

American Water Works Company, Inc.

Form S-1/A

March 27, 2008

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As filed with the Securities and Exchange Commission on March 26, 2008.

Registration No. 333-145725

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 4 to

Form S-1

REGISTRATION STATEMENT UNDER

THE SECURITIES ACT OF 1933

AMERICAN WATER WORKS COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of

incorporation or organization)

4941
(Primary Standard Industrial

Classification Code Number)
1025 Laurel Oak Road

51-0063696
(I.R.S. Employer

Identification Number)

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Voorhees, NJ 08043

(856) 346-8200

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Donald L. Correll

President and Chief Executive Officer

American Water Works Company, Inc.

1025 Laurel Oak Road

Voorhees, NJ 08043

(856) 346-8200

(Name and address, including zip code, and telephone number, including area code, of agent for service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. "

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration number of the earlier effective registration statement for the same offering. "

CALCULATION OF REGISTRATION FEE

Title of Each Class of	Proposed Maximum Aggregate	Amount of
Securities to be Registered	Offering Price(1)(2)	Registration Fee
Common Stock, par value \$0.01 per share	\$1,500,000,000	\$46,050.00(3)

- (1) Includes shares to be sold upon exercise of the underwriters' option to purchase additional shares. See Underwriting.
- (2) Estimated solely for the purposes of calculating the registration fee pursuant to Rule 457(o) of Regulation C under the Securities Act of 1933, as amended.
- (3) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this preliminary prospectus is not complete and may be changed. The selling stockholder may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities, and we and the selling stockholder are not soliciting an offer to buy these securities, in any state where the offer or sale is not permitted.

Subject to Completion, dated March 26, 2008.

(Preliminary Prospectus)

Shares

American Water Works Company, Inc.

Common Stock

This is an initial public offering of common stock of American Water Works Company, Inc. The selling stockholder is selling all of the shares in the offering. We will not receive any of the proceeds from the sale of shares by the selling stockholder.

The initial public offering price per share of the common stock is currently estimated to be between \$ and \$. We intend to apply to list our common stock for trading on the New York Stock Exchange under the symbol AWK.

Investing in our common stock involves risks. See Risk Factors beginning on page 9 to read about factors you should consider before buying shares of our common stock.

Neither the Securities and Exchange Commission, any state securities commission or 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.

	Per share	Total
Initial public offering price	\$	\$
Underwriting discount	\$	\$
Proceeds, before expenses, to the selling stockholder	\$	\$

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The underwriters may also purchase up to an additional _____ shares of common stock from the selling stockholder at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus.

The underwriters expect to deliver the shares against payment in New York, New York on _____, 2008.

Goldman, Sachs & Co.

Citi

Merrill Lynch & Co.

Credit Suisse

JPMorgan

Morgan Stanley

UBS Investment Bank

**Edward Jones
Boenning & Scattergood, Inc.**

**Janney Montgomery Scott LLC
Cabrera Capital Markets, LLC**

HSBC

**Societe Generale
Stanford Group Company**

**Wachovia Securities
The Williams Capital Group, L.P.**

Prospectus dated _____, 2008.

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Our regulated subsidiaries are subject to economic regulation by state PUCs in Arizona, California, Hawaii, Illinois, Indiana, Iowa, Kentucky, Maryland, Missouri, New Jersey, New Mexico, New York, Ohio, Pennsylvania, Tennessee, Texas, Virginia and West Virginia. Some of these states have enacted laws that require regulatory approval for the acquisition of control of any regulated utility. In those states, obtaining control of the parent or any other company that controls a regulated utility also requires prior regulatory approval. The threshold for a change in control is a fact-specific inquiry that varies by state. For example, in some states, a presumption of control will arise when an acquiring party acquires more than 9.9% of the voting securities of the regulated utility or the controlling entity. In addition to ownership, other states may analyze the degree of influence or control an acquiror may exert over the company. Any person acquiring our common stock in this offering or in any other purchase of our common stock in a quantity sufficient to trigger a change in control under state law would need the prior approval of the applicable state PUC.

Dealer Prospectus Delivery Obligation

Through and including _____, 2008 (the 25th day after the date of this prospectus), all dealers that effect transactions in our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers obligation to deliver a prospectus when acting as an underwriter and with respect to unsold allotments or subscriptions.

(i)

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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 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

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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.

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;

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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 wholly 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 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, 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 \$1,500.0 million aggregate principal amount of senior notes of AWCC, which we refer to as the new senior 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. The new senior notes were not registered under the Securities Act and were offered in reliance on an exemption from the registration requirements of the Securities Act.

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.

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Organizational Structure

American Water is currently a direct wholly owned subsidiary of RWE Aqua Holdings GmbH, which we refer to as the selling stockholder, 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 after giving effect to the consummation of this offering:

* Assumes that RWE, through its subsidiary RWE Aqua Holdings GmbH, will sell its shares of our common stock in more than one offering.

The Selling Stockholder

All of our issued and outstanding common stock is currently owned by the selling stockholder, 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. Upon consummation of this offering, the selling stockholder will continue to own % of our outstanding common stock (assuming no exercise of the underwriters option to purchase additional shares). RWE intends to fully divest its ownership of American Water as soon as reasonably practicable, subject to market conditions.

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.

The Company plans to issue through AWCC up to \$200 million aggregate principal amount of senior notes in a private placement prior to or substantially contemporaneously with the consummation of this offering, the proceeds of which will be used to refinance outstanding short-term indebtedness of AWCC and for general corporate purposes. This offering is not conditioned on consummation of the private placement of the senior notes and there can be no assurances that any such private placement will be consummated.

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THE OFFERING

Common stock offered by the selling stockholder	shares
Common stock to be outstanding after this offering	160,000,000 shares
Option to purchase additional shares	The underwriters have an option to purchase a maximum of additional shares from the selling stockholder.
Use of proceeds	We will not receive any proceeds from this offering. See Use of Proceeds.
Listing	We will apply to list our common stock on the New York Stock Exchange, which we refer to as the NYSE, under the symbol AWK .
Dividend policy	Upon the completion of this offering and subject to applicable law and the discretion of our board of directors, we will pay quarterly cash dividends at an initial rate of approximately \$0.20 per share per quarter on our common stock or \$0.80 per share per year, to be paid approximately 60 days after the end of each fiscal quarter (beginning with the first full fiscal quarter ending after the consummation of this offering) for at least the first four quarters following the consummation of this offering, and a one-time dividend of \$ per share (representing the pro rata portion of the expected initial dividend for the remaining period of the quarter following the consummation of this offering) on or about , 2008 to stockholders of record on , 2008. The declaration, payment and amount of future dividends to holders of our common stock will be at the discretion of our board of directors and will depend on many factors, including our financial condition and results of operations, liquidity requirements, capital requirements of our subsidiaries, legal requirements, regulatory constraints and other factors our board of directors deems relevant. See Dividend Policy , Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations Dividends.
Risk factors	See Risk Factors for a discussion of factors you should consider before investing in our common stock.
All information in this prospectus, unless otherwise indicated or the context otherwise requires:	

assumes the common stock will be sold at \$ per share (the midpoint of the price range set forth on the cover of this prospectus);

assumes no exercise of the underwriters option to purchase additional shares;

gives effect to the 160,000 for 1 stock split effected on November 7, 2007; and

excludes, (i) _____ shares of common stock reserved for issuance under our 2007 Omnibus Equity Compensation Plan (_____ of which and _____ of which will be granted to key employees upon the consummation of the offering in the form of restricted stock and stock options, respectively) and (ii) _____ shares reserved for issuance under an employee stock purchase plan that the Company is considering establishing following the consummation of this offering.

