American Water Works Company, Inc.
Form S-1/A
November 18, 2008
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As filed with the Securities and Exchange Commission on November 18, 2008.

Registration No. 333-155245

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1 to

Form S-1

REGISTRATION STATEMENT UNDER

THE SECURITIES ACT OF 1933

AMERICAN WATER CAPITAL CORP.

AMERICAN WATER WORKS COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware	**522300**	**22-3732448**
Delaware	**4941**	**51-0063696**

(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

1025 Laurel Oak Road

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	George W. Patrick
President and Chief Executive Officer	Vice President and Secretary
American Water Works Company, Inc.	American Water Capital Corp.
1025 Laurel Oak Road	1025 Laurel Oak Road
Voorhees, NJ 08043	Voorhees, NJ 08043
(856) 346-8200	(856) 346-8200

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

Copies to:

William V. Fogg, Esq.	Robert E. Buckholz, Jr., Esq.
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825 Eighth Avenue	New York, NY 10004
New York, NY 10019	(212) 558-4000
(212) 474-1000	

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. ¨

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. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company.

Large accelerated filer ¨
Accelerated filer ¨
Non-accelerated filer x
Smaller reporting company ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Amount to be Registered**	**Proposed Maximum Offering Price per Unit**	**Proposed Maximum Aggregate Offering Price**	**Amount of Registration Fee**
% Senior Monthly Notes due 2038	$ 50,000,000	100%	$ 50,000,000	$ 1,965(1)
Support Agreement(2)	(2)	(2)	(2)	(3)

(1) Calculated pursuant to Rule 457(o) of the Securities Act. The registrants previously paid a registration fee of $30,700 with a registration statement on Form S-1, File No. 333-145757, initially filed on August 29, 2007, pursuant to which no securities were sold. Pursuant to Rule 457(p) of the Securities Act, $1,965 of the previously paid fee is offset against the registration fee otherwise due for this registration statement.

(2) The American Water Works Company, Inc. Support Agreement is offered as a component of the % Senior Monthly Notes due 2038 for no additional consideration.

(3) No further fee is payable pursuant to Rule 457(n).

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. We 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 are not soliciting an offer to buy these securities, in any state where the offer or sale is not permitted.

Subject to Completion, dated November 18, 2008.

(Preliminary Prospectus)

American Water Capital Corp.

$50,000,000

% Senior Monthly Notes due 2038

This is an offering by American Water Capital Corp., which we refer to as AWCC or the issuer, of its % Senior Monthly Notes due 2038, which we refer to as the notes. We will pay interest on the notes on the first day of each month, beginning on January 1, 2009. The notes will mature on December 1, 2038. However, we can redeem the notes, in whole or in part from time to time, on or after December 1, 2013 at 100% of the principal amount thereof plus any accrued interest thereon. In addition, we will be required to redeem the notes at the option of the representative of any deceased beneficial owner (subject to limitations and conditions specified herein) at 100% of the principal amount thereof plus any accrued interest thereon. If we experience certain change of control triggering events, we must offer to purchase the notes at 101% of their aggregate principal amount, plus accrued interest. Notes will be issued only in registered form and in denominations of $1,000 and integral multiples of $1,000 in excess thereof.

The notes will be unsecured, will rank equally with the issuer s existing and future senior debt and will rank senior to the issuer s future subordinated debt. The notes will be effectively subordinated to the issuer s existing and future secured debt to the extent of the collateral securing that debt. The notes will have the benefit of a support agreement from American Water Works Company, Inc., AWCC s parent company. The notes will not be guaranteed by any of our subsidiaries. AWCC is a finance subsidiary whose activities are limited to borrowing funds through the issuance of debt securities and lending those funds under loan agreements with our operating subsidiaries.

We will apply to list the notes on the New York Stock Exchange.

Investing in these notes involves risks. See Risk Factors beginning on page 12 to read about factors you should consider before buying these notes.

Neither the Securities and Exchange Commission, any state securities commission nor any other regulatory body has approved or disapproved of these securities or passed on the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

The underwriter proposes to offer the notes from time to time for sale in negotiated transactions, or otherwise, at varying prices to be determined at the time of each sale. The underwriter has agreed to purchase the notes from the issuer at % of their principal amount ($ aggregate proceeds to the issuer before expenses), subject to the terms and conditions in the underwriting agreement.

The underwriter expects to deliver the notes against payment therefor in New York, New York on , 2008.

EdwardJones

Prospectus dated , 2008.

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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 section entitled Glossary.

Our Company

Founded in 1886, American Water Works Company, Inc., which we refer to, together with its subsidiaries, as American Water, the Company or the support provider, is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our approximately 7,000 employees provide approximately 15 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. For the nine months ended September 30, 2008 we generated $1,768.4 million in total operating revenue, $315.9 million in operating loss, which includes $750.0 million of impairment charges, and a net loss of $598.8 million. Our Regulated Businesses, operating in 20 states in the United States, generated 89.8% and 89.3% of our total operating revenue in 2007 and for the nine months ended September 30, 2008, respectively.

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 and for the nine months ended September 30, 2008, our Non-Regulated Businesses generated $242.7 million and $202.1 million, respectively, 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

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provide service within an authorized service area. The utility segment of the United States water and wastewater industry is highly fragmented, with approximately 52,000 community water systems and approximately 16,000 community wastewater facilities, according to the United States Environmental Protection Agency, or EPA, and therefore presents opportunities for consolidation. Larger utilities, such as ours, that have greater access to capital are generally more capable of making mandated and other necessary infrastructure upgrades to water and wastewater systems.

Our Strengths

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

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

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

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

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

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

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

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

Experienced senior management team. Our four most senior executives, Donald L. Correll, President and Chief Executive Officer, Ellen C. Wolf, Senior Vice President and Chief Financial Officer, John S. Young, President, American Water Services, and Walter J. Lynch, President, Regulated Operations, have an average of over 20 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.

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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.

The Transactions

American Water is currently an indirect majority-owned subsidiary of RWE Aktiengesellschaft, which we refer to as RWE, 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. 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 in order 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 sold approximately 63.2 million shares in the initial public offering of American Water s common stock in April 2008. Of the approximately 63.2 million shares sold, approximately 5.2 million were sold pursuant to the partial exercise of the underwriters over-allotment option on May 27, 2008. RWE intends to fully divest its remaining ownership of American Water through the consummation of additional public offerings of common stock of American Water as soon as reasonably practicable, subject to market conditions, which, together with RWE s sale of shares in the initial public offering, we refer to as the RWE Divestiture. As of September 30, 2008, RWE owned approximately 60% of American Water s outstanding shares of common stock.

On September 28, 2007, Thames Water Aqua US Holdings, Inc., which we refer to as Thames US Holdings, at the time an indirect wholly-owned subsidiary of RWE, 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, AWCC, our wholly-owned financing subsidiary, 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, and were offered in reliance on an exemption from the registration requirements of, the Securities Act of 1933, as amended, which we refer to as 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.

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These financing 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.

On May 13, 2008, RWE made a cash equity contribution of $245.0 million to us, which we refer to as the Equity Contribution, in order to ensure compliance with relevant state PUC capital structure requirements. The Equity Contribution, the Refinancing, the 160,000-for-1 split of common stock, the Merger, the initial public offering and the issuance and sale of notes by us in this offering and our application of our proceeds therefrom are collectively referred to in this prospectus as the Transactions.

Recent Developments

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 $100.0 million. The agreement was approved by the Trenton City Council but 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.

In September 2008, our Contracts Operation Group was awarded two United States military contracts for operation and maintenance of the water and wastewater systems at Fort Polk and Fort Hood Army Installations. The estimated gross revenues we will receive from these 50-year fixed price contracts which are subject to modification as described below will be approximately $348 million and $329 million for Fort Polk and Fort Hood, respectively. All of the contracts with the U.S. government may be terminated, in whole or in part, prior to the end of the 50-year term for convenience of the U.S. government or as a result of a default or non-performance by the subsidiary performing the contract. In either event, we are entitled to recover the remaining amount of our capital investment pursuant to the terms of a termination settlement with the U.S. government at the time of termination as provided in each of the contracts. The contract price for each of these contracts is subject to redetermination two years after commencement of operations and every three years thereafter. Price redetermination is a contract mechanism to periodically adjust the service fee in the next period to reflect changes in contract obligations and anticipated market conditions.

Organizational Structure

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

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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.

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THE OFFERING

Issuer	American Water Capital Corp.
Securities Offered	$50,000,000 aggregate principal amount of % Senior Monthly Notes due 2038.
Maturity Date	The notes will mature on December 1, 2038.
Interest Payment Dates	We will pay interest on the notes on the first day of each month, beginning on January 1, 2009, to the holders of the notes as of the day that is 15 calendar days (whether or not a business day) prior to the relevant interest payment date and, if applicable, upon redemption.
Support Agreement	The notes will have the benefit of a support agreement from American Water, pursuant to which American Water has agreed to pay to any debt investor or lender any principal or interest owed by the issuer to such debt investor or lender that the issuer fails to pay on a timely basis, referred to herein as the support agreement.
Optional Redemption	We will have the right to redeem the notes in whole at any time or in part from time to time, on or after December 1, 2013 at 100% of the principal amount to be redeemed plus any accrued and unpaid interest thereon to the date of redemption.
Redemption Option of a Deceased Beneficial Owner s Representative	We will be required to redeem the notes at the option of the representative of any deceased beneficial owner of notes on a quarterly basis at 100% of the principal amount to be redeemed plus any accrued and unpaid interest thereon to the date of redemption, subject to the limitations and conditions that, during the period from the original issue date of the notes through December 1, 2009 and during each twelve-month period after December 1, 2009, the maximum principal amount we are required to redeem is $25,000 per deceased beneficial owner and an aggregate of $1,000,000 (2% of the aggregate principal amount of the notes sold in this offering) for all deceased beneficial owners. For a complete description, see Description of the Notes Limited Right of Redemption Upon Death of Beneficial Owner.
Repurchase Right of Holders Upon a Change in Control	Upon the occurrence of both (i) a change of control of American Water and (ii) a downgrade of the notes below an investment grade rating by each of Moody s Investors Service, Inc. and Standard & Poor s Ratings Services within a specified period, you will have the right to require us to repurchase the notes at a price equal to 101% of the aggregate principal amount of notes repurchased plus accrued and unpaid interest, if any, on the notes repurchased, to the date of purchase. See Description of the Notes Change of Control.

