	2007
Balance at January 1	$ 2,202
Decreases relating to tax authority settlements	(36)
Decreases due to lapse of statute of limitations	(524)
Balance at December 31	$ 1,642

The ending liability balance does not include interest and penalties of $341, which is recorded as a component of income tax expense. The Company does not anticipate material changes to its unrecognized tax benefits within the next year. If the Company sustains all of its positions an unrecognized tax benefit of $1,396 would impact the Company s effective tax rate.

Note 14: Employee Benefits

Pension and Other Postretirement Benefits

The Company maintains noncontributory defined benefit pension plans covering eligible non-union employees of its regulated utility and shared services operations. Benefits under the plans are based on the employee s years of service and compensation. The pension plans have been closed for any employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and

Table of Contents

will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan.

The Company s funding policy is to contribute at least the minimum amount required by the Employee Retirement Income Security Act of 1974. Pension plan assets are invested in a number of investments including equity and bond mutual funds, fixed income securities and guaranteed interest contracts with insurance companies.

Pension expense in excess of the amount contributed to the pension plans is deferred by certain regulated subsidiaries pending future recovery in rates charged for utility services as contributions are made to the plans. (See Note 7)

The Company also has several unfunded noncontributory supplemental non-qualified pension plans that provide additional retirement benefits to certain employees.

The Company maintains postretirement benefit plans providing varying levels of medical and life insurance to eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002.

The Company s policy is to fund postretirement benefit costs accrued. Plan assets are invested in equity and bond mutual funds.

The obligations of the plans are dominated by obligations for active employees. Because the timing of expected benefit payments is so far in the future and the size of the plan assets are small relative to the Company s assets, the investment strategy is to allocate a large portion of assets to equities, which the Company believes will provide the highest return over the long-term period. The fixed income assets are invested in long duration debt securities in order to better match the duration of the plan liability.

The liabilities of the pension and other postretirement benefit plans were adjusted to their fair value at the time of the Acquisitions.

The Company periodically conducts an asset liability modeling study to ensure the investment strategy is aligned with the profile of the obligations. The long-term goals are to maximize the plan funded status and minimize contributions and pension expense, while taking into account the potential volatility risks on each of these items.

The asset allocation for the Company s U.S. pension plan at December 31, 2007 and 2006 by asset category, are as follows:

	Target Allocation	Percentage of Plan Assets At December 31,	
Asset category	**2007**	**2007**	**2006**
Equity securities	60%	60%	60%
Fixed income	40%	40%	40%
Total	100%	100%	100%

The investment policy guidelines of the pension plan require that the fixed income portfolio has an overall weighted average credit rating of AA or better by Standard & Poor s and the minimum credit quality for fixed income securities must be BBB- or better. Up to 20% of the portfolio may be invested in collateralized mortgage obligations backed by the United States Government.

Table of Contents

The Company s other postretirement benefit plans are partially funded. The asset allocation for the Company s other postretirement benefit plans at December 31, 2007 and 2006, by asset category, are as follows:

Asset category	Target Allocation 2007	Percentage of Plan Assets At December 31, 2007	2006
Equity securities	60%	61%	60%
Fixed income	40%	39%	40%
Total	100%	100%	100%

The postretirement benefit plan assets are invested in a manner consistent with the pension plan investment policy.

The following table provides a rollforward of the changes in the benefit obligation and plan assets for the most recent two years for all plans combined:

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Change in benefit obligation				
Benefit obligation at January 1	$ 892,857	$ 869,922	$ 426,294	$ 427,853
Service cost	25,611	24,308	12,683	11,613
Interest cost	53,288	49,622	25,383	24,348
Plan participants contributions			1,682	1,038
Amendments		507		(144)
Actuarial (gain) loss	(23,284)	(18,042)	5,656	(18,882)
Curtailments		(1,692)		(238)
Settlements		(619)		
Special termination benefits	93	373		
Gross benefits paid	(31,571)	(28,577)	(21,300)	(20,694)
Federal subsidy			1,546	1,400
Other		(2,945)		
Benefit obligation at December 31	$ 916,994	$ 892,857	$ 451,944	$ 426,294
Change in Plan Assets				
Fair value of plan assets at January 1	$ 578,280	$ 499,416	$ 281,390	$ 243,249
Actual return on plan assets	25,535	55,562	4,403	29,284
Employer contributions	54,028	53,654	27,217	27,837
Plan participants contributions			1,682	1,038
Benefits paid	(31,571)	(30,352)	(21,300)	(20,018)
Fair value of plan assets at December 31	$ 626,272	$ 578,280	$ 293,392	$ 281,390
Funded status at December 31	$ (290,722)	$ (314,577)	$ (158,552)	$ (144,904)
Amounts recognized in the balance sheet consist of:				
Current liability	$ (1,609)	$ (1,609)	$ (44)	$ (32)
Noncurrent liability	(289,113)	(312,968)	(158,508)	(144,872)
Net amount recognized	$ (290,722)	$ (314,577)	$ (158,552)	$ (144,904)