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SUMMARY HISTORICAL CONSOLIDATED AND UNAUDITED PRO FORMA FINANCIAL DATA

The following table presents our summary historical consolidated financial data and summary unaudited pro forma consolidated financial data, at the dates and for the periods indicated. The historical data as of December 31, 2006 and 2007 and for the years ended December 31, 2005, 2006 and 2007 have been derived from our audited historical consolidated financial statements and the notes to those statements included elsewhere in this prospectus. See footnote 1 to the table below.

The summary unaudited pro forma financial data have been derived from our historical financial statements and adjusted as described below. The summary unaudited pro forma financial data have been prepared to give effect to the Transactions as if they had occurred on January 1, 2007, in the case of the summary unaudited pro forma statement of operations data, and have been prepared to give effect to the adjustment of restricted stock units from liability-classified awards to equity-classified awards as a result of this offering as if it had occurred on December 31, 2007, in the case of the summary unaudited pro forma balance sheet data. The pro forma adjustments are based upon available information and certain assumptions that we believe are reasonable. The summary unaudited pro forma financial data are for informational purposes only and do not purport to represent what our results of operations or financial position actually would have been if the Transactions had occurred at any date, and such data do not purport to project the results of operations for any future period. See Unaudited Pro Forma Condensed Consolidated Financial Information.

Our historical 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. Because the data in this table is only a summary and does not provide all of the data contained in our financial statements, the information should be read in conjunction with Use of Proceeds, Capitalization, Unaudited Pro Forma Condensed Consolidated Financial Information, Selected Historical Consolidated Financial Data, Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and related notes thereto appearing elsewhere in this prospectus.

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	For the years ended December 31,			Pro forma for the year ended December 31, 2007 (unaudited)
	2005	2006	2007	
(In thousands, except per share data)				
Statement of operations data(1):				
Operating revenues	\$ 2,136,746	\$ 2,093,067	\$ 2,214,215	\$ 2,214,215
Operating expenses				
Operation and maintenance	1,201,566	1,174,544	1,246,479	1,247,499
Depreciation and amortization	261,364	259,181	267,335	267,335
General taxes	183,324	185,065	183,253	183,253
Loss (gain) on sale of assets(2)	(6,517)	79	(7,326)	(7,326)
Impairment charges	385,434	221,685	509,345	509,345
Total operating expenses, net	2,025,171	1,840,554	2,199,086	2,200,106
Operating income (loss)	111,575	252,513	15,129	14,109
Other income (deductions)				
Interest	(345,257)	(365,970)	(283,165)	(281,232)
Amortization of debt expense	(4,367)	(5,062)	(4,867)	(5,411)
Other, net(3)	13,898	9,581	17,384	17,384
Total other income (deductions)	(335,726)	(361,451)	(270,648)	(269,259)
Income (loss) from continuing operations before income taxes	(224,151)	(108,938)	(255,519)	(255,150)
Provision for income taxes	50,979	46,912	86,756	86,903
Income (loss) from continuing operations	\$ (275,130)	\$ (155,850)	\$ (342,275)	\$ (342,053)
Income (loss) from continuing operations per basic common share(4)(5)	\$ (1.72)	\$ (0.97)	\$ (2.14)	\$ (2.14)
Income (loss) from continuing operations per diluted common share(4)(5)	\$ (1.72)	\$ (0.97)	\$ (2.14)	\$ (2.14)
Basic weighted average common shares	160,000	160,000	160,000	160,000
Diluted weighted average common shares	160,000	160,000	160,000	160,000
Other data(1):				
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)	

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	As of December 31,		Pro forma as of December 31, 2007 (unaudited)
	2006	2007	
	(In thousands)		
Balance sheet data(1):			
Cash and cash equivalents	\$ 29,754	\$ 13,481	\$ 13,481
Utility plant at original cost, net of accumulated depreciation	8,605,341	9,199,909	9,199,909
Goodwill	2,962,493	2,456,952	2,456,952
Total assets	12,783,059	12,934,072	12,934,072
Redeemable preferred stock at redemption value(6)	1,774,475	24,296	24,296
Other long-term debt	3,096,404	4,674,837	4,674,837
Other short-term and current portion of long-term debt(7)	1,007,128	316,969	316,969
Total debt	5,878,007	5,016,102	5,016,102
Common stockholder's equity	3,817,397	4,542,046	4,542,726
Preferred stock without mandatory redemption requirements(6)	4,568	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 wholly 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 common shares used to compute net income per basic share and net income per diluted 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 as no dilutive options or instruments were outstanding during these periods.
- (5) The number of common shares used to compute net income per basic share is 160.0 million, which gives effect to the 160,000-for-1 stock split effected on November 7, 2007. Pro forma net income per diluted share considers the effect of all potentially dilutive instruments, which include restricted shares, restricted stock units and stock options to be granted under our 2007 Omnibus Equity Compensation Plan to certain of our employees upon the consummation of this offering. However, there are no dilutive incremental common shares included in pro forma diluted earnings per share as all potentially dilutive instruments would be antidilutive.
- (6) Includes preferred stock held by RWE and other preferred stock issued by subsidiaries of the Company.
- (7) Includes the current portion of redeemable preferred stock and the unamortized debt discount attributable to preferred stock of \$0.6 million and \$0.4 million as of December 31, 2006 and 2007, respectively.

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RISK FACTORS

An investment in our common stock involves risk. Before you decide to purchase our common stock, 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 the value of our common stock.

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.

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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.

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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.

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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.

Upon the consummation of this offering RWE will have certain registration rights with respect to future issuances of our equity securities and, subject to lock-up provisions described under [Shares Eligible for Future Sale Lock-Up Agreements](#), 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 as set forth in the sections [Dividend Policy](#) and [Management's Discussion and Analysis of Financial Condition and Results of Operations Dividends](#) 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](#). For further discussion of the relationship of our dividend policy to our ability to pursue potential growth opportunities, see [Management's Discussion and Analysis of Financial Condition and Results of Operations Dividends Assumptions and Considerations](#).

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

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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.

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

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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 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,

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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;

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 this 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.

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We 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 our common stock and its value relative to our book equity at the consummation of this offering or a decline over a period of time of our stock price following the consummation of this offering. 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 may also result in an incremental impairment charge. 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.

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 the date of effectiveness of this registration statement and another approval 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 this registration statement, 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.

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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.

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

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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 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

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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 the trading price of our common stock.

After the consummation of this offering, we will become a public company. As a public company, we will be required to comply with the Sarbanes-Oxley Act and other rules and regulations that govern public companies. In particular, we will be required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require 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 assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. However, since 2003, we have been 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 will be 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.

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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 AWCC. 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 this Offering

There has been no prior public trading market for shares of our common stock since our acquisition by RWE, and an active trading market may not develop following the completion of this offering.

Since our acquisition by RWE in 2003, there has been no public market for our shares. It is likely that the initial public offering price for our shares will differ from the market price for our shares after the initial public offering. We cannot assure you that an active trading market for our shares will develop. A significant portion of our shares may not trade following the offering because RWE will own approximately % of our shares after the offering (or approximately % of our shares if the underwriters' option to purchase additional shares is exercised in full). If no trading market develops, securities analysts may not initiate or maintain research coverage of us, which could further depress the market for our shares. The price of our shares could decline if one or more equity analysts downgrade our shares or if those analysts issue other unfavorable commentary or cease publishing reports about us or our business. Furthermore, our operating results and prospects from time to time may be below the expectations of market analysts and investors. As a result, investors may not be able to sell their shares at or above the initial public offering price or at the time that they would like to sell.

The market price of our common stock may be volatile, which could cause the value of your investment to decline.