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Ranking	The notes will be the issuer s unsecured senior obligations and will:

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

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

- rank equal in right of payment to all existing and future unsecured obligations of American Water that are not, by their terms, expressly subordinated in right of payment to such obligations;
- rank senior in right of payment to any future obligations of American Water that are, by their terms, expressly subordinated in right of payment to such obligations; and
- rank (i) effectively junior in right of payment to any future secured indebtedness of American Water to the extent of the value of the assets securing such indebtedness and (ii) structurally junior in right of payment to any liabilities of the applicable American Water subsidiaries.

As of September 30, 2008, on a pro forma basis after giving effect to this offering:

- The issuer would have had $3,300.3 million of senior indebtedness, including (i) $2,884.0 million of currently outstanding senior notes, (ii) $50.0 million of notes offered hereby, (iii) $86.9 million of other senior indebtedness and (iv) $279.4 million of short-term debt and no subordinated indebtedness;
- the support provider would have had no indebtedness other than its obligations under the support agreement with respect to the issuer s indebtedness; and
- the subsidiaries of the support provider (other than the issuer) would have had approximately $1,818.7 million of indebtedness and other liabilities.

Certain Covenants	The indenture governing the notes will contain certain covenants that will, among other things, limit our ability to:

- create or assume liens; and
- enter into sale and leaseback transactions.

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These limitations are subject to a number of significant exceptions. See Description of the Notes Certain Covenants.

Use of Proceeds	We estimate that the proceeds from this offering, net of discounts and expenses, will be approximately $47.8 million. We intend to use the proceeds from this offering to fund the repayment of short-term debt.
Risk Factors	Investing in the notes involves risk. See the section entitled Risk Factors in this prospectus for a description of certain of the risks you should consider before investing in the notes.
Governing Law	The indenture and the notes are governed by, and construed in accordance with, the laws of the state of New York.

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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. The historical data as of September 30, 2008 and for the nine months ended September 30, 2007 and 2008 have been derived from our unaudited historical consolidated financial statements and the notes to those statements included elsewhere in this prospectus, which have been prepared on a basis consistent with our annual consolidated financial statements. In the opinion of management, such unaudited financial data reflect all adjustments, consisting only of normal and recurring adjustments, necessary for fair presentation of the results for those periods. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year or any future period. 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 this offering as if it had occurred on September 30, 2008, 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,			For the Nine Months Ended September 30,		Pro Forma For the Year Ended December 31, 2007 (unaudited)	Pro Forma For the Nine Months Ended September 30, 2008 (unaudited)
	2005	2006	2007	2007 (unaudited)	2008 (unaudited)		
	(in thousands, except per share data)						
Statement of operations data(1):							
Operating revenues	$ 2,136,746	$ 2,093,067	$ 2,214,215	$ 1,660,394	$ 1,768,377	$ 2,214,215	$ 1,768,377
Operating expenses							
Operation and maintenance	1,201,566	1,174,544	1,246,479	910,304	984,063	1,248,920	982,498
Depreciation and amortization	261,364	259,181	267,335	202,463	199,599	267,335	199,599
General taxes	183,324	185,065	183,253	140,910	151,074	183,253	151,074
Loss (gain) on sale of assets(2)	(6,517)	79	(7,326)	(6,821)	(413)	(7,326)	(413)
Impairment charges	385,434	221,685	509,345	243,345	750,000	509,345	750,000
Total operating expenses, net	2,025,171	1,840,554	2,199,086	1,490,201	2,084,323	2,201,527	2,082,758
Operating income (loss)	111,575	252,513	15,129	170,193	(315,946)	12,688	$ (314,381)
Other income (deductions)							
Interest, net	(345,257)	(365,970)	(283,165)	(211,709)	(212,718)	(283,108)	(214,516)
Amortization of debt expense	(4,367)	(5,062)	(4,867)	(3,624)	(4,360)	(5,484)	(4,415)
Other, net(3)	13,898	9,581	17,384	11,532	17,808	17,384	17,808
Total other income (deductions)	(335,726)	(361,451)	(270,648)	(203,801)	(199,270)	(271,208)	(201,123)
Income (loss) from continuing operations before income taxes	(224,151)	(108,938)	(255,519)	$ (33,608)	$ (515,216)	$ (258,520)	$ (515,504)
Provision for income taxes	50,979	46,912	86,756	74,095	83,612	85,570	83,498
Income (loss) from continuing operations	$ (275,130)	$ (155,850)	$ (342,275)	$ (107,703)	$ (598,828)	$ (344,090)	$ (599,002)
Income (loss) from continuing operations per basic common share(4)(5)	$ (1.72)	$ (0.97)	$ (2.14)	(0.67)	(3.74)	(2.15)	(3.74)
Income (loss) from continuing operations per diluted common share(4)(5)	$ (1.72)	$ (0.97)	$ (2.14)	(0.67)	(3.74)	(2.15)	(3.74)
Basic weighted average common shares	160,000	160,000	160,000	160,000	159,960	160,000	159,960
Diluted weighted average common shares	160,000	160,000	160,000	160,000	159,960	160,000	159,960
Other data(1):							
Cash flows provided by (used in):							
Operating activities	$ 525,435	$ 323,748	$ 473,712	$ 329,913	$ 392,913		
Investing activities	(530,165)	(691,438)	(746,578)	(482,950)	(723,574)		
Financing activities	(9,049)	332,367	256,593	274,542	323,869		
Construction expenditures	(558,446)	(688,843)	(758,569)	(507,237)	(714,559)		

Ratio of Earnings to Fixed Charges(6)	

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	As of December 31, 2006	As of December 31, 2007	As of September 30, 2008 (unaudited)	Pro Forma as of September 30, 2008 (unaudited)
	(in thousands)			
Balance sheet data(1):				
Cash and cash equivalents	$ 29,754	$ 13,481	$ 6,689	$ 6,689
Utility plant at original cost, net of accumulated depreciation	8,605,341	9,199,909	9,742,671	9,742,671
Goodwill	2,962,493	2,456,952	1,704,310	1,704,310
Total assets	12,783,059	12,934,072	12,780,732	12,782,932
Redeemable preferred stock at redemption value(7)	1,774,475	24,296	24,217	24,217
Other long-term debt	3,096,404	4,674,837	4,669,502	4,719,502
Other short-term and current portion of long-term debt(8)	1,007,128	316,969	423,021	375,221
Total debt	5,878,007	5,016,102	5,116,740	5,118,940
Common stockholders equity	3,817,397	4,542,046	4,162,357	4,162,357
Preferred stock without mandatory redemption requirements(7)	4,568	4,568	4,557	4,557

(1) On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. Prior to the initial public offering in April 2008, American Water was 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 loss from continuing operations per basic common share and loss from continuing operations per diluted common share for the fiscal years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2007 and 2008 is 160.0 million, after giving effect to the 160,000-for-1 stock split on November 7, 2007. The same number of shares of common stock is used to compute both loss from continuing operations per basic common share and loss from continuing operations per diluted common share, as no dilutive options or instruments were outstanding during these periods.

(5) The number of common shares used to compute loss from continuing operations per basic common share is 160.0 million, which gives effect to the 160,000-for-1 stock split effected on November 7, 2007. Pro forma loss from continuing operations per diluted common share considers the effect of all potentially dilutive instruments, which include restricted shares, restricted stock units and stock options granted under our 2007 Omnibus Equity Compensation Plan to certain of our employees upon the consummation of our initial public 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) For the years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2008, earnings were insufficient to cover fixed charges and there were deficiencies of $224.3 million, $109.1 million, $255.7 million and $515.4 million, respectively. On a pro forma basis after giving effect to the offering of notes, earnings would have been insufficient to cover fixed charges and there would have been a deficiency of $258.7 million and $516.7 million for the year ended December 31, 2007 and for the nine months ended September 30, 2008, respectively.

(7) Includes preferred stock held by RWE and other preferred stock issued by subsidiaries of the Company.

(8) 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, and $0.3 million as of September 30, 2008, respectively.

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RISK FACTORS

An investment in the notes involves risk. Before you decide to purchase the notes, 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 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 the notes.

Risks Related to Our Industry and Business

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

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

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

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

Our water and wastewater operations are subject to extensive United States Federal, state and local and, in the case of our Canadian operations, Canadian, laws and regulations, that govern the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat, discharge and dispose of 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, discharge and disposal 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. There have been no mandatory water use restriction orders to date in 2008, although voluntary conservation efforts or water use restrictions were implemented during certain periods in parts of New Jersey, New Mexico, New York and California. 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 and we expect to invest approximately $950 million in net capital improvements in 2008. 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 on favorable terms or at all.

RWE has certain registration rights with respect to future issuances of our equity securities and intends to fully divest its remaining ownership of American Water as soon as reasonably practicable, subject to market conditions. The registration rights agreement entered into with RWE imposes certain restrictions on our ability to issue equity securities in amounts beyond specified thresholds without RWE s consent. 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 on favorable terms or at all.

In addition, we believe that our dividend policy, which, subject to applicable law and the discretion of our board of directors, is to pay cash dividends of approximately $0.20 per share per quarter, could limit, but not preclude, our ability to pursue growth. In particular, this limitation could be significant, for example, with respect to large acquisitions and growth opportunities that require cash investments in amounts greater than our operating subsidiaries available cash or external financing resources. In order to fund construction expenditures, acquisitions (including tuck-in acquisitions) and principal and interest payments on our indebtedness, and pay dividends at the level currently anticipated under our dividend policy, we expect that we will need additional financing. However, we intend to retain sufficient cash from operating activities after the distribution of dividends to fund a portion of our capital expenditures. For further discussion of our acquisition strategy, see Business Our Regulated Businesses Acquisitions.

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

Market disruptions could affect our ability to meet our liquidity needs.

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. On September 15, 2008, we sought to issue commercial paper but were unable to consummate the issuance due to adverse market conditions. In order to meet our short-term liquidity needs we are borrowing under our existing $800.0 million revolving credit facility, which was scheduled to expire on September 15, 2012. On September 15, 2008, a majority of our lenders agreed to extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. AWCC had $197.2 million of outstanding borrowings and $42.9 million of outstanding letters of credit under this credit facility as of November 13, 2008. AWCC had $120.0 million of outstanding overnight commercial paper as of November 13, 2008. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

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.

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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 cleanup obligations.