Table of Contents

The following table provides the components of the Company s accumulated other comprehensive income and regulatory assets that have not been recognized as components of periodic benefit costs as of December 31.

	Pension Benefits		Other Benefits	
	2007	2006	2007	2006
Net actuarial loss (gain)	$ 77,927	$ 79,956	$ 53,627	$ 31,309
Prior service cost (credit)	1,053	1,181	(14,482)	(15,663)
Transition obligation (asset)			867	1,041
Net amount recognized	$ 78,980	$ 81,137	$ 40,012	$ 16,687

At December 31, 2007 and 2006, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with a projected obligation in excess of plan assets were as follows:

	Projected Benefit Obligation Exceeds the Fair Value of Plans Assets	
	2007	2006
Projected benefit obligation	$ 917,000	$ 893,000
Fair value of plan assets	626,000	578,000

	Accumulated Benefit Obligation Exceeds the Fair Value of Plans Assets	
	2007	2006
Accumulated benefit obligation	$ 793,000	$ 771,000
Fair value of plan assets	626,000	578,000

The accumulated postretirement benefit obligation exceeds plan assets for all of the Company s other postretirement benefit plans.

In August 2006, the Pension Protection Act (PPA) was signed into law in the U.S. The PPA replaces the funding requirements for defined benefit pension plans by requiring that defined benefit plans contribute to a 100% of the current liability funding target over 7 years. Defined benefit plans with a funding status of less than 80% of the current liability are defined as being at risk and additional funding requirements and benefit restrictions may apply. The PPA is effective for the 2008 plan year with short-term phase-in provisions for both the funding target and at-risk determination. The Company s qualified defined benefit plan is currently funded above the at-risk threshold, and therefore the Company expects that the plans will not be subject to the at risk funding requirements of the PPA. The Company is proactively monitoring the plan s funded status and projected contributions under the new law to appropriately manage the potential impact on cash requirements.

Minimum funding requirements for qualified defined benefit pension plans are determined by government regulations and not by accounting pronouncements. The Company plans to contribute at least amounts equal to the minimum required contributions in 2008 to the qualified pension plans. The Company plans to contribute its 2008 other postretirement benefit cost to its Voluntary Employee s Benefit Association Trust.

Information about the expected cash flows for the pension and postretirement benefit plans is as follows:

	Pension Benefits	Other Benefits
2008 expected employer contributions		
To plan trusts	$ 76,000	$ 27,352
To plan participants	1,610	44

Table of Contents

The Company made 2008 contributions to fund pension benefits and other benefits of $23,000 and $6,838, respectively through February 2008.

The following table reflects the net benefits expected to be paid from the plan assets or the Company s assets:

	Pension Benefits	Other Benefits	
	Expected Benefit Payments	Expected Benefit Payments	Expected Federal Subsidy Payments
2008	$ 34,637	$ 19,442	$ 1,616
2009	37,489	21,646	1,749
2010	40,748	23,845	1,887
2011	44,224	26,257	2,014
2012	48,070	28,167	2,188
2013 - 2017	303,904	170,973	13,602

Because the above amounts are net benefits, plan participants contributions have been excluded from the expected benefits.

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company s employees, mortality, turnover and medical costs. Each assumption is reviewed annually. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes.