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The initial public offering price for the shares of common stock being sold in this offering will be determined by negotiations between the representatives of the underwriters and the selling stockholder and may

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not be indicative of prices that will prevail in the open market following this offering. You may not be able to resell your shares at or above the initial public offering price due to fluctuations in the market price of our common stock caused by changes in our operating performance or prospects and other factors, including broad market fluctuations. Some specific factors that may have a significant effect on the market price of our common stock include:

actual or anticipated fluctuations in our operating results or future prospects;

the public's reaction to our press releases, our other public announcements and our filings with the SEC;

strategic actions by us or our competitors, such as acquisitions or restructurings;

new laws or regulations or new interpretations of existing laws or regulations applicable to our business;

changes in accounting standards, policies, guidance, interpretations or principles;

adverse conditions in the financial markets or general economic conditions, including those resulting from war, incidents of terrorism and responses to such events;

sales of common stock by us, the selling stockholder or members of our management team; and

changes in stock market analyst recommendations or earnings estimates regarding our common stock, other comparable companies or the water services industry generally.

There has not been a public market for our common stock since our acquisition by RWE in 2003. We cannot predict the extent to which investor interest in our company will lead to the development of an active trading market on the New York Stock Exchange or otherwise or how liquid that market might become. If an active trading market does not develop, you may have difficulty selling any of our common stock that you buy. Consequently, you may not be able to sell our common stock at prices equal to or greater than the price you paid in this offering.

Future sales of our shares, or the perception by the market that future sales of our shares may occur, could depress the market price of our common stock.

Future sales, or the perception of the availability for sale in the public market, of substantial amounts of our common stock could adversely affect the prevailing market price of our common stock and could impair our ability to raise capital through future sales of equity securities at a time and price that we deem appropriate. As of December 31, 2007, there were 160.0 million shares of our common stock outstanding.

The shares of common stock sold by RWE in this offering will be freely transferable without restriction or further registration under the Securities Act. The remaining _____ shares of common stock owned by RWE will be restricted securities within the meaning of Rule 144 under the Securities Act but will be eligible for resale subject to applicable volume, manner of sale, holding period and other limitations of Rule 144 and the lock-up provisions described below. RWE has certain registration rights with respect to the common stock that they will retain following this offering and, subject to the lock-up provisions described in this prospectus, intends to fully divest its ownership of American Water as soon as reasonably practicable, subject to market conditions.

Following the consummation of this offering, we intend to grant _____ restricted stock units and _____ stock options under our 2007 Omnibus Equity Compensation Plan, and are considering establishing an employee stock purchase plan, for which we would reserve _____ shares of our common stock to be issued and sold thereunder.

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We, our executive officers and directors and the selling stockholder have agreed to a lock-up, meaning that, subject to specified exceptions, neither we nor they will sell any shares or engage in any hedging transactions without the prior consent of the representatives of the underwriters for 180 days after the date of this prospectus. Following the expiration of this 180-day lock-up period, all of the shares of our common stock held by our executive officers and directors and by the selling stockholder will be eligible for future sale, subject to the applicable volume, manner of sale, holding period and other limitations of Rule 144.

We expect to pursue issuances of our common stock in order to meet our capital expenditure needs. We may also issue shares of our common stock, or other securities, from time to time as consideration for future acquisitions and investments. The number of shares of our common stock or the number or aggregate principal amount, as the case may be, of other securities that we may issue may in turn be significant. To the extent such shares or other securities are issued in private transactions, we may also grant registration rights covering those shares or other securities. In connection with any such acquisitions and investments any additional capital raised through the sale of our equity securities may dilute your percentage ownership in us. See *Shares Eligible for Future Sale* for a discussion of the shares of common stock that may be sold into the public market in the future.

You may never receive dividends on your investment in our common stock, which may limit your returns.

Upon the completion of this offering and subject to applicable law and the discretion of our board of directors, we will pay regular quarterly cash dividends on our common stock. See *Dividend Policy* and *Management's Discussion and Analysis of Financial Condition and Results of Operations - Dividends*. However, you may not receive dividends in the amounts disclosed in this prospectus, or at all, as a result of the following factors:

we are not legally or contractually required to pay dividends;

we may modify or revoke our policy to pay a regular quarterly dividend at any time;

even if we do not modify or revoke our dividend policy, the actual amount of dividends distributed and the decision to make any distribution is entirely at the discretion of our board of directors, and any future dividends with respect to shares of our common stock will depend on, among other things, our financial condition and results of operations, liquidity requirements, capital requirements of our subsidiaries, legal requirements, regulatory constraints, management's assessment of our ability to fund capital expenditures through debt and equity offerings and other factors deemed relevant by our board of directors;

some of our debt agreements restrict our ability, subject to specified exceptions, to pay dividends, and our ability to pay dividends may be subject to restrictions imposed by agreements governing our future indebtedness. See *Description of Certain Indebtedness*;

our ability to pay dividends will depend on our ability to generate cash flow from operations in the future. This ability, to an extent, is subject to general economic, financial, competitive, regulatory and other factors that are beyond our control. In addition, we are a holding company with no substantial assets. Because substantially all of our operations are conducted through our subsidiaries, we will not be able to pay dividends unless we receive sufficient cash distributions from our operating subsidiaries. We cannot assure you that our operating subsidiaries will generate sufficient cash flow from operations, or have sufficient surplus or net profits to make cash contributions to us in an amount sufficient to enable us to pay dividends. Even if these amounts are sufficient, our operating subsidiaries are subject to regulation by applicable state PUCs which may limit their ability to pay distributions to us, and the amount of dividends our subsidiaries may distribute is restricted by the agreements governing their indebtedness; and

the amount of dividends we may distribute is subject to Delaware law restrictions.

If we do not have sufficient cash to fund dividend payments, we would either reduce or eliminate dividends or rely on cash provided by financing activities to fund dividend payments, and such financing may or may not be available.

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If our dividend policy had been in effect for the year ended December 31, 2007, without making any pro forma adjustments other than the proposed payment of dividends, we would have been able to fund dividends at the level described in this prospectus, but we would not have been able to fund our construction expenditures and fund our acquisitions without using excess cash, borrowings under our revolving credit facility or proceeds from additional financings.

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 stockholder.

Upon the consummation of this offering, RWE will own approximately % of our common stock (or approximately % if the underwriters option to purchase additional shares is exercised in full). As a result, RWE effectively will be able to significantly influence 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.

Provisions in our amended and restated certificate of incorporation, our bylaws, Delaware law and the laws of the states in which we operate may inhibit or discourage a takeover attempt and negatively affect the value of your shares.

Provisions of our charter documents, the General Corporation Law of the State of Delaware, the state in which we are organized, and the laws of the states in which we operate, could discourage potential acquisition proposals or make it more difficult for a third party to acquire control of our company, even if doing so might be beneficial to our stockholders. See Description of Capital Stock. Upon the consummation of the offering, our amended and restated certificate of incorporation and bylaws will provide for various procedural and other requirements that could make it more difficult for stockholders to effect certain corporate actions, or may deter, delay or prevent a third party from acquiring us. These provisions will include:

limitations on who may call special meetings of stockholders;

the inability of stockholders to act by written consent;

advance notice requirements for nominations for election to the board of directors and for stockholder proposals; and

the authority of our board of directors to issue, without stockholder approval, shares of preferred stock with such terms as our board of directors may determine and to issue additional shares of our common stock.

In addition, some of the states in which we operate have enacted laws that require regulatory approval for the acquisition of control of regulated utilities. The threshold for a change in control is a fact specific inquiry that varies by state. For instance, in some states, any person acquiring more than 9.9% of our common stock would need the prior approval of the applicable state PUC or a determination from such state PUC that control has not been acquired. In addition to ownership, other states may analyze the degree of influence or control an acquiror may exert over the company. Any person acquiring our common stock in this offering or in any other purchase of our common stock in a quantity sufficient to trigger a change in control under state law would need the prior approval of the applicable state PUC. For example, in Kentucky, KY. Rev. Stat. Ann. §278.020 requires that no person may acquire control of American Water without obtaining necessary regulatory approvals.