Our water supplies are subject to contamination, including contamination from naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources, such as perchlorate and methyl tertiary butyl ether (MTBE), and possible terrorist attacks. In the event that our water supply is contaminated, we may have to interrupt the use of that water supply until we are able to substitute the supply of water from another water source, including, in some cases, through the purchase of water from a third-party supplier. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities, or development of new treatment methods. If we are unable to substitute water supply in a cost-effective manner, our financial condition, results of operations, cash flow, liquidity and reputation may be adversely affected. We might not be able to recover costs associated with treating or decontaminating water supplies through rates, or such recovery may not occur in a timely manner. Moreover, we could be held liable for environmental damage as well as damages arising from toxic tort or other lawsuits or 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 12.6% 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.

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

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

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

- incurrence of debt and contingent liabilities;
- failure to have or to maintain effective internal control over financial reporting;
- 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. Sales of our common stock by RWE as well as the restrictions in the registration rights agreement between us and 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 a 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, retaining and integrating key personnel, achieving strategic objectives and integrating acquired assets and technological systems. 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 or require us to effect additional dilutive equity issuances.

Our total assets include substantial goodwill. At September 30, 2008, our goodwill totaled $1,704.3 million. The goodwill is primarily associated with the acquisition of American Water by an affiliate of RWE in 2003 and the acquisition of E Town Corporation in 2001. Goodwill represents 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 at November 30 of each year and interim reviews are performed when management determines that a triggering event has occurred. 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, $227.8 million, and $509.3 million for the years ended December 31, 2005, 2006 and 2007, respectively. These amounts include impairments relating to discontinued operations. Also, for the three months ended March 31, 2008 we recorded a goodwill impairment in the amount of $750.0 million.

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While our annual goodwill impairment test is conducted at November 30, we have processes to monitor for interim triggering events. During the third quarter of 2007, management determined that it was appropriate to update its valuation analysis 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 our initial public offering. As a result of that update, we recorded an impairment charge to goodwill of our Regulated Businesses in the amount of $243.3 million in the third quarter of 2007. That decline in the value of our goodwill 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.

When we completed our annual goodwill impairment test for 2007 we determined that an impairment to goodwill 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, 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.

In April of 2008, we determined that it was probable, based in large part on the initial public offering price of our common stock of $21.50 and subsequent trading levels, that the carrying value of our goodwill was impaired. At the time the Company s initial public offering price of $21.50 was established, we were unable to determine if there was any goodwill impairment or to provide a reliable estimate of the amount of goodwill impairment, if any. In light of the initial public offering price and trading levels of our common stock since the date of the initial public offering, we performed an interim impairment test, and on May 9, 2008, we concluded that the carrying value of our goodwill was impaired as a result of the market price and trading levels of our common stock. We believe the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors, recorded an impairment charge to goodwill related to our Regulated Businesses in the amount of $750.0 million in our financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of our peer companies during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of our debt (due to increased market interest rates).

As a result of the impairment and in accordance with regulatory commitments, RWE transferred $245.0 million to us on May 13, 2008. The Equity Contribution was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions. See Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Goodwill.

We may be required to recognize an impairment as a result of this year s annual test or at other times in the future. This depends on, among other factors, sustained levels of market price declines such as levels experienced during October 2008, a decline over a period of time of the Company s stock price, a decline over a period of time in valuation multiples of comparable water utilities and the lack of an increase in the Company s market price consistent with increases in the carrying value or to a level consistent with our peer companies. A decline in the 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 reported 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 debt covenants. As a result, we may be required to issue and sell additional shares of common stock at market prices, which could be dilutive to existing holders of our common stock.

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Our Regulated Businesses compete with governmental entities, 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 governmental entities, 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 governmental entities, 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.

On September 5, 2008, under threat of condemnation, California American Water sold the assets of our Felton, California water system, which served approximately 1,330 customers, to the San Lorenzo Valley Water District, which we refer to as SLVWD. The most recent prior sale of our water and wastewater systems under threat of condemnation occurred in 2003. 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 because 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 on April 22, 2010 and another approval expires on April 22, 2011. If RWE does not fully divest its remaining ownership of American Water by such dates, then we and RWE may be required to seek an extension of such approvals, as applicable, which process may result in delays, costs and the imposition of additional conditions on us or on RWE.

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

Some of the regulatory approvals contain conditions and restrictions, including reporting obligations, obligations to maintain appropriate creditworthiness, restrictions on changes of control, prohibitions on the pass- through of our initial Sarbanes-Oxley Act compliance costs, prohibitions on the pass-through of certain 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.

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Our Non-Regulated Businesses, through American Water (excluding our 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 for the provision of services to water and wastewater facilities with municipalities, other governmental entities and other customers, 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 September 30, 2008, we had remaining performance commitments as measured by remaining contract revenue totaling approximately $1,680.2 million, and this amount is likely to increase if our Non-Regulated Businesses grow. The presence of these commitments 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 instrument fails to perform certain obligations to the satisfaction of the party that holds the performance commitments that party may seek to enforce the performance commitments 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, and 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, Federal government s or other party s water or wastewater treatment and delivery facilities, which includes responsibility for certain major maintenance for some of those 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 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;

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- 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 September 30, 2008, after giving effect to this offering, our pro forma indebtedness (including preferred stock with mandatory redemption requirements) was $5,118.9 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;
- 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 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.

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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 3,700 of our employees, or approximately 51% of our total workforce, are unionized and represented by 20 different unions. Approximately one-third of our 76 union collective bargaining agreements expire annually, with 18 agreements covering 869 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.

As a public company, we are required to comply with the Sarbanes-Oxley Act and other rules and regulations that govern public companies. In particular, we 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, from 2003 until the completion of our initial public offering in April 2008, we were an indirect wholly-owned subsidiary of RWE, a stock corporation incorporated in the Federal Republic of Germany, and were not required to maintain a system of effective internal controls in compliance with the requirements of the SEC and the Sarbanes-Oxley Act, nor to prepare our own consolidated financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control.

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

- inadequate internal staffing and skills;

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- 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 in 2005 and 2006, 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

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

The notes have been issued by American Water Capital Corp., our finance subsidiary. American Water has signed a support agreement with the issuer. The notes are not guaranteed by any of our subsidiaries and are the obligations only of the issuer and American Water, by virtue of the support agreement. Accordingly, the notes are structurally subordinated to the liabilities, including trade payables, lease commitments and moneys borrowed, of American Water s subsidiaries other than the issuer. American Water has no material assets or operations other than equity interests in its subsidiaries, and the issuer has no material assets or operations except for its limited operations as a finance vehicle for our businesses. We expect that payments of interest and principal that the issuer makes on the notes (or that American Water makes pursuant to the support agreement) will be made only to the extent that our operating subsidiaries can distribute cash or other property to American Water and, through American Water, to the issuer.

The notes do not restrict our ability to incur additional indebtedness, which could adversely affect our ability to pay our obligations under the notes.

Although the terms of the notes restrict our ability and the ability of our subsidiaries to incur certain liens and to enter into certain sale and leaseback transactions, the incurrence of other indebtedness or other liabilities by any of our subsidiaries is not prohibited in connection with the notes and could adversely affect our ability to pay our obligations on the notes. As of September 30, 2008, total liabilities of our subsidiaries other than the issuer were $5,203.5 million. As of September 30, 2008, the indebtedness of our subsidiaries other than the issuer, excluding intercompany liabilities and obligations of a type not required to be reflected on a balance sheet in accordance with generally accepted accounting principles, that would effectively have been senior to the notes, was approximately $1,766.8 million. We anticipate that from time to time our subsidiaries will incur additional debt and other liabilities. Any debt incurred by our subsidiaries other than the issuer will be structurally senior to the notes.

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

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

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

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

Currently, there is no public market for the notes. If no active trading market develops, you may not be able to resell the notes at their fair market value or at all.

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

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

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

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

RWE owns approximately 60% of our common stock. As a result, RWE is able to control the outcome on virtually all matters submitted to a vote of our stockholders, including the election of directors. So long as RWE continues to own a significant portion of the outstanding shares of our common stock, it will continue to be able to significantly influence the election of our directors, subject to compliance with applicable NYSE requirements, our decisions, policies, management and affairs and corporate actions requiring stockholder approval, including the approval of transactions involving a change in control. The interests of RWE and its affiliates may not coincide with the interests of our other stockholders or with your interests as a noteholder.

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

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

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The right of a deceased beneficial owner s representative to redeem notes may be limited in amount.

The representative of a deceased beneficial owner of notes will have the right at any time to request redemption of all or part of such notes. We will have a discretionary right, however, to limit the aggregate principal amount of notes subject to redemption by the representative of any individual deceased beneficial owner of notes to $25,000 for the period prior to December 1, 2009 and each 12-month period thereafter while the notes remain outstanding. We will also have a discretionary right to limit the aggregate principal amount of notes we will redeem pursuant to such requests from all representatives of deceased beneficial owners of notes to $1,000,000 (2% of the aggregate principal amount of the notes sold in this offering) during each such period. Accordingly, we cannot assure you that a redemption request submitted by a representative of a deceased beneficial owner of notes will be permitted for the desired amount during any single period during which these limitations are calculated. In addition, any such redemptions will be effected on a quarterly basis and the right of a representative of a deceased beneficial owner of notes to request redemption of notes is subject to other conditions as described under Description of the Notes Limited Right of Redemption Upon Death of Beneficial Owner.

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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 within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. In some cases, these forward-looking statements can be identified by words with prospective meanings such as intend, plan, estimate, believe, anticipate, expect, predict, project, forecast, future, potential, continue, may, can, should and could and similar expressions. Forward-looking statements may relate to, among other 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;

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- the incurrence of impairment charges;
- 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.

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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

We estimate that we will receive net proceeds of approximately $47.8 million from this offering after deducting underwriting discounts and commissions and estimated offering expenses.

We intend to use the net proceeds to fund the repayment of short-term debt with overnight maturity and an average interest rate of 3.0%.

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CAPITALIZATION

The following table sets forth our cash and cash equivalents and capitalization as of September 30, 2008 on an actual basis and on an as adjusted basis to give effect to this offering and the use of the proceeds to us as if they had occurred on September 30, 2008.