The significant assumptions related to the Company s pension and other postretirement benefit plans are as follows:

	Pension Benefits			Other Benefits		
	2007	2006	2005	2007	2006	2005
Weighted-average assumptions used to determine December 31 benefit obligations						
Discount rate	6.27%	5.90%	5.65%	6.20%	5.90%	5.65%
Rate of compensation increase	4.25%	4.25%	4.25%	N/A	N/A	N/A
Medical trend	N/A	N/A	N/A	graded from 8% in 2008 to 5% in 2014+	graded from 9% in 2007 to 5% in 2011+	graded from 10% in 2006 to 5% in 2011+
Weighted-average assumptions used to determine net periodic cost						
Discount rate	5.90%	5.65%	6.00%	5.90%	5.65%	6.00%
Expected return on plan assets	8.00%	8.25%	8.75%	7.38%	7.95%	8.40%
Rate of compensation increase	4.25%	4.25%	4.75%	N/A	N/A	N/A
Medical trend	N/A	N/A	N/A	graded from 9% in 2007 to 5% in 2011+	graded from 10% in 2006 to 5% in 2011+	graded from 10% in 2005 to 5% in 2010+

N/A Assumption is not applicable.

Table of Contents

The discount rate assumption was determined for the pension and postretirement benefit plans independently. A yield curve was developed for a universe containing the majority of U.S. issued Aa graded corporate bonds, all of which were non callable (or callable with make-whole provisions). For each plan, the discount rate was developed as the level equivalent rate that would produce the same present value as that using spot rates aligned with the projected benefit payments.

The expected long-term rate of return on plan assets is based on historical and projected rates of return for current and planned asset classes in the plans investment portfolios. Assumed projected rates of return for each of the plans projected asset classes were selected after analyzing historical experience and future expectations of the returns and volatility of the various asset classes. Based on the target asset allocation for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to the benchmark returns and for the effect of expenses paid from plan assets. The Company s pension expense increases as the expected return on assets decreases.

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one -percentage -point change in assumed health care cost trend rates would have the following effects:

	One -Percentage-Point Increase	One -Percentage-Point Decrease
Effect on total of service and interest cost components	$ 6,143	$ (5,001)
Effect on other postretirement benefit obligation	$ 57,868	$ (48,220)

The following table provides the components of net periodic benefit costs for the years ended December 31:

	2007	2006	2005
Components of net periodic pension benefit cost			
Service cost	$ 25,611	$ 24,308	$ 26,987
Interest cost	53,288	49,622	47,594
Expected return on plan assets	(47,052)	(42,304)	(41,136)
Amortization of:			
Prior service cost (credit)	127	494	710
Actuarial (gain) loss	262	1,482	384
Periodic pension benefit cost	$ 32,236	$ 33,602	$ 34,539
Special termination pension benefit charge	93	373	890
Curtailment charge		971	135
Settlement charge (credit)		65	240
Net periodic pension benefit cost	$ 32,329	$ 35,011	$ 35,804
Other changes in plan assets and benefit obligations recognized in other comprehensive income			
Amortization of prior service (credit) cost	$ (36)		
Current year actuarial (gain) loss	(924)		
Amortization of actuarial (gain) loss	(72)		
Total recognized in other comprehensive income	$ (1,032)		
Total recognized in net periodic benefit cost and comprehensive income	$ 31,297		

Table of Contents

	2007	2006	2005
Components of net periodic other postretirement benefit cost			
Service cost	$ 12,683	$ 11,613	$ 13,660
Interest cost	25,383	24,348	25,156
Expected return on plan assets	(21,065)	(19,689)	(18,657)
Amortization of:			
Transition obligation (asset)	173	173	282
Prior service cost (credit)	(1,180)	(1,145)	81
Actuarial (gain) loss		2,011	634
Periodic other postretirement benefit cost	$ 15,994	$ 17,311	$ 21,156
Curtailment charge		(18)	655
Net periodic other postretirement benefit cost	$ 15,994	$ 17,293	$ 21,811

The Company s policy is to recognize curtailments when the total expected future service of plan participants is reduced by greater than 10% due to an event that results in terminations and/or retirements. The Company reflected curtailments in 2006 and 2005 due to a significant number of aggregate terminations and retirements at one of its subsidiaries.