These provisions may discourage acquisition proposals and may make it more difficult or expensive for a third party to acquire a majority of our outstanding voting stock or may delay, prevent or deter a merger, acquisition, tender offer or proxy contest, which may negatively affect our stock price.

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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;

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

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.

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.

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USE OF PROCEEDS

All of the shares of common stock offered by this prospectus are being sold by the selling stockholder. For information about the selling stockholder, see Principal and Selling Stockholder. We will not receive any of the proceeds from the shares of common stock sold by the selling stockholder.

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DIVIDEND POLICY

Our board of directors has adopted a dividend policy, effective upon the closing of this offering, to distribute to our stockholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes.

Our cash dividend policy reflects our basic judgment that it is in the best interest of our stockholders to distribute to them a portion of the cash generated by our business. 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 from external sources. In our judgment, our dividend policy, which is consistent with utility industry practice, will enable us to attract financing required to fund capital expenditures and acquisitions.

Upon the completion of this offering and subject to applicable law and the discretion of our board of directors, we will declare an initial quarterly dividend of \$0.20 per share per quarter or \$0.80 per share per year, to be paid approximately 60 days after the end of each fiscal quarter (beginning with the first full fiscal quarter ending after the consummation of this offering), for at least the first four quarters following the consummation of this offering, which we refer to as the initial four quarters, and a one-time dividend of \$ per share (representing the pro rata portion of the expected initial dividend for the remaining period of the quarter following the consummation of this offering) on or about , 2008 to stockholders of record on , 2008. The quarterly and annual average aggregate dividend amounts for the initial four quarters would be \$32.1 million and \$128.6 million, respectively. The aggregate dividend amounts are based upon the estimated average 160.7 million shares outstanding after this offering during the initial four quarters.

We expect that dividends will be paid every March, June, September and December of each fiscal year to holders of record approximately 15 days prior to the distribution date. Since the dividends on our common stock will not be cumulative, only declared dividends will be paid.

From 2003 to 2007, inclusive, because we were not a public company, we did not pay dividends on our common stock. However, American Water, prior to its acquisition by RWE in 2003, paid dividends to common stockholders in each of the years since it became publicly traded in 1947.

For further information about our dividend policy and our ability to pay dividends, see Management's Discussion and Analysis of Financial Condition and Results of Operations Dividends and Risk Factors Risks Related to Our Industry and Business Our Regulated Business 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 programs and Risk Factors Risks Related to this Offering You may never receive dividends on your investment in our common stock, which may limit your returns.

Table of Contents**CAPITALIZATION**

The following table sets forth our cash and cash equivalents and capitalization as of December 31, 2007 on an actual basis and on as an adjusted basis to give effect to the adjustment of restricted stock units from liability-classified awards to equity-classified awards as a result of this offering as if it had occurred on December 31, 2007.

You should read this table in conjunction with, and this table is qualified in its entirety by reference to, the sections in this prospectus entitled Summary Historical Consolidated and Unaudited Pro Forma Financial Data, Use of Proceeds, Unaudited Pro Forma Condensed Consolidated Financial Information, Selected Historical Consolidated Financial Data, 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.

	As of December 31, 2007 (In thousands)	
	Historical	As adjusted
Cash and cash equivalents	\$ 13,481	\$ 13,481
Short-term debt		
Short-term debt	220,514	220,514
Total short-term debt	220,514	220,514
Long-term debt of AWCC		
Private activity bonds and government funded debt	86,860	86,860
Senior notes	2,712,000	2,712,000
Long-term debt of other subsidiaries		
Private activity bonds and government funded debt	1,121,086	1,121,086
Mortgage bonds	731,340	731,340
Senior notes	45,473	45,473
Redeemable preferred stock at redemption value(1)	24,644	24,644
Notes payable and other	3,442	3,442
Unamortized debt discount, net	70,743	70,743
Total long-term debt	4,795,588	4,795,588
Total debt	5,016,102	5,016,102
Equity		
Common stockholders' equity(2)	4,542,046	4,542,726
Preferred stock without mandatory redemption requirements	4,568	4,568
Total equity	4,546,614	4,547,294
Total capitalization including short-term debt and current portion of long-term debt	\$ 9,562,716	\$ 9,563,396

(1) Includes current portion of redeemable preferred stock and the unamortized debt discount attributable to preferred stock of \$0.3 million.

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

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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 this 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 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.

Upon completion of this offering the Company expects to pay approximately \$3.0 million in completion bonuses 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 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.

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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.

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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;

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, Capitalization, 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 (In thousands, except per share data)	Pro forma
Operating revenues	\$ 2,214,215	\$	\$ 2,214,215
Operating expenses			
Operation and maintenance	1,246,479	1,020 (A)	1,247,499
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	1,020	2,200,106
Operating income (loss)	15,129	(1,020)	14,109
Other income (deductions)			
Interest	(283,165)	(1,705)(B) 4,116 (C) (478)(D)	(281,232)
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)	369	(255,150)
Provision for income taxes	86,756	147 (E)	86,903
Income (loss) from continuing operations	\$ (342,275)	\$ 222	\$ (342,053)
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 wholly 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 unvested stock options and restricted stock units to our employees in conjunction with this offering. The awards will be issued under the American Water 2007 Omnibus Equity Compensation Plan and will be recorded as equity awards. The awards vest over a 3-year period commencing January 1, 2007 and unvested stock options and restricted stock units are expected to vest over the three-year period based on our assessment of the probability of achieving performance conditions. The grant date value of the stock options at issuance was using the following assumptions in a Black-Scholes model: Exercise Price, Expected Term, Discount Rate, Volatility, 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	
New senior 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 sources	\$ 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 new senior notes, \$415.0 million of commercial paper and \$49.0 million of excess cash. \$202.4 million of the proceeds of the new senior 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.

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- (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.

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The resulting reduction in interest expense is computed as follows:

	RWE Notes	Commercial Paper	Total
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 this 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 this 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 "Summary Historical Consolidated and Unaudited Pro Forma Financial Data", "Use of Proceeds", "Capitalization", "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

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Diluted weighted average common shares(4)	160,000	160,000	160,000	160,000	160,000
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	For the years ended December 31,		
	2005	2006	2007
Other data:	(In thousands)		
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)

	2003	2004	As of December 31,		
	(unaudited)		2005	2006	2007
	(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 wholly 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.

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**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.

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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 anticipated sale of a portion of the Company in this 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

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common stock and its value relative to our book equity at the consummation of this offering or a decline over a period of time of our stock price following the consummation of this offering 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.

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, we have been 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 will be 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 will be required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which will require 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;

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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;

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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.

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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.

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.

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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, 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, Pennsylvania, Maryland, 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 Iowa, 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 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 prudence of the project and/or the project financing.

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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 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

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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, 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.

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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 this 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.

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, a decline in 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, 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.

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)

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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

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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.

State	Annualized Rate Increases Granted During the years		
	2005	2006	2007
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 \$59.4 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 \$16.2 million. Water service

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operating revenues also increased due to growth of 0.6% in our Regulated Businesses customer base through small acquisitions in our service areas and through growth in existing service areas. Water sales volume associated 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:

Customer Class	For the years ended December 31,			
	Operating Revenues		Water Sales Volume	
	2006	2007	2006	2007
Water service:				
Residential	57.6%	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	12.5%	12.5%	15.3%	14.7%
Other water revenues	1.4%	1.9%		
Total water revenues	96.1%	96.2%	100.0%	100.0%
Wastewater service	3.7%	3.6%		
Management fees	0.2%	0.2%		
	100.0%	100.0%		

Water Services Water service operating revenues from residential customers for 2007 amounted to \$1,146.0 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 \$16.1 million for 2007 to \$247.6 million from \$231.5 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 \$15.3 million from 2006.