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 September 30, 2008 (in thousands)	
	Historical (unaudited)	**As Adjusted (unaudited)**
Cash and cash equivalents	$ 6,689	$ 6,689
Short-term debt		
Short-term debt	327,185	279,385
Total short-term debt	327,185	279,385
Long-term debt of AWCC including current portion		
Private activity bonds and government funded debt	86,860	86,860
Senior notes	2,884,000	2,884,000
New senior notes		50,000
Long-term debt of other subsidiaries including current portion		
Private activity bonds and government funded debt	969,186	969,186
Mortgage bonds	715,800	715,800
Senior notes	40,705	40,705
Redeemable preferred stock at redemption value(1)	24,503	24,503
Notes payable and other	2,993	2,993
Unamortized debt discount, net	65,508	65,508
Total long-term debt	4,789,555	4,839,555
Total debt	5,116,740	5,118,940
Equity		
Common stockholders equity	4,162,357	4,162,357
Preferred stock without mandatory redemption requirements	4,557	4,557
Total equity	4,166,914	4,166,914
Total capitalization including short-term debt and current portion of long-term debt	$ 9,283,654	$ 9,285,854

(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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RATIO OF EARNINGS TO FIXED CHARGES

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

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

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

	For the Year Ended December 31,					For the nine months ended September 30,
	2003	2004	2005	2006	2007	2008
American Water						
Ratio of Earnings to Fixed Charges (1)	1.35	1.38				
Pro Forma Ratio of Earnings to Fixed Charges (2)						
American Water Capital Corp.						
Ratio of Earnings to Fixed Charges	1.00	1.00	1.00	1.00	1.00	1.00
Pro Forma Ratio of Earnings to Fixed Charges					1.00	1.00

(1) For the years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2008, earnings were insufficient to cover fixed charges and there were deficiencies of $224.3 million, $109.1 million, $255.7 million and $515.4 million, respectively.

(2) On a pro forma basis after giving effect to the offering of notes, earnings would have been insufficient to cover fixed charges and there would have been a deficiency of $258.7 million and $515.7 million for the year ended December 31, 2007 and for the nine months ended September 30, 2008, respectively.

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UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL INFORMATION

The following unaudited pro forma condensed consolidated financial information has been developed by applying pro forma adjustments to the historical 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 this offering as if it had occurred on September 30, 2008. No pro forma adjustments to the balance sheet are made for transactions that occurred prior to September 30, 2008. 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 was 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 the early repayment of RWE notes;
  - the issuance of $415.0 million of commercial paper to fund the partial repayment of $464.0 million of RWE redemption notes with the balance of $49.0 million of the RWE redemption notes repaid with excess cash; and
  - the cash equity contribution to the Company by RWE of $266.0 million on December 21, 2007, which was used to pay down commercial paper.
- The 160,000-for-1 split of common stock effected on November 7, 2007.
- The initial public offering of our common stock in April 2008, pursuant to which RWE sold approximately 63.2 million shares of our common stock. Of the approximately 63.2 million shares sold, approximately 5.2 million were sold pursuant to the partial exercise of the underwriters over-allotment option on May 27, 2008.

The Equity Contribution, comprising the cash equity contribution of $245.0 million from RWE to us on May 13, 2008.

The issuance and sale by us of $50.0 million aggregate principal amount of notes through this offering with estimated gross proceeds of $47.8 million, net of an estimated $2.2 million of issuance costs, to fund the repayment of short-term debt.

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.

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.

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American Water Works Company, Inc. and Subsidiary Companies

Unaudited Pro Forma Condensed Consolidated Statement of Operations

For the Year Ended December 31, 2007

	Historical	Pro Forma Adjustments	Pro Forma
	(in thousands, except per share data)		
Operating revenues	$ 2,214,215	$	$ 2,214,215
Operating expenses			
Operation and maintenance	1,246,479	2,441(A)	1,248,920
Depreciation and amortization	267,335		267,335
General taxes	183,253		183,253
Loss (gain) on sale of assets	(7,326)		(7,326)
Impairment charges	509,345		509,345
Total operating expenses, net	2,199,086	2,441	2,201,527
Operating income (loss)	15,129	(2,441)	12,688
Other income (deductions)			
Interest	(283,165)	(3,581)(B)	(283,108)
		4,116(C)	
		(478)(D)	
Amortization of debt expense	(4,867)	(617)(B)	(5,484)
Other, net	17,384		17,384
Total other income (deductions)	(270,648)	(560)	(271,208)
Income (loss) from continuing operations before income taxes	(255,519)	(3,001)	(258,520)
Provision for income taxes	86,756	(1,186)(E)	85,570
Income (loss) from continuing operations	$ (342,275)	$ (1,815)	$ (344,090)
Unaudited pro forma earnings per share:			
Basic	$ (2.14)		$ (2.15)
Diluted	$ (2.14)		$ (2.15)
Weighted average shares used in calculating earnings per share:			
Basic	160,000		160,000
Diluted	160,000(F)		160,000

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

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American Water Works Company, Inc. and Subsidiary Companies

Unaudited Pro Forma Condensed Consolidated Statement of Operations

For the Nine Months Ended September 30, 2008

	Historical	Pro Forma Adjustments	Pro Forma
	(in thousands, except per share data)		
Operating revenues	$ 1,768,377	$	$ 1,768,377
Operating expenses			
Operation and maintenance	984,063	(1,565)(A)	982,498
Depreciation and amortization	199,599		199,599
General taxes	151,074		151,074
Loss (gain) on sale of assets	(413)		(413)
Impairment charges	750,000		750,000
Total operating expenses, net	2,084,323	(1,565)	2,082,758
Operating income (loss)	(315,946)	1,565	(314,381)
Other income (deductions)			
Interest	(212,718)	(1,798)(B)	(214,516)
Amortization of debt expense	(4,360)	(55)(B)	(4,415)
Other, net	17,808		17,808
Total other income (deductions)	(199,270)	(1,853)	(201,123)
Income (loss) from continuing operations before income taxes	(515,216)	(288)	(515,504)
Provision for income taxes	83,612	(114)(E)	83,498
Income (loss) from continuing operations	$ (598,828)	$ (174)	$ 599,002
Unaudited pro forma earnings per share:			
Basic	$ (3.74)		$ (3.74)
Diluted	$ (3.74)		$ (3.74)
Weighted average shares used in calculating earnings per share:			
Basic	159,960		159,960
Diluted	159,960(F)		159,960

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

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American Water Works Company, Inc. and Subsidiary Companies

Unaudited Pro Forma Condensed Consolidated Balance Sheet

As of September 30, 2008

	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	$ 9,742,671	$	$ 9,742,671
Nonutility property, net of accumulated depreciation	128,920		128,920
Total property, plant and equipment	9,871,591		9,871,591
Current assets			
Cash and cash equivalents	6,689		6,689
Other current assets	490,535		490,535
Total current assets	497,224		497,224
Regulatory and other long-term assets			
Goodwill	1,704,310		1,704,310
Other regulatory and other long-term assets	707,607	2,200(G)	709,807
Total regulatory and other long-term assets	2,411,917	2,200	2,414,117
TOTAL ASSETS	$ 12,780,732	$ 2,200	$ 12,782,932
CAPITALIZATION & LIABILITIES			
Capitalization			
Common stockholders equity	$ 4,162,357	$	$ 4,162,357
Preferred stock without mandatory redemption requirements	4,557		4,557
Long-term debt			
Long-term debt	4,669,502	50,000(B)	4,719,502
Redeemable preferred stock at redemption value	24,217		24,217
Total capitalization	8,860,633	50,000	8,910,633
Current liabilities			
Short-term debt and current portion of long-term debt	423,021	(47,800)(B)	375,221
Other current liabilities	514,469		514,469
Total current liabilities	937,490	(47,800)	889,690
Total regulatory and other long-term liabilities	2,104,311		2,104,311
Contributions in aid of construction	878,298		878,298
TOTAL CAPITALIZATION AND LIABILITIES	$ 12,780,732	$ 2,200	$ 12,782,932

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

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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 was an indirect wholly-owned subsidiary of RWE until its initial public offering in April 2008. 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 2,077,814 unvested stock options, 269,254 restricted stock units and 89,921 restricted stock awards to our employees in connection with the initial public offering. The awards were issued under the American Water 2007 Omnibus Equity Compensation Plan and were recorded as equity awards. The restricted stock units and stock options vest over the 3-year periods commencing January 1, 2007 and 2008 and approximately 566,562 unvested stock options and 71,852 restricted stock units are expected to vest over the three-year periods based on our assessment of the probability of achieving performance conditions. The 89,921 restricted stock awards vested over a three-month period which commenced with the pricing of our initial public offering.

(B) The sources and uses of funds in connection with the Transactions 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	Interest Expense 9 Months(2) (in thousands)	Debt Expense Amortization 12 Months	Debt Expense Amortization 9 Months(2)
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					
RWE cash equity contribution(3)	245,000					
Excess cash(1)	49,026					
Debt issuance through this offering(4)	50,000		4,500	3,375		
Total sources	$ 4,275,026		$ 203,782	$ 3,375	$	
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)			
Short-term debt(4)	47,800		(2,624)	(1,577)		
Financing costs	13,856				617	55
Working capital(3)	245,000					
Total used	$ 4,275,026		$ (200,201)	$ (1,577)	$ 617	$ 55
Net increase (decrease)			$ 3,581	$ 1,798	$ 617	$ 55

(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

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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.

(2) No interest and amortization expense adjustment is required for transactions that occurred prior to January 1, 2008 as the impact of the transaction is already reflected in the unaudited historical consolidated statement of operations of American Water for the nine months ended September 30, 2008.

(3) The $245.0 million Equity Contribution by RWE to the Company on May 13, 2008 was used to fund working capital.

(4) The issuance and sale of % Senior Monthly Notes due 2038 through this offering with estimated gross proceeds of $50 million, net of $2.2 million of issuance costs to fund repayment of $47.8 million of short term debt. For each 0.25% change in the assumed interest rates with respect to the notes offered hereby our annual interest expense would change by $0.1 million.

(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.

The resulting reduction in interest expense is computed as follows:

	RWE Notes	Commercial Paper	Total
Principal redemption	$ 100,000	$ 232,500	$ 332,500
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 weighted average number of shares of common stock used to compute pro forma diluted earnings per share is based on the number of shares of our common stock 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 shares of common stock included in the calculation of pro forma diluted earnings per share, as the potentially dilutive instruments would be antidilutive.

(G) Estimated issuance costs of $2.2 million, associated with the notes have been reflected as other assets and will be amortized over the term of the notes.