The estimated amounts that will be amortized from accumulated other comprehensive income and regulatory assets into net periodic benefit cost in 2008 are as follows:

	Pension Benefits	Other Benefits
Actuarial (gain) loss	$ 5	$ 774
Prior service cost (credit)	102	(1,180)
Transition obligation (asset)		173
Total	$ 107	$ (233)

Savings Plans for Employees

The Company maintains 401(k) savings plans that allow employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee s contribution, subject to certain limitations. Due to the Company s discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. The Company expensed contributions to the plans totaling $7,305 for 2007, $6,898 for 2006 and $5,511 for 2005. All of the Company s contributions are invested in one or more funds at the direction of the employee.

Employees Investment Plan

Upon completion of the American Water Works Company, Inc. acquisition, the Company created the Employees Investment Plan and converted the former American Water Works Company, Inc. Employees Stock Ownership Plan into this plan. Each participating employee can elect to contribute an amount that does not exceed 2% of their wages. In addition to the employee s participation, the Company makes a contribution equivalent to 1/2% of each participant s qualified compensation, and matches 100% of the contribution by each participant. The Company made contributions to the plan totaling $1,010 for 2005 that were primarily invested in a retirement trust fund. This plan was discontinued as of May 22, 2005.

Table of Contents

Long-Term Incentive Plan

The Company participates in a RWE long-term incentive plan for executives (RWE LTIP). Under the RWE LTIP, Company employees were granted 120,004 performance shares of RWE common stock which vest over three years beginning January 1, 2005. Subject to the vesting provisions, the performance shares are payable in cash. In accordance with SFAS 123R Share-Based Payment , the performance shares have been accounted for as a liability. The liability will be remeasured at fair value at each reporting period until settlement. The Company recorded a liability of $8,398 and $4,271 related to the performance shares at December 31, 2007 and 2006, which has been included in Other current liabilities. For the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately $4,127, $2,604 and $1,667, respectively, of share-based compensation expense related to the performance shares in operations and maintenance expense.

The fair value of the performance shares was estimated using Monte Carlo simulations. The fair value of the performance shares granted on January 1, 2005 was $25.09 per share of RWE common stock at the grant date and $81.54 and $65.42 per share of RWE common stock at December 31, 2007 and 2006.

The following table summarizes performance share transactions under the RWE LTIP plan:

	2005 tranche
Outstanding at January 1, 2007	104,816
Granted	
Forfeited	(1,817)
Outstanding at December 31, 2007	102,999
Vested at December 31, 2007	102,999

Retention Bonuses

The Company established a retention bonus program that is intended to retain employees in key leadership roles through the timely completion of the IPO. If a participant remains employed by the Company through March 31, 2008, the participant will receive a cash bonus based on a predetermined percentage of his or her base salary in effect on January 1, 2006, or his or her hire date, if he or she was hired after January 1, 2006. For the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately $2,498, $2,907 and $0, respectively, of expense related to the retention bonuses in operations and maintenance expense.

Completion Bonuses

The Company has offered a completion bonus to reward selected senior executives for their contributions to the IPO process. Each eligible executive is entitled to receive a cash bonus based on a predetermined percentage of his or her base salary in effect on January 1, 2006, or his or her hire date, if he or she was hired after January 1, 2006. For the years ended December 31, 2007, 2006 and 2005, the Company recognized approximately $832, $1,750 and $0, respectively, of expense related to the completion bonuses in operations and maintenance expense.

Note 15: Commitments and Contingencies

OMI/Thames Water Stockton, Inc. (OMI/TW) is a 50/50 joint venture between a subsidiary of the Company and Operations Management International, Inc. (OMI). In February 2003, OMI/TW and the City of Stockton California (the City) entered into a 20-year service contract for water, wastewater and storm water utilities capital improvements and management services. In 2007, OMI/TW and the City of Stockton mutually agreed to end the contract effective February 29, 2008, at which time the responsibility for management and operation of the system will be returned to the City. Under the agreement, OMI/TW is required to provide a

Table of Contents

warranty relating to certain construction activities and is required to pay for certain employee transition costs. The length and the exact nature of that warranty and certain other details are subject to the conclusion of a supplemental agreement still being negotiated by the parties. In addition, the City received a Settlement Communication from the California State Water Resources Control Board (the Board) related to a discharge into an adjacent river. Under the agreement, OMI/TW is responsible for financial settlement of this matter with the Board. Given the uncertainties related to resolving the remaining issues surrounding the transition and termination of the contract, financial settlement of the Board matter and the construction warranty, the Company has recorded a loss reserve of approximately $4,000 at December 31, 2007.