Wastewater Services Our subsidiaries provide wastewater services in 11 states. Operating revenues from these services increased by 5.1% to \$71.6 million for 2007. The increase reflects a growth of 0.1% 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).

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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 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 revenues and a new military project 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,

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

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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 1.5%, 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%	57.6%	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%	12.5%	15.1%	15.3%
Other water revenues	1.4%	1.4%		
Total water revenues	96.4%	96.1%	100.0%	100.0%
Wastewater service	3.4%	3.7%		
Management fees	0.2%	0.2%		
	100.0%	100.0%		

Water Services Water service operating revenues from residential customers in 2006 amounted to \$1,068.2 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

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Jersey, Pennsylvania and Indiana and decreased usage related to enhanced conservation education, the installation of low-flow appliances and reduced household sizes.

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 \$231.5 million, a 3.6% 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 \$133.0 million in 2006, a 0.4% decrease from 2005.

Wastewater Services Our subsidiaries provide wastewater services in 11 states. Operating revenues from these services increased by 8.1% to \$68.1 million for 2006, from \$63.0 million for 2005. The increases were attributable to 4.3% 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

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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.

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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 7.5% 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 begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable

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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.

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(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. 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

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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 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, Maricopa 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, Maricopa 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:

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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.

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

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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.

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)
<i>Long-term debt:</i>				
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
<i>Preferred stock with mandatory redemption requirements</i>				
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

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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.

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.

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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%

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 this offering. 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 following the consummation of this offering, at which point our credit rating will no longer reflect RWE's controlling ownership.

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 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.

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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. On January 29, 2008, S&P indicated that if the initial public offering is further significantly delayed, it would likely downgrade both companies' corporate credit ratings and long-term debt credit ratings. 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 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.

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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 4.80% to 4.85% 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. The Company is currently pursuing a refunding and refinancing plan, which is subject to applicable state financing authorities and utility regulators. If the Company is unable to successfully refund and refinance these debt instruments, the impact of paying higher interest rates on the outstanding auction rate debt is not expected to materially effect the Company's overall financial position, results of operations or cash flows.

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 to 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 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.

Table of Contents*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.

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.

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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.

Dividends

General

Our board of directors has adopted a dividend policy, effective upon the closing of this offering, to distribute to our stockholders a portion of our net cash provided by operating activities as regular quarterly dividends, rather than retaining that cash for other purposes. Our policy will be to distribute 40% to 70% of our net income annually.

Rationale for Our Cash Dividend Policy

Our cash dividend policy reflects our basic judgment that it is in the best interest of our stockholders to distribute to them a portion of the cash generated by our business rather than retaining these amounts for use in investing activities such as acquisitions or construction expenditures. Because we believe we will generally finance a portion of our construction expenditures from external financing sources, we believe that our investors are best served by distributing a portion of our net cash provided by operating activities. 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. In our judgment, our dividend policy, which is consistent with utility industry practice, will enable us to attract financing required to fund capital expenditures and acquisitions. For information on the risks associated with our dividend policy, see Risk Factors Risks Related to Our Industry and Business Our Regulated Business 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 programs and Risk Factors Risks Related to this Offering You may never receive dividends on your investment in our common stock, which may limit your returns.

Our Initial Dividend Rate

Upon the completion of this offering and subject to applicable law and the discretion of our board of directors, we will declare an initial quarterly dividend of \$0.20 per share per quarter, or \$0.80 per share per year, to be paid approximately 60 days after the end of each fiscal quarter (beginning with the first full fiscal

quarter ending after the consummation of this offering) for at least the first four quarters following the consummation of this offering, which we refer to as the initial four quarters, and a one-time dividend of \$ per share (representing the pro rata portion of the expected initial dividend for the remaining period of the quarter following the consummation of this offering) on or about , 2008 to stockholders of record on , 2008. The quarterly and annual average aggregate dividend amounts for the initial four quarters would be \$32.1 million and \$128.6 million, respectively. The aggregate dividend amounts are based upon the estimated average 160.7 million shares outstanding after this offering during the initial four quarters. In determining our intended dividend level for the initial four quarters, we reviewed and analyzed the items described below under Assumptions and Considerations.

We expect that dividends will be paid every March, June, September and December of each fiscal year to holders of record approximately 15 days prior to the distribution date. Since the dividends on our common stock will not be cumulative, only declared dividends will be paid.

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From 2003 to 2007, inclusive, because we were not a public company, we did not pay dividends on our common stock. However, American Water, prior to its acquisition by RWE in 2003, paid dividends to common stockholders in each of the years since it became publicly traded in 1947.

Basis for Initial Dividend Rate Minimum net cash provided by operating activities and cash available to pay dividends

In determining our intended dividend rate for the initial four quarters we reviewed and analyzed the following factors:

our operating and financial performance in recent years,

our anticipated debt service requirements,

our expected working capital and other cash needs,

the borrowing capacity under our credit facilities,

the dividend restrictions imposed on our subsidiaries by their indebtedness and our subsidiaries' ability to make dividend payments, including regulatory constraints,

our access to other financing sources to fund capital expenditures, and

legal requirements.

We do not as a matter of course make public projections as to future revenues, earnings or other results. However, we have prepared the estimated cash available to pay dividends on outstanding common stock and assumptions set forth below to substantiate our belief that we will have sufficient cash available to pay the initial dividend during the initial four quarters. The assumptions and estimates underlying the estimated financial information below are inherently uncertain and, though considered by us, to the best of our knowledge and belief as of the date of their preparation, to be reasonable and to present our expected course of action and our expected future financial performance, they are subject to a wide variety of significant business, economic, and competitive risks and uncertainties, including those described in greater detail in the sections entitled Risk Factors and Forward-Looking Statements. Accordingly, we cannot assure you that the estimated financial information is indicative of our future performance or that the actual results will not differ materially from the estimated financial information presented below, and you are cautioned not to place undue reliance on the estimated financial information.

The estimated financial information presents the estimated net cash provided by operating activities that would be sufficient to fund the cash dividends for the initial four quarters and has been prepared by, and is the responsibility of, our management.

Neither PricewaterhouseCoopers LLP, nor any other independent registered public accounting firm, has examined, compiled or performed any procedures with respect to the accompanying estimated financial information contained herein, and neither PricewaterhouseCoopers LLP nor any other independent registered public accounting firm expresses an opinion or any other form of assurance with respect thereto. The PricewaterhouseCoopers LLP report included in this prospectus relates to the Company's historical financial information. It does not extend to the accompanying estimated financial information. In the view of our management, the estimated financial information was prepared on a reasonable basis, reflects the best currently available estimates and judgments, and presents, to the best of management's knowledge and belief, our expected course of action and our expected future financial performance. The estimated financial information was not prepared with a view toward compliance with published guidelines of the Securities and Exchange Commission or the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information. However, this information is not fact and should not be relied upon as being necessarily indicative of future results, and you are cautioned not to place undue reliance on the estimated financial information.

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We believe that in order to fund dividends on our common stock and comply with our anticipated debt covenants for the initial four quarters at the level described above, our net cash provided by operating activities, including net cash provided by operating activities for our operating subsidiaries, for the initial four quarters would need to be at least \$558.5 million as set forth in the following table. As described under

Assumptions and Considerations below, we believe that our net cash provided by operating activities for the initial four quarters will be at least equal to our estimated minimum net cash provided by operating activities of \$558.5 million, and we have determined that our estimates of capital expenditures and debt amortization payments are reasonable. In order to fund capital expenditures at these levels we will be required to borrow under our existing revolving credit facility or to seek additional financing through a combination of public or private debt and equity offerings. Our ability to generate consistent cash flows from operations and obtain financing to fund capital expenditures is dependent upon the economic regulation of our Regulated Businesses, which affords a return of and on our investments. Prior to 2007, rate stay-out requirements imposed as conditions to the approval of the RWE acquisition caused a reduction in cash flows from operations. During 2007, we generated a significant increase in cash flows from operations as the rate case stay-out agreements expired, and we received rate increases to reflect increases in operating costs and a return of and on our prudent investments in fixed assets.