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SELECTED HISTORICAL CONSOLIDATED FINANCIAL DATA

The following table presents our selected historical consolidated financial data at the dates and for the periods indicated. The statement 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. The statement of operations data for the nine months ended September 30, 2007 and 2008 and the balance sheet dated as of September 30, 2008 have been derived from our unaudited historical consolidated financial statements and the notes to those statements included elsewhere in this prospectus, which have been prepared on a basis consistent with our annual consolidated financial statements. In the opinion of management, such unaudited financial data reflects all adjustments, consisting only of normal and recurring adjustments, necessary for fair presentation of the results for those periods. The results of operations for the nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year or any future period.

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 sections of 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,					For the Nine Months Ended September 30,	
	2003 (unaudited)	2004	2005	2006	2007	2007 (unaudited)	2008 (unaudited)
	(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	$ 1,660,394	$ 1,768,377
Operating expenses							
Operation and maintenance	1,089,071	1,121,970	1,201,566	1,174,544	1,246,479	910,304	984,063
Depreciation and amortization	210,588	225,260	261,364	259,181	267,335	202,463	199,599
General taxes	164,677	170,165	183,324	185,065	183,253	140,910	151,074
Loss (gain) on sale of assets(2)	(16,771)	(8,611)	(6,517)	79	(7,326)	(6,821)	(413)
Impairment charges	3,555	78,688	385,434	221,685	509,345	243,345	750,000
Total operating expenses, net	1,451,120	1,587,472	2,025,171	1,840,554	2,199,086	1,490,201	2,084,323
Operating income (loss)	439,171	430,399	111,575	252,513	15,129	170,193	(315,946)
Other income (deductions)							
Interest	(280,501)	(315,944)	(345,257)	(365,970)	(283,165)	(211,709)	(212,718)
Amortization of debt expense	(3,872)	(3,377)	(4,367)	(5,062)	(4,867)	(3,624)	(4,360)
Other, net(3)	(52,387)	14,350	13,898	9,581	17,384	11,532	17,808
Total other income (deductions)	(336,760)	(304,971)	(335,726)	(361,451)	(270,648)	(203,801)	(199,270)
Income (loss) from continuing operations before income taxes	102,411	125,428	(224,151)	(108,938)	(255,519)	$ (33,608)	$ (515,216)
Provision for income taxes	60,271	66,328	50,979	46,912	86,756	74,095	83,612
Income (loss) from continuing operations	$ 42,140	$ 59,100	$ (275,130)	$ (155,850)	$ (342,275)	$ (107,703)	$ (598,828)
Income (loss) from continuing operations per basic common share(4)	$ 0.26	$ 0.37	$ (1.72)	$ (0.97)	$ (2.14)	(0.67)	(3.74)

Income (loss) from continuing operations per diluted common share(4)	$ 0.26	$ 0.37	$ (1.72)	$ (0.97)	$ (2.14)	(0.67)	(3.74)
Basic weighted average common shares(4)	160,000	160,000	160,000	160,000	160,000	160,000	159,960
Diluted weighted average common shares(4)	160,000	160,000	160,000	160,000	160,000	160,000	159,960

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	For the Years Ended December 31, 2005	2006	2007	For the Nine Months Ended September 30, 2007 (unaudited)	2008 (unaudited)
			(in thousands)		
Other data:					
Cash flows provided by (used in):					
Operating activities	$ 525,435	$ 323,748	$ 473,712	$ 329,913	$ 392,913
Investing activities	(530,165)	(691,438)	(746,578)	(482,950)	(723,574)
Financing activities	(9,049)	332,367	256,593	274,542	323,869
Construction expenditures	(558,446)	(688,843)	(758,569)	(507,237)	(714,559)

	As of December 31, 2003 (unaudited)	2004	2005	2006	2007	As of September 30, 2008 (unaudited)
			(in thousands)			
Balance sheet data:						
Cash and cash equivalents	$ 71,097	$ 78,856	$ 65,077	$ 29,754	$ 13,481	$ 6,689
Utility plant and property, net of depreciation	7,377,195	7,754,434	8,101,769	8,605,341	9,199,909	9,742,671
Total assets	12,629,354	12,728,410	12,542,029	12,783,059	12,934,072	12,780,732
Other short-term and long-term debt	5,063,344	5,101,891	5,030,078	4,103,532	4,991,806	5,092,523
Redeemable preferred stock	1,787,777	1,775,224	1,774,691	1,774,475	24,296	24,217
Total debt	6,851,121	6,877,115	6,804,769	5,878,007	5,016,102	5,116,740
Common stockholders equity	3,198,144	3,129,555	2,804,716	3,817,397	4,542,046	4,162,357
Preferred stock without mandatory redemption requirements	5,687	4,651	4,571	4,568	4,568	4,557

(1) On September 28, 2007, Thames US Holdings was merged with and into American Water, with American Water as the surviving entity. American Water was an indirect wholly-owned subsidiary of RWE until its initial public offering in April 2008. 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 common share and income (loss) from continuing operations per diluted common share for the fiscal years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2007 is 160.0 million after giving effect to the 160,000-for-1 stock split on November 7, 2007. For the nine months ended September 30, 2008, the number of shares used to compute loss from continuing operations per basic common share and loss from continuing operations per diluted common share is 160.0 million. For the nine months ended September 30, 2008 there are no dilutive incremental common shares included in diluted earnings per share as all potentially dilutive instruments would be antidilutive.

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 our initial public offering and related transactions. Accordingly, the discussion and analysis of historical periods before our initial public offering and related transactions do not reflect the significant impact that these transactions have had or 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. Certain 2007, 2006 and 2005 amounts have been reclassified within operations and maintenance expense to conform to the 2008 presentation.

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 approximately 7,000 employees provide approximately 15 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 the nine months ended September 30, 2008, we generated $1,768.4 million in total operating revenue, $315.9 million in operating loss, which includes $750.0 million of impairment charges, and a net loss of $598.8 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. For the year ended December 31, 2007 and for the nine months ended September 30, 2008, our Regulated Businesses generated $1,987.6 million and $1,579.2 million, respectively, in operating revenue, prior to inter-segment eliminations, representing 89.8% and 89.3%, respectively, 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. For the year ended December 31, 2007 and for the nine months ended September 30, 2008, our Non-Regulated Businesses generated $242.7 million and $202.1 million, respectively, 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.

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 reflect 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 the initial public offering, an interim impairment test was performed, and a pre-tax impairment charge to goodwill of $243.3 million was recorded in the third quarter of 2007. We completed our annual impairment test for 2007 and recorded an additional pre-tax goodwill impairment charge to the Regulated Businesses reporting unit in the amount of $266.0 million during the fourth quarter of 2007. We determined that an impairment to goodwill 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.

In our initial public offering, RWE Aqua Holdings GmbH, the selling stockholder, sold approximately 63.2 million shares of the Company s common stock. The Company did not receive any proceeds from the sale of the shares. RWE currently owns approximately 60% of the Company s shares of common stock.

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In light of the initial public offering price and trading levels of our common stock since the date of the initial public offering, we performed an interim impairment test, and, on May 9, 2008, we concluded that the carrying value of our goodwill was impaired as a result of the market price and trading levels of our common stock. We believe the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors, recorded an impairment charge to goodwill related to our Regulated Businesses in the amount of $750.0 million in our financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of our common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of our peer companies during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of our debt (due to increased market interest rates). As a result of this impairment charge, and in order to ensure compliance with relevant state PUC approvals, RWE made a cash equity contribution of $245.0 million to us on May 13, 2008. RWE is not obligated to make any additional capital contributions.

Annual impairment reviews are performed at November 30 of each year. We may be required to recognize additional impairments in the future, depending on, among other factors, a decline over a period of time in valuation multiples of comparable water utilities, a decline over a period of time of the Company s stock price and the lack of an increase in the Company s equity value consistent with increases in the equity value of peer companies. A decline in the 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 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, from 2003 to April 28, 2008, we were an indirect wholly-owned subsidiary of RWE and, as a privately owned company, were not required to maintain a system of effective internal control consistent with those reported upon by management in compliance with the requirements of the SEC and the Sarbanes-Oxley Act, or to prepare our own consolidated financial statements. As a public reporting company, we are required, among other things, to maintain a system of effective internal control over financial reporting suitable to prepare our publicly reported financial statements in a timely and accurate manner, and also to evaluate and report on such system of internal control. In particular, we are required to certify our compliance with Section 404 of the Sarbanes-Oxley Act for the year ended December 31, 2009, which 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.

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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 when necessary;
- Implementing detailed processes and procedures related to our period-end financial closing processes, key accounting applications and our financial reporting processes;
- Implementing or enhancing systems used in the financial reporting processes and month-end close processes;
- Conducting extensive training on existing and newly developed processes and procedures as well as explaining to employees Sarbanes-Oxley Act requirements and the value of internal controls;
- Enhancing our internal audit staff;
- Hiring a director of internal control and a director of taxes during 2007;
- 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 formulated remediation plans, which we believe address the areas of material weakness, and tested the effectiveness of controls designed to address certain material weaknesses. Based on these actions and the length of time we believe that certain controls have been operating effectively, as of September 30, 2008, we no longer consider the following control deficiencies to be material weaknesses:

- Inadequate internal staffing and skills; and
- Inadequate controls over month-end closing processes, including account reconciliations.

While we believe that remediation procedures related to the identified material weaknesses are substantially complete, our testing procedures have not yet been fully completed. Therefore, we can make no assurances as to the success of our remediation efforts.

As of September 30, 2008, the Company had incurred $57.8 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 deficiencies. Based upon our current assessment, we expect to complete our remediation procedures related to the identified material weaknesses during 2008 with an estimated additional cost of approximately $0.4 million. The Company cannot indicate with certainty that all deficiencies, including material weaknesses, will be remediated or what additional costs may be incurred. The Company needs to finalize its remediation efforts of the controls and complete the testing of the effectiveness of controls prior to concluding that all 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.

The Company believes the additional control procedures as designed, when implemented, will fully remediate the material weaknesses described above.

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Factors Affecting Our Results of Operations

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

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

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

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

Economic Utility Regulation

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

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

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

Currently, Pennsylvania, Illinois, Missouri, Indiana, New York, California and Ohio have allowed the use of these infrastructure surcharges. These surcharges adjust periodically based on qualified capital expenditures being completed or anticipated in a future period. These surcharges are typically reset to zero when new base rates are effective and incorporate the costs of these infrastructure expenditures. As of November 13, 2008, we have been granted an additional $18.0 million in revenues, assuming constant sales volumes, from such surcharges in several of our states. Furthermore, we were granted a $0.6 million increase for an arsenic surcharge in our Arizona subsidiary, allowing recovery for costs associated with the construction and operation of arsenic treatment facilities.