The Company is also routinely involved in condemnation proceedings and legal actions incident to the normal conduct of its business. At December 31, 2007, the Company has accrued approximately $5,000 as probable losses and it is reasonably possible that losses could range up to $19,000 for these matters. For certain matters, the Company is unable to estimate any possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such claims or actions will not have a material adverse effect on the Company s results of operations, financial position or cash flows.

Commitments have been made in connection with certain construction programs. The estimated capital expenditures required under legal and binding contractual obligations amounted to $163,930 at December 31, 2007.

The Company s regulated subsidiaries maintain agreements with other water purveyors for the purchase of water to supplement their water supply. The Company s subsidiaries purchased water expense under these types of agreements amounted to approximately $92,403, $85,345, and $92,395 during the years ended December 31, 2007, 2006 and 2005, respectively. The estimated annual commitment related to the minimum quantities of water purchased is expected to approximate $44,678 in 2008, $43,016 in 2009, $43,625 in 2010, $44,386 in 2011, $45,417 in 2012 and $560,962 thereafter.

Note 16: Net Loss per Common Share

Basic net loss per common share, loss from continuing operations per common share and loss from discontinued operations, net of tax per common share are based on the weighted average number of common shares outstanding. Diluted net loss per common share, loss from continuing operations per common share and loss from discontinued operations, net of tax per common share are based on weighted average number of common shares outstanding and potentially dilutive shares. The Company had no potentially dilutive shares for the years ended December 31, 2007, 2006 and 2005. All common shares are held by a wholly-owned subsidiary of RWE.

On November 5, 2007, the Company s Board of Directors authorized 500,000 shares of common stock, par value $.01 per share and declared a one hundred and sixty thousand-for-one common stock split effective November 7, 2007 for all common shares outstanding. The Company s par value of $1.00 per share changed to $.01 per share and $1,599 was transferred from paid-in capital to common stock to record the split. All share and per share data for all periods presented have been restated to give effect to the stock split.

Note 17: Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities: The carrying amount reported in the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt due to the short-term maturities and variable interest rates, approximates their fair values.

Table of Contents

Preferred stock with mandatory redemption requirements and long-term debt: The fair values of preferred stock with mandatory redemption requirements and long-term debt are estimated using discounted cash flow analyses based on current incremental financing rates for similar types of securities.

The carrying amounts and fair values of the financial instruments at December 31 are as follows:

2007	Carrying Amount	Fair Value
Preferred stocks with mandatory redemption requirements	$ 24,514	$ 25,264
Long-term debt (excluding capital lease obligations)	4,769,092	4,653,765

2006	Carrying Amount	Fair Value
Preferred stocks with mandatory redemption requirements	$ 1,774,863	$ 1,786,027
Long-term debt (excluding capital lease obligations)	3,381,208	3,390,536

Note 18: Operating Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were $34,946 for 2007, $36,136 for 2006 and $34,662 for 2005. The operating leases for facilities will expire over the next 20 years and the operating leases for equipment will expire over the next five years. Certain operating leases have renewal options ranging from one to five years.

At December 31, 2007, the minimum annual future rental commitment under operating leases that have initial or remaining non-cancelable lease terms in excess of one year are $28,248 in 2008, $27,128 in 2009, $23,527 in 2010, $17,704 in 2011, $11,901 in 2012 and $119,410 thereafter.

The Company has a series of agreements with various public entities to establish certain joint ventures, commonly referred to as public-private partnerships . The Company agreed to transfer and convey some of its real and personal property (facilities), to various public entities, subject to lien of its General Mortgage Indenture, in exchange for an equal principal amount of Industrial Development Bonds (IDBs), to be issued by the various public entities under a state Industrial Development Bond and Commercial Development Act. The Company leased back the facilities under capital leases for a period of 40 years. The leases have payments that approximate the payments required by the terms of the IDBs. In accordance with Financial Accounting Standards Board Interpretation Number 39, Offsetting of Amounts Related to Certain Contracts , the transaction is presented on a net basis. The carrying value of the facilities was $161,803 and $162,627 at December 31, 2007 and 2006, respectively.

At December 31, 2007, the minimum annual future rental commitment under these additional operating leases that have initial or remaining non-cancelable lease terms in excess of one year included in the proceeding minimum annual rental commitments are $3,471 in 2008, $3,475 in 2009, $3,472 in 2010, $3,472 in 2011, $3,472 in 2012 and $96,430 thereafter.