	Amount (In thousands)
Estimated Cash Available to Pay Dividends Based on Estimated Minimum net cash provided by operating activities:	
Estimated minimum net cash provided by operating activities (1)	\$ 558,480
Plus:	
Financing to fund capital expenditures, acquisitions and debt amortization, net (2)	826,900
Advances and contributions for construction, net of referrals	56,100
Less:	
Estimated construction expenditures (3)	1,091,200
Estimated acquisitions (4)	118,800
Estimated amortization payments on indebtedness (5)	102,900
 Estimated cash available to pay dividends on outstanding common stock	 \$ 128,580
 Estimated cash dividends (6)	 \$ 128,580

If our dividend policy had been in effect for the year ended December 31, 2007, without making any pro forma adjustments other than the proposed payment of dividends, we would have been able to fund dividends at the level described in this prospectus, but we would not have been able to fund our construction expenditures and fund our acquisitions without using excess cash, borrowings under our revolving credit facility or proceeds from additional financings. At December 31, 2007, we had \$530.1 million of available capacity under the AWCC commercial paper program.

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The following tables set forth our net cash provided by operating activities and excess cash available to pay dividends for the year ended December 31, 2007, on an actual basis and on a pro forma basis to give effect to the Transactions as if they had occurred on January 1, 2007, before one-time transaction expenses and subject to the assumptions described in the table.

	Historical Year Ended December 31, 2007	Pro forma adjustments (In thousands)	Pro forma Year Ended December 31, 2007
Cash Available to Pay Dividends:			
Net cash provided by operating activities (1)	\$ 473,712	\$ (16,207)(7)	\$ 457,505
Plus:			
Other investing activities, net	27,868		27,868
Financing to fund capital expenditures, acquisitions, net	220,747		220,747
Advances and contributions for construction, net of refunds	35,846		35,846
Cash and cash equivalents at beginning of period	29,754		29,754
Less:			
Construction expenditures	758,569		758,569
Acquisitions	15,877		15,877
Historical cash available to pay dividends	13,481	(16,207)(8)	(2,726)
Assumed borrowings to fund capital expenditures (7)	114,519		130,726
Excess cash that would have been available to pay dividends (7)	\$ 128,000	\$	\$ 128,000
Amount of dividend on common stock (6)	\$ 128,000	\$	\$ 128,000

- (1) Our income and net cash provided by operating activities are entirely dependent upon the results of operations of our subsidiaries. The following table sets forth net cash provided by operating activities for the year ended December 31, 2007 for our regulated subsidiaries in the states where our Regulated Businesses provide services:

	Historical Year Ended December 31, 2007 (In thousands)
Net cash provided by operating activities	
New Jersey-American Water	\$ 138,266
Pennsylvania-American Water	137,523
Missouri-American Water	46,092
Illinois-American Water	24,825
Indiana-American Water	48,025
California-American Water	11,895
West Virginia-American Water	29,155
Subtotal (Top Seven States)	435,781
Other	37,931
Total	\$ 473,712

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Our subsidiary dividend policy requires all regulated subsidiaries to pay quarterly dividends of 75% of their net income in the previous quarter. Regulated subsidiary debt agreements prohibit dividend payments in excess of net income that would reduce the subsidiary's equity below a pre-determined threshold set when the debt was issued; however, our regulated subsidiaries are permitted to lend excess cash to AWCC, and AWCC is permitted to lend this excess cash to other regulated subsidiaries or American Water.

- (2) Represents the net proceeds from a combination of potential debt and equity offerings. The water utility industry routinely funds capital expenditures through a combination of periodic debt and equity offerings. It is our judgment that we must maintain our equity to capitalization ratio between 44% and 50% to secure

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additional financing needed to fund our capital expenditures. The increase in financing to fund capital expenditures and acquisitions, net from \$220.7 million in 2007 to an estimated \$724.0 million (representing \$826.9 million net of \$102.9 million of financing to fund estimated debt amortization payments) in the initial four quarters is due to the estimated increases in capital expenditures and acquisitions described in footnotes (3) and (4), respectively, as well as the assumed use of operating cash flow to pay dividends in the initial four quarters. We intend to secure anticipated financing through a combination of long-term debt issuance, private debt offerings or commercial paper issuances on terms and conditions similar to those in the agreements governing our existing indebtedness. For further information, see Liquidity and Capital Resources.

- (3) Includes \$1,091.2 million of construction expenditures, net of advances for the initial four quarters as compared to \$758.6 million in 2007, which is based upon management's estimate of the amount needed to comply with existing and new regulations, renew aging infrastructure and network assets, provide capacity for new growth and enhance system reliability, security and quality of service. The increase in estimated construction expenditures from 2007 is due to our continued investment in regulated infrastructure projects.
- (4) Includes \$118.8 million of acquisitions for the initial four quarters. The increase in estimated acquisitions from 2007 is primarily due to the acquisition by New Jersey America Water of Trenton's Water System. See Prospectus Summary Recent Developments.
- (5) We have scheduled debt maturities of \$102.9 million during the initial four quarters and do not anticipate additional maturities on indebtedness during the initial four quarters.
- (6) Upon the completion of this offering and subject to applicable law and the discretion of our board of directors, our cash dividend payments on our common stock will be as follows:

	Average Number of Shares	Quarterly Base Dividend Per Share	Dividends (In thousands)	
			Quarterly Aggregate	Annual Aggregate
Common stock issued and outstanding	160,000,000	\$ 0.20	\$ 32,000	\$ 128,000
Estimated offering per quarter for the initial four quarters	727,250	0.20	145	580
Total	160,727,250		\$ 32,145	\$ 128,580

- (7) We plan to first pay dividends from cash flows provided by operating activities, and the remaining cash flows provided by operating activities will be used to fund construction expenditures. If our dividend policy had been in effect for the year ended December 31, 2007, without making any pro forma adjustments other than the proposed payment of dividends, we would have been able to fund dividends at the level described in this prospectus, but we would not have been able to fund our construction expenditures and fund our acquisitions without using excess cash, borrowings under our revolving credit facility or proceeds from additional financings. As of December 31, 2007, we had \$530.1 of available capacity under the AWCC commercial paper program.
- (8) The impact on cash interest expense related to the Transactions, which is defined and further discussed elsewhere in this prospectus, is summarized below. See Unaudited Pro Forma Condensed Consolidated Financial Statements.

	Year Ended December 31, 2007 (In thousands)
Issuance of new senior notes	\$ (95,085)
Issuance of RWE redemption notes	(100,122)
Issuance of commercial paper	(22,036)
Redemption of RWE redemption notes	100,122
Redemption of RWE notes	8,497
Redemption of preferred stock	74,569
Redemption of commercial paper	13,732
RWE cash equity contribution used to pay short-term debt	4,116
Net increase (decrease) in cash flows from operations	\$ (16,207)

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Assumptions and Considerations

Based upon a review and analysis conducted by our management, we believe that our net cash provided by operating activities for the initial four quarters will be at least equal to our estimated minimum net cash provided by operating activities of \$558.5 million and that we will meet our financial ratios in our borrowing agreements. We considered various factors in determining our dividend goal for the initial four quarters and establishing our belief concerning the minimum net cash provided by operating activities required to support our dividend policy, including:

Net cash provided by operating activities was \$525.4 million, \$323.7 million and \$473.7 million in 2005, 2006 and 2007, respectively.

Our capital expenditures were \$558.4 million, \$688.8 million and \$758.6 million in 2005, 2006 and 2007, respectively.