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

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

Another regulatory mechanism to address issues of regulatory lag includes the ability, in some circumstances, to recover in rates a return on utility plant before it is actually in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Texas, Pennsylvania, Ohio, Kentucky, Virginia 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 associated costs. In this pre-approval process, the PUCs assess the prudency of such projects.

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. In the first nine months of 2008 we received authorizations for additional annualized revenues from general rate cases of $73.9 million. We are awaiting the final order for Hawaii s general rate case that was filed in 2007, requesting $1.3 million in total additional annual revenues. In October 2008, The Hawaii Public Utility Commission approved on an interim basis an increase in additional annualized revenues of $0.7 million. The interim rates will be effective for the fourth quarter of 2008. In the first nine months of 2008, we filed general rate cases in ten additional states that would provide $272.9 million of additional revenues, if approved as filed. Of the rate cases filed in 2008, two states rates were effective through the nine months ended September 30, 2008 with an additional annualized increase of $1.9 million and are included in the $73.9 million of annualized revenues referred to above. In addition, new rates which would provide for additional $4.3 million of annualized revenues were put into effect under bond for our Virginia subsidiary. In October 2008, the Virginia commission issued a final order which would provide $3.4 million in additional annual revenue. In October 2008, additional annualized revenues of $5.7 million and $0.5 million resulting from infrastructure charges for our Pennsylvania subsidiary and the arsenic cost recovery mechanism surcharge, which we refer to as ACRM, for our Arizona subsidiary, respectively, became effective. In November 2008, we received authorizations for additional annualized revenues from general rate cases in Ohio and Missouri of $5.3 million and $34.5 million, respectively. Also, in November 2008 we received authorizations for additional annualized wastewater revenues in Pennsylvania of $1.9 million and for additional revenues associated with ACRM in our Arizona subsidiary of $0.1 million. The residual amount of $211.0 million for the other seven states remains under consideration by state public utility commissions at this time. There is no assurance that the filed amount, or any portion thereof, of any requested increases will be granted.

Infrastructure Investment

The water and wastewater utility industry is highly capital intensive. In 2007, we invested $758.6 million in net Company-funded capital improvements and we expect to invest approximately $950 million in net capital improvements in 2008. From 2008 to 2012, we estimate that Company-funded capital investment will total between $4,000 and $4,500 million. We anticipate spending between $770 and $1,050 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 2008 to 2012, we estimate we will invest approximately $1,600 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, discharge and dispose of 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 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 12.6% 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 Business 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.

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 September 30, 2008, the Company s goodwill totaled $1,704.3 million. The Company s annual goodwill impairment test is conducted at November 30 of each calendar year and interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

The market price of the Company s common stock at September 30, 2008 was below its consolidated carrying value. Subsequent to September 30, 2008, the Company s market price has experienced a high degree of volatility. As a result, management considered whether the Company s market capitalization being below the consolidated carrying value of its reporting units represented an interim triggering event.

Having considered both qualitative and quantitative factors, management concluded that no interim triggering event has occurred. As such, an interim impairment test was not performed, as management believes there were no significant adverse changes in its business. Further, the Company s methodology is not based purely on stock price but adjusts for other valuation techniques and relevant market information, as described in the testing methodology below, including the expected impact to the share price once RWE divests a substantial portion of its ownership.

The Company may be required to recognize an impairment as a result of this year s annual test or at other times in the future. This depends on other factors identified below in the description of the Company s test approach. These include market price declines such as levels experienced during October 2008, a decline over a period of time of the Company s stock price, a decline over a period of time in valuation multiples of comparable water utilities and the lack of an increase in the Company s market price consistent with increases in the carrying value or to a level consistent with its peer companies. A decline in the 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 the Company s reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to secure financing on attractive terms and maintain compliance with debt covenants.

In light of the initial public offering price and trading levels in our common stock since the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, concluded that the current carrying value of the Company s goodwill was impaired as a result of the current market price at that time and trading levels of the Company s common stock. The Company believes the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors, recorded an impairment charge to goodwill related to its Regulated Businesses in the amount of $750.0 million in the financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of the Company s common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of peer companies during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company s debt (due to increased market interest rates). As a result of the impairment charge RWE Aqua Holdings GmbH transferred $245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

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During the third quarter of 2007, as a result of the Company s debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its 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.

The Company uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any) in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, which we refer to as SFAS 142. The step 1 calculation used to identify potential impairment compares the fair value for each of the Company s reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit s carrying value, then step 2 shall be performed to measure the amount of the impairment loss (if any) for such reporting units.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of net fair value of each reporting unit s assets and liabilities above the carrying value of such reporting unit s assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss shall be recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

If step 2 is required, the determination of the fair value of each reporting unit and the fair value of each reporting unit s assets and liabilities will be performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date). The step 2 fair value determination will use a combination of the following valuation techniques:

- quoted market prices of the Company s securities;
- observable market prices of comparable equity of publicly-traded water utilities considered by us to be peers; and
- discounted cash flow models developed from the Company s internal forecasts.

Each of the Company s reporting unit s fair value is determined by weighting, according to relevance, the results of three valuation techniques. The first, and primary, valuation is based upon the observable market price of the Company s common equity as adjusted for control premiums and other relevant market conditions.

The second model-based valuation technique applies an average peer multiple to the Company s historic and forecasted cash flows. The cash flow multiple is calculated using the quoted market equity prices of comparable publicly-traded water utilities, and their published cash flows. This market multiple is then applied to the applicable reporting unit s internal historic and forecasted cash flows as adjusted to remove non-recurring items and forecast acquisitions.

The third model-based valuation technique discounts the five-year business plan forecast cash flows, as adjusted to remove non-recurring items and forecast acquisitions, at the Company s weighted average cost of capital.

If step 2 of the impairment test is required, the Company will determine the fair value of the applicable reporting unit s assets and liabilities. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions at the measurement date. For the step 2 calculations of the fair value of debts, the Company will use observable prices of instruments and indices which share similar risk to those instruments being valued, adjusted to compensate for different credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit s debts.

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As a result of the impairment and in accordance with certain regulatory commitments, RWE transferred $245.0 million to us on May 13, 2008. RWE is not obligated to make any additional capital contributions.

Results of Operations

The following table sets forth our consolidated statement of operations data for the years ended December 31, 2005, 2006 and 2007 and for the nine months ended September 30, 2007 and 2008:

	For the Years Ended December 31,			For the Nine Months Ended September 30,	
	2005	2006	2007	2007	2008
	(in thousands, except per share data)				
Operating revenues	$ 2,136,746	$ 2,093,067	$ 2,214,215	$ 1,660,394	$ 1,768,377
Operating expenses:					
Operation and maintenance	1,201,566	1,174,544	1,246,479	910,304	984,063
Depreciation and amortization	261,364	259,181	267,335	202,463	199,599
General taxes	183,324	185,065	183,253	140,910	151,074
Loss (gain) on sale of assets	(6,517)	79	(7,326)	(6,821)	(413)
Impairment charges	385,434	221,685	509,345	243,345	750,000
Total operating expenses, net	2,025,171	1,840,554	2,199,086	1,490,201	2,084,323
Operating income (loss)	111,575	252,513	15,129	170,193	(315,946)
Other income (deductions):					
Interest	(345,257)	(365,970)	(283,165)	(211,709)	(212,718)
Allowance for other funds used during construction	5,810	5,980	7,759	5,197	10,370
Allowance for borrowed funds used during construction	2,420	2,652	3,449	2,358	6,063
Amortization of debt expense	(4,367)	(5,062)	(4,867)	(3,624)	(4,360)
Preferred dividends of subsidiaries	(227)	(215)	(225)	(169)	(169)
Other, net	5,895	1,164	6,401	4,146	1,544
Total other income (deductions)	(335,726)	(361,451)	(270,648)	(203,801)	(199,270)
Income (loss) from continuing operations before income taxes	(224,151)	(108,938)	(255,519)	(33,608)	(515,216)
Provision for income taxes	50,979	46,912	86,756	74,095	83,612
Income (loss) from continuing operations	(275,130)	(155,850)	(342,275)	(107,703)	(598,828)
Income (loss) from discontinued operations, net of tax	(49,910)	(6,393)	(551)	(551)	
Net income (loss)	$ (325,040)	$ (162,243)	$ (342,826)	$ (108,254)	(598,828)
Net income (loss) per common share:					
Basic					
Income (loss) from continuing operations	$ (1.72)	$ (0.97)	$ (2.14)	$ (0.67)	$ (3.74)
Income (loss) from discontinued operations, net of tax	$ (0.31)	$ (0.04)	(0.00)	(0.00)	
Net income (loss)	$ (2.03)	$ (1.01)	$ (2.14)	$ (0.68)	$ (3.74)
Diluted					
Income (loss) from continuing operations	$ (1.72)	$ (0.97)	$ (2.14)	$ (0.67)	$ (3.74)
Income (loss) discontinued operations, net of tax	$ (0.31)	$ (0.04)	(0.00)	(0.00)	

Net income (loss)	$ (2.03)	$ (1.01)	$ (2.14)	$ (0.68)	$ (3.74)
Average common shares outstanding during the period:					
Basic	160,000	160,000	160,000	160,000	159,960
Diluted	160,000	160,000	160,000	160,000	159.960

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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		For the Nine Months Ended September 30, 2007		2008	
	Regulated Businesses	Non-Regulated Businesses	Regulated Businesses	Non-Regulated Businesses	Regulated Businesses	Non-Regulated Businesses	Regulated Businesses (unaudited)	Non-Regulated Businesses (unaudited)	Regulated Businesses (unaudited)	Non-Regulated Businesses (unaudited)
	(in thousands)									
Operating revenues	$ 1,836,061	$ 310,771	$ 1,854,618	$ 248,451	$ 1,987,565	$ 242,678	$ 1,499,763	$ 175,172	$ 1,579,214	$ 202,080
Adjusted EBIT(1)	$ 469,921	$ (106)	$ 468,701	$ (4,725)	$ 500,088	$ 23,579	$ 394,601	$ 17,606	$ 411,076	$ 16,358

(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 services to residential, commercial and industrial customers. As such, our results of operations are significantly impacted by rates authorized by the state regulatory commissions in the states in which we operate. The table below details the annualized revenues, including step increases resulting from rate authorizations and infrastructure charges, which were granted in 2005, 2006 and 2007 and the nine months ended September 30, 2008.