Note 19: Related Party Transactions

Thames Water Plc, formerly an affiliate and wholly owned subsidiary of RWE, provided certain management services to the Company which amounted to $0 in 2007, $1,386 in 2006 and $9,147 in 2005.

Thames Water International Services Limited, formerly an affiliate and wholly owned subsidiary of RWE, provided services of expatriate employees to the Company which amounted to $0 in 2007, $1,763 in 2006 and $4,970 in 2005.

Interest on the Company s borrowings with RWE amounted to $26,797, $131,005, and $93,907 in 2007, 2006 and 2005, respectively.

Table of Contents

TWILUX, an affiliate and wholly owned subsidiary of RWE, was the holder of $1,750,000 of the Company s preferred stock. Preferred dividends included in interest expense amounted to $74,569, $103,270, and $103,250 in 2007, 2006 and 2005, respectively. The preferred stock was redeemed in 2007 utilizing the proceeds from $1,750,000 in variable rate borrowings from RWE. The variable rate borrowings from RWE were subsequently redeemed with proceeds from the senior notes issuance. (See Note 10)

The Company maintains agreements with both public and private water providers for the purchase of water to supplement water supply, particularly during periods of peak demand. The President and CEO of the Company is a Commissioner of one of these water providers. The Company purchased approximately $16,793, $16,374, and $16,693 of water from this provider in the years ended December 31, 2007, 2006 and 2005, respectively. The minimum purchase quantity amounts are known and the rates are set annually. Assuming an annual inflationary rate adjustment of 3.5%, the estimated commitments related to the minimum quantities of purchased water under these agreements are $14,925 in 2008, $15,448 in 2009, $15,988 in 2010, $16,548 in 2011, $17,127 in 2012 and $301,822 thereafter.

Note 20: Guarantees

A subsidiary holds a 50% interest in American Water-Pridesa LLC (AW-Pridesa), a Delaware limited liability company. Pridesa America Corporation, a former subsidiary of RWE also holds a 50% interest. AW-Pridesa has contracted with Tampa Bay Water (Tampa Bay), an interlocal governmental agency of the State of Florida, to remedy and operate the Tampa Bay Seawater Desalination Plant. The Company entered into a guarantee with Tampa Bay in November 2004 for the full and prompt performance of certain contractual obligations limited to a total aggregate liability of $35,000. Contractual obligations call for certain construction activities and management services to be completed satisfactorily**.** AW-Pridesa took over operation of the plant in January 2005.

At December 31, 2007, the plant was fully operational and successful performance testing of the construction activities had been completed.

The Company provides financial guarantees or deposits to ensure performance of certain of its obligations on its non-regulated military agreements and O&M agreements. These guarantees and deposits totaled $475,278 and $ $476,244 at December 31, 2007 and 2006, respectively.

Note 21: Discontinued Operations

Based on management s ongoing evaluation of the non-regulated businesses, it was determined that the Company s Residuals, Underground**,** Ashbrook, and Engineering businesses were not meeting growth expectations and were not considered core businesses of the Company s operations. Accordingly, the Company sold and/or disposed of these businesses. As a result of these dispositions, the Company recorded a net gain/loss of $0 in 2007, a net loss of $1,001 in 2006, and a net loss of $15,407 in 2005.

In 2006, the Company sold a group of assets of the Residuals business for $2,500 and reported the related operations within discontinued operations. In June 2007, the Company sold another component of Residuals business for $9,660. The Company completed the sale of this component in 2007.

The Company s Underground business was sold for $27,651. As a result of the sale, the Company recorded a loss of $1,001 in 2006.

During the fourth quarter of 2005, the Company sold Engineering s Canadian operations, a provider of engineering services to corporate and municipal clients, for initial consideration of $489 and contingent consideration of $430. Furthermore, the Company disposed through abandonment components of Engineering s operations based in the United States. As a result of the disposition of these components of Engineering in 2005, the Company recorded a loss of $15,407 which included a goodwill write-off $16,216.

Table of Contents

During the first quarter of 2005, the Company sold substantially all the assets of its Ashbrook subsidiary, a provider of wastewater treatment services, for $14,847. There was no gain or loss recorded at the time of sale.