Annualized revenues (assuming constant sales volume) resulting from authorized rate increases, including distribution and other surcharges, granted in 2005, 2006 and 2007 (see Results of Operations).

Scheduled maturities on our existing indebtedness will be \$102.9 million in the initial four quarters.

After giving pro forma effect to our dividend rate, we determined that our revolving credit facility would have had sufficient capacity during the three years ended December 31, 2007 to finance any fluctuations in working capital and other cash needs, including the payment of dividends at the rate disclosed in this prospectus. Our revolving credit facility contains a covenant that requires that we maintain, at the end of each fiscal quarter, a consolidated total debt-to-consolidated total capitalization ratio of not more than 0.70 to 1.0. We do not believe that the payment of dividends at the rate disclosed in this prospectus during the three years ended December 31, 2007 would have caused us to fail to maintain this ratio.

We are currently permitted to fund the payment of dividends from borrowings under our revolving credit facility but intend to use cash from operations as the principal means to fund dividends over the initial four quarters. We do not believe that the payment of dividends at the level described in this prospectus for the initial four quarters would cause us to fail to maintain the consolidated total debt-to-consolidated total capitalization ratio described above.

To the extent we finance capital expenditures with indebtedness, we will begin to incur incremental debt service obligations; however, we do not anticipate any additional debt maturities during the initial four quarters.

We may have access to other potential sources of liquidity, including the issuance of additional debt and equity in capital markets transactions.

Our ability to pay dividends will depend on the earnings and distributions of funds from our operating subsidiaries, and we cannot be certain that our operating subsidiaries will generate sufficient cash flow from operations, or have sufficient surplus or net profits, as the case may be, to make cash contributions to us in an amount sufficient to enable us to pay dividends; these distributions are also regulated.

The amount of dividends our subsidiaries may distribute is restricted by the agreements governing their indebtedness. We have also assumed:

that our general business climate, including such factors as customer demand for our services, the level of competition we experience and our regulatory environment, will remain consistent with previous periods;

that our operating expenses and gross margins will not differ materially from previous periods relative to our net revenues;

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that we will have access to debt markets on terms and conditions similar to those in the agreements governing our existing indebtedness;

that LIBOR, on which interest under a number of agreements governing our indebtedness is determined, will not increase beyond currently anticipated amounts; and

the absence of extraordinary business events, such as new industry-altering technological developments or adverse regulatory developments, that may adversely affect our business, results of operations or anticipated capital expenditures.

As noted above, we have estimated our initial dividend level and the minimum net cash provided by operating activities required to pay dividends at that level only for the initial four quarters. We cannot assure you that we will pay dividends during or following that period at the level estimated above, or at all. Dividend payments are within the absolute discretion of our board of directors and will be dependent upon many factors and future developments that could differ materially from our current expectations. Over time, our capital and other cash needs will invariably be subject to uncertainties, which could affect the level of any dividends we pay in the future.

In accordance with our dividend policy and subject to applicable law and the discretion of our board of directors, we will distribute, as dividends to our stockholders, a substantial portion of the net cash provided by our operating activities. We believe that our dividend policy will limit, but not preclude, our ability to pursue growth. In order to pay dividends at the level currently anticipated under our dividend policy, we expect that we will be required to borrow under our revolving credit facility or to seek additional financing and would need additional financing to fund significant acquisitions or to pursue growth opportunities requiring capital expenditures significantly beyond our anticipated capital expenditure levels. Such additional financing could include, among other transactions, the issuance of additional shares of common stock. Management will evaluate potential growth opportunities as they arise and, if our board of directors determines that it is in our best interest to use cash that would otherwise be available for distribution as dividends to pursue an acquisition opportunity, to materially increase capital spending or for some other purpose, the board would be free to depart from, or change, our dividend policy at any time.

Restrictions on Payment of Dividends

Delaware Law

Under Delaware law, our board of directors may declare dividends only to the extent of our surplus (which is defined as total assets at fair market value *minus* total liabilities, *minus* statutory capital) or, if there is no surplus, out of our net profits for the then current and/or immediately preceding fiscal year. The value of a corporation's assets can be measured in a number of ways and may not necessarily equal their book value. The value of our capital may be adjusted from time to time by our board of directors. Our board of directors may base this determination on our financial statements, a fair valuation of our assets or another reasonable method. Although we believe we will have sufficient net profits or surplus to pay dividends at the anticipated levels during the initial four quarters, our board of directors will seek periodically to assure itself of this before actually declaring any dividends. In future periods, our board of directors may seek opinions from outside valuation firms to the effect that our solvency or assets are sufficient to allow payment of dividends, and such opinions may not be forthcoming. If we sought and were not able to obtain such an opinion, we likely would not be able to pay dividends.

Our Subsidiary Indebtedness and Future Indebtedness

Our existing indebtedness is issued by our finance subsidiary, AWCC, and by our operating subsidiaries. Some of the agreements governing the indebtedness of our operating subsidiaries restrict the ability of the operating subsidiaries to pay dividends and make distributions where this would cause them to fail to maintain certain debt-to-equity ratios. Our revolving credit facility contains a covenant that requires that we maintain, at the end of each fiscal quarter, a consolidated total debt-to-consolidated total capitalization ratio of not more than 0.70 to 1.0.

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We and our subsidiaries are permitted to incur future indebtedness under the terms of the agreements governing our existing indebtedness, and any such future indebtedness may further restrict or prohibit the payment of dividends. See Description of Certain Indebtedness.

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 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

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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 performed 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 need to consider the market price of our common stock at the offering date or a decline over a period of time of our stock price following the consummation of this 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 this 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 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, a decline in 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.

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

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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.

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.

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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 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.

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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.

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

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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 us on January 1, 2008. We do not believe SFAS 159 will have a significant effect on our 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 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. 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. This statement defines fair value, establishes a framework for using fair value to measure assets and liabilities, and expands disclosures about fair value measurements. The statement applies when other statements require or permit the fair value measurement of assets and liabilities. This statement does not expand the use of fair value measurement. 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 the 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. We are currently evaluating the impact on our financial statements of adopting SFAS 157.

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.

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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
	Joins Fortune magazine's list of 50 largest United States public utility companies

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Year	Event
1969	Acquires Paradise Valley Water Company in Arizona
1972	Passage of Clean Water Act
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

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.

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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

Regulated Businesses Customers

(dollars in millions)

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;

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 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.

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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:

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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 absorb the impact of adverse weather, such as droughts, excessive rain and cool temperatures in specific areas.

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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

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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, 655 groundwater treatment plants and 41 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 factors. In addition, residential customers generally do not have the option of switching to another

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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 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

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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.

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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

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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 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

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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, 655 groundwater treatment plants, 1,013 groundwater wells, 41 wastewater treatment facilities, 921 treated water storage facilities, 1,268 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 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.

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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%	167,909	5.1%
Subtotal (Top Seven States)	1,657.0	83.4%	2,673,946	80.7%
Other	330.6	16.6%	638,682	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.

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

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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 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.

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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 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

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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 2006, 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.

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.

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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:

	2005		Year Ended December 31, 2006		2007	
	Water	Wastewater	Water	Wastewater	Water	Wastewater
Residential	2,820,727	124,882	2,865,667	130,355	2,886,904	131,571
Commercial	230,187	5,756	229,354	5,922	227,833	5,929
Industrial	4,768	11	4,668	13	4,650	14
Private Fire	32,106	10	33,208	10	34,618	9
Public Authority & Other	16,844	178	16,990	177	17,028	177
Total	3,104,632	130,837	3,149,887	136,477	3,171,033	137,700

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

	Year ended December 31,		
	2005	2006	2007
	(In millions)		
Water service			
Residential	\$ 1,068.1	\$ 1,068.2	\$ 1,146.0
Commercial	353.7	362.7	385.3
Industrial	97.2	92.0	94.7
Public and other	223.4	231.5	285.9
Total water services	1,742.4	1,754.4	1,911.9
Wastewater services	63.0	68.1	71.6
Total	\$ 1,805.4	\$ 1,822.5	\$ 1,983.5

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 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.