	Annualized Rate Increases Granted During the Years Ended December 31, 2005	2006	2007	Nine Months Ended September 30, 2008
State				
New Jersey	$	$	$ 56.2	$
Pennsylvania	5.8	8.0	40.6	4.6
Missouri		6.8	24.0	2.7
Illinois		0.9	1.7	22.7
Indiana	0.9	1.8	14.0	3.9
California	8.4	15.1	0.5	13.0
West Virginia	10.0			14.5
New York	7.8			6.6
Arizona		7.9	3.7	8.6
Other	2.1	0.8	18.2	9.6
Total	$ 35.0	$ 41.3	$ 158.9	$ 86.2

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.

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Comparison of Results of Operations for the Nine Months Ended September 30, 2008 and 2007

Operating revenues. Our operating revenues increased by $108.0 million, or 6.5%, for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. Regulated Businesses revenues increased by $79.5 million, or 5.3%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The Non-Regulated Businesses revenues for the nine months ended September 30, 2008 increased by $26.9 million, or 15.4%, compared to the nine months ended September 30, 2007.

The increase in the Regulated Businesses revenues for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 was primarily due to rate increases obtained through general rate cases in New Jersey, Pennsylvania, Missouri and Indiana (which were granted and became effective in 2007) as well as other states totaling approximately $95.1 million and a $1.4 million retroactive rate adjustment in California made in June 2008. This increase was offset by a $25.0 million decrease in revenues related to lower customer consumption, mainly in our states in the Midwestern region of the United States, for the nine months ended September 30, 2008 compared to the same period in the prior year.

Non-Regulated Businesses operating revenues increased by $26.9 million, or 15.4%, for the nine months ended September 30, 2008 compared to the same period in 2007. The net increase was primarily attributable to higher revenues of $28.6 million in our Contract Operations Group and $5.6 million in our Homeowner Services Group, partially offset by decreased revenues of $6.8 million and $0.7 million in our Applied Water Management Group and Canadian Fixed Residuals, respectively. The increase in Contract Operations Group revenues was primarily attributable to incremental revenues associated with design and build contracts, as well as increased military construction and O&M project revenues. The increase from our Homeowner Service Group represented increased product penetration within its existing customer base. Applied Water Management Group revenues were lower due to the decline in design and build activity resulting from the downturn in new home construction.

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

	For the Nine Months Ended September 30,			
	2007	2008	2007	2008
	Operating Revenues		Water Sales Volume	
Customer Class				
Water service:				
Residential	57.9%	57.9%	53.0%	53.0%
Commercial	19.4%	19.3%	21.9%	22.1%
Industrial	4.8%	5.0%	10.5%	10.5%
Public and other	12.3%	12.1%	14.6%	14.4%
Other water revenues	1.8%	2.0%		
Total water revenues	96.2%	96.3%	100.0%	100.0%
Wastewater service	3.8%	3.7%		
	100.0%	100.0%		

Water Services Water service operating revenues from residential customers for the nine months ended September 30, 2008 totaled $913.1 million, a $44.3 million increase, or 5.1%, over the same period of 2007, mainly due to rate increases offset by a decrease in sales volume. The volume of water sold to residential customers decreased by 3.5% for the nine months ended September 30, 2008 to 162.3 billion gallons, from 168.2 billion gallons for the same period in 2007, largely as a result of wetter weather conditions in California and the Midwestern region in the United States.

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Water service operating revenues from commercial water customers for the nine months ended September 30, 2008 increased by $14.3 million, or 4.9%, to $305.4 million mainly due to rate increases offset by decreases in sales volume compared to the same period in 2007. The volume of water sold to commercial customers decreased by 2.9% for the nine months ended September 30, 2008, to 67.8 billion gallons, from 69.8 billion gallons for the nine months ended September 30, 2007.

Water service operating revenues from industrial customers totaled $78.4 million for the nine months ended September 30, 2008, an increase of $5.9 million, or 8.1%, over those recorded for the same period of 2007 mainly due to rate increases offset by decreased sales volume. The volume of water sold to industrial customers totaled 32.2 billion gallons in the nine months ended September 30, 2008, a decrease of 3.6% from the 33.4 billion gallons for the nine months ended September 30, 2007.

Water service operating revenues from public and other customers increased $7.1 million, or 3.9%, for the nine months ended September 30, 2008 to $191.4 million from $184.3 million for the nine months ended September 30, 2007 mainly due to rate increases. Revenues from municipal governments for fire protection services and customers requiring special private fire service facilities totaled $77.8 million for the nine months ended September 30, 2008, an increase of $3.8 million over the same period of 2007. Revenues generated by sales to governmental entities and resale customers for the nine months ended September 30, 2008 totaled $113.6 million, an increase of $3.3 million from the nine months ended September 30, 2007.

Wastewater services Our subsidiaries provide wastewater services in 12 states. Revenues from these services increased by $2.5 million, or 4.4%, to $59.1 million for the nine months ended September 30, 2008, from $56.6 million for the same period of 2007. The increase was attributable to increases in rates charged to customers principally in Arizona, Hawaii, and New Jersey.

Operation and maintenance. Operation and maintenance expense increased $73.8 million, or 8.1%, for the nine months ended September 30, 2008 compared to the same period in the prior year.

Operation and maintenance expenses for the nine months ended September 30, 2008 and 2007, by major expense category, were as follows:

	For the Nine Months Ended September 30,	
	2007	2008
	(in thousands)	
Production costs	$ 212,612	$ 220,902
Employee-related costs	341,154	385,639
Operating supplies and services	211,012	208,394
Maintenance materials and services	87,250	104,218
Customer billing and accounting	26,025	32,796
Other	32,251	32,114
Total	$ 910,304	$ 984,063

Production costs, including fuel and power, purchased water, chemicals and waste disposal increased by $8.3 million, or 3.9%, for the nine months ended September 30, 2008 compared to the same period in 2007. The increase was primarily the result of increased costs in our Regulated Businesses of $5.2 million. Fuel and power costs were higher by $2.8 million, due to increases in electricity prices. Chemical costs also increased by $2.1 million primarily due to rising chemical costs and waste disposal costs were also higher by $0.7 million. Partially offsetting these increases were lower purchased water costs of $0.4 million.

Employee-related costs including wage and salary, group insurance, and pension expense increased $44.5 million, or 13.0%, for the nine months ended September 30, 2008 compared to the same period in the prior year. These employee-related costs represented 39.2% and 37.5% of operation and maintenance expenses for the nine months ended September 30, 2008 and 2007, respectively. The increase was due to higher wage and salary

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expenses of $23.2 million and $3.7 million in our Regulated and Non-Regulated Businesses, respectively, primarily resulting from stock-based compensation expense of $3.5 million mainly attributable to the issuance of awards granted in connection with the initial public offering and an increase in the number of employees primarily as a result of enhancing customer service and wage rate increases. In addition, our Regulated Businesses pension expense increased by $8.0 million, or 29.1%, for the nine months ended September 30, 2008 compared to the same period in the prior year. Pension expense in excess of the amount contributed to the pension plans is deferred by certain of our regulated subsidiaries pending future recovery in rates as contributions are made to the plans. Although our pension expense in accordance with SFAS 87 remained relatively unchanged, pension expense increased for the nine months ended September 30, 2008 due to increased contributions in certain of our regulated operating companies, which costs are recovered based on the Company s funding policy which is the minimum amount required by ERISA, rather than the SFAS 87 expense. The increase in the contributions is attributable to lower than expected returns on plan assets.

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 rental charges. For the nine months ended September 30, 2008, these costs decreased by $2.6 million, or 1.2%, compared to the same period in 2007. Factors contributing to this decrease include lower remediation costs, mainly consulting fees in connection with the Sarbanes-Oxley Act, of $16.6 million, or 65.1%, to $8.9 million for the nine months ended September 30, 2008 compared to $25.5 million for the nine months ended September 30, 2007. Also, contributing to the decrease are lower divestiture and initial public offering related costs of $1.7 million for the nine months ended September 30, 2008 including costs associated with regulatory approval, condemnation and retention/completion bonuses. Partially offsetting these decreases was an overall increase in general office costs and travel costs of $3.3 million, mainly due to inflation, and higher fuel and other transportation costs of $4.2 million. Corresponding with the increase in revenues, the Non-Regulated Businesses operating supplies and service expenses increased by $8.2 million for the nine months ended September 30, 2008 compared to the same period in the prior year. The Non-Regulated Businesses increase is mainly attributable to additional expense in the Contract Operations group of $13.8 million associated with several operating contracts (including a design, build and operate project in Fillmore, California), partially offset by lower contracted services costs in the Applied Water Management Group, due to the downturn in new home construction, of $4.9 million and profits of $1.5 million as a result of the acceptance by a third party of a construction contract.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased $17.0 million, or by 19.4%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The Regulated Businesses maintenance materials and service costs increased by $13.8 million in the first nine months of 2008 mainly due to increased costs of $2.2 million associated with a program in Illinois to maintain valves, higher cost of removal expenses of $9.2 million in certain of our operating companies and increased tank painting costs of $1.8 million in our New Jersey and Missouri operating companies. Partially offsetting these increases were lower main break costs in 2008, as we experienced higher than average main break costs in the first half of 2007 due to winter weather conditions in the Midwest region of the United States. The Non-Regulated Businesses maintenance and services expenses increased by $3.3 million as a result of higher frequency service line protection contract usage by Homeowner Services Group customers as well as increased cost associated with the Contract Operations Group mainly attributable to costs associated with new military operations and maintenance projects.

Customer billing and accounting expenses increased by $6.8 million, or 26.0%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The increase was primarily the result of higher uncollectible accounts expense in our Regulated Businesses of $2.3 million, including increases in specific provisions for certain receivables due to the uncertainty of collectibility and stricter shut-off practices for delinquent accounts by certain subsidiaries. In addition, the 2008 expense is higher as the 2007 expense included recoveries of amounts previously written off. Our Non-Regulated Businesses uncollectible expense increased by $3.1 million primarily due to increased uncollectible expense in the Applied Water Management Group of $1.9 million as the result of the downturn in the construction market and increased uncollectible expense in our

Contract Operation Group. In addition, postage expense increased in our Regulated subsidiaries $0.7 million compared to the same period in the prior year.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs decreased by $0.1 million, or 0.4%, in 2008 primarily due to decreased insurance costs of $3.6 million for the nine months ended September 30, 2008 due to more favorable claims experience compared to the nine months ended September 30, 2007, partially offset by increased regulatory expenses of $3.4 million related to write-offs of deferred rate case expenses, primarily in Tennessee, Illinois, and Ohio of $1.7 million, $0.9 million, and $0.5 million, respectively.