A summary of the assets and liabilities classified as discontinued operations in the Consolidated Balance Sheets includes the following:

	2006
Assets of discontinued operations	
Non-utility property	$ 1,690
Other receivables, net	2,151
Other current assets	6,323
Goodwill	2,670
Total assets of discontinued operations	12,834
Liabilities of discontinued operations	
Accounts payable	654
Other liabilities	1,824
Total liabilities of discontinued operations	2,478
Net assets of discontinued operations	$ 10,356

A summary of discontinued operations presented in the Consolidated Statements of Operations include the following:

	2007	2006	2005
Operating revenues	$ 7,128	$ 59,872	$ 80,979
Operating expenses			
Operation, maintenance and depreciation	7,071	60,297	84,277
Impairment charges		6,117	34,936
Total operating expenses, net	7,071	66,414	119,213
Operating income (loss)	57	(6,542)	(38,234)
Other income (deductions)			
Interest, net	56	322	(21)
Other, net	(749)	1,875	1,135
Total other income (deductions)	(693)	2,197	1,114
Loss before income taxes	(636)	(4,345)	(37,120)
Provision for income taxes	(85)	1,047	(2,617)
Loss from operations	(551)	(5,392)	(34,503)
Loss on sale, net of tax benefit		(1,001)	(15,407)
Loss from discontinued operations	$ (551)	$ (6,393)	$ (49,910)

Note 22: Segment Information

The Company has two operating segments which are also the Company s two reportable segments referred to as the Regulated Businesses and Non-regulated Businesses segments. The Company s chief operating decision maker regularly reviews the operating results of the Regulated and Non-regulated Businesses segments to assess segment performance and allocate resources. The evaluation of segment performance and the allocation of resources are based on several measures. The measure that is most consistent with that used by management is adjusted earnings before interest and income taxes from continuing operations (Adjusted EBIT). Management has grouped the Company s

Table of Contents

businesses into its Regulated and Non-regulated Businesses segments based upon the products and services they provide and whether they function under the rules and regulations of the public utility regulatory environment.

The Regulated Businesses segment includes the Company s 23 utility subsidiaries that provide water and wastewater services to customers in 20 U.S. states. With the exception of one company, each of these public utility subsidiaries is subject to regulation by public utility commissions and local governments. In addition to providing similar products and services and being subject to the public utility regulatory environment, each of the regulated subsidiaries has similar economic characteristics, production processes, types and classes of customers and water distribution or wastewater collection processes. Each of these companies is also subject to both federal and state regulation regarding the quality of water distributed and the discharge of wastewater residuals.

The Non-regulated Businesses segment is comprised of non-regulated businesses that provide a broad range of non-regulated water and wastewater services and products including homeowner water and sewer line maintenance services, water and wastewater facility operations and maintenance services, granular carbon technologies and products for cleansing water and wastewater, wastewater residuals management services and water and wastewater facility engineering services.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies (see Note 2). The Regulated and Non-regulated Businesses segment information includes intercompany costs that are allocated by American Water Works Service Company, Inc. and intercompany interest that is charged by AWCC, which are eliminated to reconcile to the consolidated results of operations. Inter-segment revenues, which are primarily recorded at cost plus mark-up that approximates current market prices, include carbon regeneration services and leased office space, furniture and equipment provided by the Company s non-regulated subsidiaries to its regulated subsidiaries.

Other includes corporate costs which are not allocated to the Company s subsidiaries, eliminations of inter-segment transactions, and fair value adjustments and associated income and deductions related to the Acquisitions which have not been allocated to the segments for evaluation of segment performance and allocation of resource purposes. The adjustments related to the Acquisitions are reported in Other, as they are excluded from segment performance measures evaluated by management. The following table includes the Company s summarized segment information:

	As of or for the Year Ended December 31, 2007			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 1,987,565	$ 242,678	$ (16,028)	$ 2,214,215
Depreciation and amortization	254,998	10,295	2,042	267,335
Impairment charges			509,345	509,345
Total operating expenses, net	1,490,794	225,600	482,692	2,199,086
Adjusted EBIT (1)	500,088	23,579		
Total assets	10,163,227	280,692	2,490,153	12,934,072
Capital expenditures	746,583	11,986		758,569