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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.

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

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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.

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

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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, California 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, 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, Pennsylvania, Maryland, 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 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

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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.

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

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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.

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

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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, 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

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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.

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

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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.

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.

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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 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

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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.

Legal Proceedings

California

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 governing the implementation of the Coastal Water Project. 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

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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.

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.

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.

Name¹	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
Walter Q. Howard	56	Senior Vice President, Sales and Business Development
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	49	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	50	President, Western Region
George MacKenzie	58	Director and Chairman of the Board
Martha Clark Goss	58	Director
Dr. Manfred Döss	49	Director
William J. Marrazzo	58	Director
Dr. Rolf Pohlig	55	Director
Andreas G. Zetsche	52	Director

(1) Dr. Volker Heischkamp, 48, currently serves as our Senior Vice President, Capital Markets, a position he will resign prior to the consummation of this offering.

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

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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.

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.

Walter Q. Howard has been our Senior Vice President, Sales and Business Development since January 2007, Interim Chief Growth Officer of American Water Works Service Company, Inc. from March 2006 to January 2007, and Vice President, Sales and Development from November 2005 to March 2006. Prior to joining us, Mr. Howard served as a consultant for General Electric Company from June 2003 to August 2004, and Chief Executive Officer of Noble Power Assets, LLC from March 2002 to June 2003. Mr. Howard has tendered his resignation to the Company and will no longer be an employee of the Company effective March 31, 2008.

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.

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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 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

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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 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 since January 2007 has served as Vice President, Group Corporate Development and 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

Upon completion of this offering, our board of directors will conduct 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 this offering and entirely of independent directors within one year following the completion of this offering.

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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 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

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independence under the rules and regulations of the NYSE. Our board of directors has adopted a written charter 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. Prior to completion of this offering, the Code of Ethics and the corporate governance guidelines will be available on our website.

Compensation Discussion and Analysis

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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,

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who has served as our Executive Vice President of Business Operations, Eastern Division, since July 2, 2007; 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 has served as our Senior Vice President of Capital Markets since November 15, 2005. 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

Since January 2003, American Water has been owned and controlled by RWE, and our compensation strategy for our named executive officers has been primarily determined by the management of RWE based on its internal compensation practices and, until 2006, managed by Thames Water. The compensation for our named executive officers will continue to be determined by the internal compensation practices of RWE until the consummation of this offering. 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 will administer and oversee our compensation and employee benefits programs after the consummation of this offering, including our executive compensation programs and policies. Since our compensation committee has only recently been established, we have not yet determined what the role of our named executive officers will be in establishing executive compensation following this offering. 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 following the consummation of this offering: 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. However, we did grant contingent cash awards in 2007 that will vest in 2009 and pay out in 2010 if the initial public offering does not occur before such times.

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

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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 seven 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 are expected to be established in the same manner. Following this offering, the compensation committee will assume 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

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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 this offering. The Company operating income target (as adjusted for impairment charges and costs of this offering) was approximately \$542.9 million and the regional operating income targets (as adjusted for impairment charges and costs of this 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

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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%), (2) lead and manage RWE Divestiture activities with RWE, Securities and Exchange Commission compliance,

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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.

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

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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 closing price of an RWE share on July 23, 2007 was greater than \$90, the maximum payouts were made under the plan.

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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 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.

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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 will not be triggered by this 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 Senior Vice President, Legal, and Volker Heischkamp, our 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 is intended to retain employees in key leadership roles through the timely completion of American Water's initial public offering. If a participant remains 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 will 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 are payable to employees whose employment is terminated without cause prior to the applicable payment date. The retention bonus has been offered to employees in lieu of a 2006 grant under the RWE long-term incentive program.

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The named executive officers who participate in the retention bonus program are 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 has offered a completion bonus to reward selected senior executives for their contributions to this offering. Each eligible executive is 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 participate in the completion bonus program are 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 will be awarded if this offering is consummated. The remaining 50% is payable at the discretion of RWE, based upon the executive's leadership and support in positively marketing the business and preparing for this offering. All of Dr. Heischkamp's completion bonus is discretionary, and it will be based on his personal contribution to this offering.

New Omnibus Equity Compensation Plan

American Water has adopted an omnibus equity compensation plan in connection with this offering pursuant to which equity-based awards will be granted to certain employees and non-employee directors of American Water. The plan will encourage 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.

At the time of this offering, two grants of performance-based non-qualified stock options and performance-based restricted stock units will be made to employees, including the named executive officers, under the plan.

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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 will be determined by RWE based on certain performance conditions, as described below. Sixty percent of the award value granted under the plan will be in the form of stock options and 40% will be in the form of restricted stock units. The exercise price of the stock options will be 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 is no longer employed and will not receive a grant). Other employees will receive 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 will be used for the first grant of awards, and January 1, 2008 base salaries will be 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 this 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 this 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 this 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 this 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 this offering.

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 this offering and American Water's target net income for 2009 (as adjusted as described above) at the time of this offering.

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The number of stock options and restricted stock units initially granted at the time of this offering will be determined by RWE based on its goals for our 2007, 2008 and 2009 net income.

Assuming the shares being offered pursuant to this prospectus are offered at \$ per share, which is the midpoint of the estimated offering price range set forth on the cover page of this prospectus, options to purchase a total of shares of common stock and restricted stock units will be granted to employees upon the completion of this offering. Of this total, the following named executive officers will receive 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				
Ellen C. Wolf				
John S. Young				
Walter J. Lynch				
Paul G. Townsley				

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.

If an initial public offering of American Water's common stock has not occurred by December 31, 2009, with respect to the first grant of awards, or December 31, 2010, with respect to the second grant of awards, participants will not receive the stock options or restricted stock units described above and will instead receive cash equal to the value of the restricted stock units they otherwise would have received at the target level.

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, which is not yet effective, 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.

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

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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	All Other Compensation (\$)(11)	Total (\$)(12)
							Earnings (\$)(10)		
<i>Donald L. Correll</i>	2007	\$ 562,059	\$	\$	\$	\$ 457,415	\$	\$ 82,843	\$ 1,102,317
President and Chief Executive Officer(1)									
<i>Ellen C. Wolf</i>	2007	\$ 459,865	\$	\$	\$	\$ 238,587	\$	\$ 66,578	\$ 765,030
Senior Vice President and Chief Financial Officer(2)									
<i>John S. Young</i>	2007	\$ 408,771	\$	\$ 226,486	\$	\$ 206,927	\$ 208,700	\$ 26,183	\$ 1,077,067
Chief Operating Officer(3)									
<i>Walter J. Lynch</i>	2007	\$ 318,769	\$	\$ 209,911	\$	\$ 138,698	\$ 22,197	\$ 17,761	\$ 707,336
Executive Vice President Business Operations, Eastern Division(4)									
<i>Paul G. Townsley</i>	2007	\$ 275,847	\$	\$ 207,204	\$	\$ 78,240	\$ 71,615	\$ 84,224	\$ 717,130
President, Western Region(5)									
<i>Dietrich Firnhaber</i>	2007	\$ 205,846	\$	\$ 122,760	\$	\$	\$	\$ 1,124,889	\$ 1,453,495
Senior Vice President, Legal(6)									
<i>Volker Heischkamp</i>	2007	\$ 390,872	\$	\$ 136,556	\$	\$ 148,703	\$ 7,051	\$ 108,944	\$ 792,126
Senior Vice President, Capital Markets(7)									

(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 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

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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 has been seconded to American Water