	As of or for the Year Ended December 31, 2006			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 1,854,618	$ 248,451	$ (10,002)	$ 2,093,067
Depreciation and amortization	243,311	13,990	1,880	259,181
Impairment charges			221,685	221,685
Total operating expenses, net	1,387,418	253,850	199,286	1,840,554
Adjusted EBIT (1)	468,701	(4,725)		
Total assets	9,439,975	339,761	3,003,323	12,783,059
Capital expenditures	662,135	26,708		688,843

Table of Contents

	As of or for the Year Ended December 31, 2005			
	Regulated	Non-regulated	Other	Consolidated
Net operating revenues	$ 1,836,061	$ 310,771	$ (10,086)	$ 2,136,746
Depreciation and amortization	246,802	15,187	(625)	261,364
Impairment charges		4,850	380,584	385,434
Total operating expenses, net	1,373,677	319,135	332,359	2,025,171
Adjusted EBIT (1)	469,921	(106)		
Total assets	8,941,859	402,803	3,197,367	12,542,029
Capital expenditures	512,519	45,927		558,446

(1) Management evaluates the performance of its segments and allocates resources based on several factors, of which the primary measure is Adjusted EBIT. Adjusted EBIT does not represent cash flow for periods presented and should not be considered as an alternative to net income as an indicator of the Company s operating performance or as an alternative to cash flows as a source of liquidity. Adjusted EBIT as defined by the Company may not be comparable with Adjusted EBIT as defined by other companies.

The following table reconciles Adjusted EBIT, as defined by the Company, to loss from continuing operations before income taxes:

	For the Year Ended December 31, 2007		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 500,088	$ 23,579	$ 523,667
Add:			
Allowance for other funds used during construction	7,759		7,759
Allowance for borrowed funds used during construction	3,449		3,449
Less:			
Interest, net	(219,371)	(8,629)	(228,000)
Preferred dividends of subsidiaries	(225)		(225)
Amortization of debt expense	(5,169)		(5,169)
Segments income from continuing operations before income taxes	$ 286,531	$ 14,950	301,481
Impairment charges			(509,345)
Interest, net			(55,165)
Other			7,510
Loss from continuing operations before income taxes			$ (255,519)

	For the Year Ended December 31, 2006		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 468,701	$ (4,725)	$ 463,976
Add:			
Allowance for other funds used during construction	5,980		5,980
Allowance for borrowed funds used during construction	2,652		2,652
Less:			
Interest, net	(209,589)	(12,163)	(221,752)
Preferred dividends of subsidiaries	(273)		(273)
Amortization of debt expense	(5,196)		(5,196)
Segments income from continuing operations before income taxes	$ 262,275	$ (16,888)	245,387
Impairment charges			(221,685)
Interest, net			(144,218)
Other			11,578

Loss from continuing operations before income taxes	$ (108,938)

Table of Contents

	For the Year Ended December 31, 2005		
	Regulated	Non-regulated	Total Segments
Adjusted EBIT	$ 469,921	$ (106)	$ 469,815
Add:			
Allowance for other funds used during construction	5,810		5,810
Allowance for borrowed funds used during construction	2,420		2,420
Less:			
Impairment charges		(4,850)	(4,850)
Interest, net	(202,901)	(12,301)	(215,202)
Preferred dividends of subsidiaries	(285)		(285)
Amortization of debt expense	(5,327)		(5,327)
Segments income from continuing operations before income taxes	$ 269,638	$ (17,257)	252,381
Impairment charges			(380,584)
Interest, net			(130,055)
Other			34,107
Loss from continuing operations before income taxes			$ (224,151)

Table of Contents

American Water Capital Corp.

American Water Works Company, Inc.

Offer to Exchange

6.085% Senior Notes Due 2017
For a Like Principal Amount of New
6.085%% Senior Notes Due 2017

6.593% Senior Notes Due 2037
For a Like Principal Amount of New
6.593% Senior Notes Due 2037

PROSPECTUS

May 12, 2008

Dealer Prospectus Delivery Obligation

Until August 10, 2008, all broker-dealers that effect transactions in the new notes, whether or not participating in the exchange offer, may be required to deliver a prospectus. This is in addition to the obligation of broker-dealers to deliver a prospectus when acting as underwriters and with respect to any unsold allotments or subscriptions.