Depreciation and amortization. Depreciation and amortization expense decreased by $2.9 million, or 1.4%, for the nine months ended September 30, 2008 compared to the same period in the prior year. This decrease was primarily due to depreciation rate adjustments resulting from rate orders, particularly in our Pennsylvania subsidiary, partially offset by increased expense due to additional utility plant placed in service.

General taxes. General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by $10.2 million, or 7.2%, in the nine months ended September 30, 2008 compared to the first nine months of 2007. This increase is primarily due to increased gross receipts taxes of $5.7 million in New Jersey and $0.7 million in Missouri and higher property tax expense of $1.7 million and $1.0 million in Ohio and Missouri, respectively.

Gain on sale of assets. The gain on sale of assets was $0.4 million for the nine months ended September 30, 2008 compared to a gain of $6.8 million for the nine months ended September 30, 2007. The gain in 2008 and 2007 is primarily attributable to non-recurring sales of assets no longer used in our operations. Partially offsetting the 2008 gain was the loss attributable to the sale of the Felton water system to SLVWD.

Impairment charge. The impairment charge was $750.0 million for the nine months ended September 30, 2008 compared to $243.3 million for the nine months ended September 30, 2007. The 2008 impairment charge was primarily due to the market price of the Company s common stock (both the initial public offering price and the price during subsequent trading) being less than what was anticipated during our 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company s debt (due to increased interest rates). The 2007 impairment charge to goodwill to our Regulated Businesses was primarily due to slightly lower long-term earnings forecast caused by our updated customer demand and usage expectations and expectations for timing of capital expenditures and rate recovery.

Other income (deductions). Interest expense, net of interest income, the primary component of our other income (deductions), increased by $1.0 million, or 0.5%, for the nine months ended September 30, 2008 compared to the same period in the prior year. The increase is primarily due to increased borrowings associated with capital expenditures. Offsetting the change in interest expense is an increase in AFUDC of $8.9 million for the nine months ended September 30, 2008 compared to the same period in 2007 as a result of increased construction work in progress. Other items contributing to the change include higher miscellaneous income for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 primarily as a result of losses recorded for a contract in our Non-Regulated business in 2007 of $2.1 million, and an increase in the amortization of debt expense of $0.7 million for the nine months ended September 30, 2008 compared to the same period in 2007 as a result of the debt restructuring.

Provision for income taxes. Our consolidated provision for income taxes increased $9.5 million, or 12.8%, to $83.6 million for the nine months ended September 30, 2008 from $74.1 million for the nine months ended September 30, 2007.

Net income (loss). The net loss for the nine months ended September 30, 2008 was $598.8 million compared to a net loss of $108.3 million for the nine months ended September 30, 2007. The variation between the periods is the result of the aforementioned changes.

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

Operating revenues. Our consolidated operating revenues increased $121.1 million, or 5.8%, from $2,093.1 million for 2006 to $2,214.2 million for 2007. An increase in operating revenues for our Regulated Businesses of $132.9 million in 2007 was somewhat offset by a decrease in operating revenues for our Non-Regulated Businesses of $5.8 million. The increase in the Regulated Businesses operating revenues was primarily due to rate increases of approximately $61.9 million obtained through general rate cases in New Jersey, Ohio, Arizona, California and other states. In addition, rate increases obtained through infrastructure-related provisions in Pennsylvania, Missouri, Illinois and Indiana totaled approximately $15.5 million. Water service operating revenues also increased due to growth of 0.7% in our Regulated Businesses customer base through small acquisitions in our service areas and through growth in existing service areas. Water sales volume associated with existing customers increased by 1.5% in 2007 compared to the prior year due to drier weather mainly in our Mid-Atlantic states.

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

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

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

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

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

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

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Wastewater Services Our subsidiaries provide wastewater services in 12 states. Operating revenues from these services increased by 4.7% to $75.6 million for 2007. The increase reflects a growth of 0.4% in the number of wastewater customers served but is primarily due to increases in rates charged to customers in states where we have wastewater operations (principally Arizona, Hawaii, and New Jersey).

Our Non-Regulated revenues decreased by $5.8 million, or 2.3%, from $248.5 million for 2006 to $242.7 million for 2007. The net decline in revenues is primarily attributable to a $15.8 million decrease in revenues of our Contract Operations Group, partially offset by a $7.4 million increase in revenues of our Homeowner Services Group, and an increase of $3.5 million from our other Non-Regulated Businesses. The decline in revenues of our 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 of construction revenue 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 $12.3 million of incremental revenues and new military projects generating approximately $10.0 million of revenues. The increase from our Homeowner Services Group represents expansion into new geographic markets (Virginia and Trenton, New Jersey). The increase in our other Non-Regulated Businesses revenues is due to revenues attributable to special projects in 2007.

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

Operation and maintenance expense by major category was as follows:

	For the Years Ended December 31,	
	2006	2007
	(in thousands)	
Production costs	$ 257,727	$ 278,065
Employee-related costs	412,515	463,362
Operating supplies and services	297,644	293,475
Maintenance materials and services	109,797	128,016
Customer billing and accounting	54,624	38,256
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 7.9% 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 12.3% for 2007 compared to the same period in 2006. These costs represented 35.1% and 37.2% 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 decreased by 1.4% compared to the same period in 2006. A factor contributing to this overall decrease was the 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 operating contracts of our Non-Regulated Businesses 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.

Partially offsetting these Non-Regulated Businesses decreases was additional expense associated with several contracts, including a DBO project in Fillmore of $12.4 million, and increased military contract expenses of $11.4 million, reflecting increased contracted services primarily on two projects and a $5.0 million loss recorded on one project. Also offsetting the decreases were higher accounting and legal expenses. In addition, our remediation efforts in connection with the Sarbanes-Oxley Act resulted in an increase of $15.1 million for 2007, as compared to 2006. The Regulated Businesses transportation costs for 2007 increased by $3.2 million due to 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.

Maintenance materials and services, which include emergency repairs as well as costs for preventive maintenance, increased by 16.6% 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, increased paving costs for our New Jersey, Missouri, Illinois and Pennsylvania subsidiaries, as well as higher expenses in our Non-Regulated Businesses, primarily the Homeowner Services Group.

Customer billing and accounting expenses decreased by 30.0% 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 $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.

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

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

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

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

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

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

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 $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.

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

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

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

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

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

Wastewater Services Our subsidiaries provide wastewater services in 12 states. Operating revenues from these services increased by 8.9% to $72.2 million for 2006, from $66.3 million for 2005. The increases were attributable to 4.4% growth in the number of wastewater customers served, with the remainder due to rate increases.

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.

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Operation and maintenance expense by major category was as follows:

	For the Years Ended December 31,	
	2005	2006
	(in thousands)	
Production costs	$ 255,051	$ 257,727
Employee-related costs	368,564	412,515
Operating supplies and services	379,878	297,644
Maintenance materials and services	108,429	109,797
Customer billing and accounting	42,793	54,624
Other	46,851	42,237
Total	$ 1,201,566	$ 1,174,544

Production costs, including fuel and power, purchased water, chemicals and waste disposal, increased by 1.0% 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 35.1% of operation and maintenance expense in 2006 and increased 11.9% in 2006 as compared to 2005. Wage and salary expenses were up $28.2 million, or 9.9%, 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 21.6% 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, increased by 1.3% in 2006 compared to 2005. Higher maintenance costs in our Non-Regulated Businesses Homeowner Services Group, offset by the cessation of some O&M contracts also managed by our Non-Regulated Businesses, was the primary reason for this increase.

Customer billing and accounting expenses increased by 27.6% 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.

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

General taxes. Our consolidated general taxes expense, which includes taxes for property, payroll, gross receipts and other miscellaneous items, was relatively unchanged from $183.3 million for 2005 to $185.1 million for 2006. The increase was primarily due to higher gross receipts taxes as a result of increased Regulated Businesses operating revenues. Gross receipts and franchise taxes that vary based on operating revenues were higher by 3.5% in 2006 compared to 2005. Property and capital stock taxes that are assessed on the basis of tax values assigned to assets and capitalization were down 3.0% 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, net of interest income, 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.

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Unaudited Quarterly Financial Data

The following table sets forth certain supplemental unaudited consolidated quarterly financial data for each of the eleven quarters in the period ended September 30, 2008. The unaudited consolidated quarterly financial data for the quarters ended September 30, 2007 and September 30, 2008 have been derived from our unaudited consolidated financial statements included elsewhere in this prospectus. The unaudited consolidated quarterly financial data as of March 31, 2007, June 30, 2007, March 31, 2008 and June 30, 2008 have been derived from our unaudited consolidated financial statements not included in this prospectus. The unaudited consolidated quarterly financial data for the quarters ended March 31, 2006, June 30, 2006, September 30, 2006, December 31, 2006 and December 31, 2007 have been derived from our unaudited historical accounting records. The operating results for any quarter are not indicative of results that may be expected for a full year or any future periods.

2008	**First Quarter**	**Second Quarter**	**Third Quarter**
	(in thousands, except per share data)		
Operating revenues	$ 506,815	$ 589,369	$ 672,193
Operating income (loss)	(670,358)	142,658	211,753
Income (loss) from continuing operations	(732,484)	45,498	88,158
Income (loss) from discontinued operations			
Net income (loss)	(732,484)	45,498	88,158
Basic and diluted earnings (loss) per common share	$ (4.58)	$ 0.28	$ 0.55

2007	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
	(in thousands, except per share data)			
Operating revenues	$ 468,544	$ 558,733	$ 633,117	$ 553,821
Operating income (loss)	73,318	151,490	(54,615)	(155,064)
Income (loss) from continuing operations	2,429	49,985	(160,117)	(234,572)
Income (loss) from discontinued operations	256	(807)		
Net income (loss)	2,685	49,178	(160,117)	(234,572)
Basic and diluted earnings (loss) per common share	$ 0.02	$ 0.31	$ (1.00)	$ (1.47)

2006	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
	(in thousands, except per share data)			
Operating revenues	$ 482,996	$ 524,695	$ 592,684	$ 492,692
Operating income (loss)	93,213	130,717	176,282	(147,699)
Income (loss) from continuing operations	3,757	24,398	43,058	(227,063)
Income (loss) from discontinued operations	1,388	315	128	(8,224)
Net income (loss)	5,145	24,713	43,186	(235,287)
Basic and diluted earnings (loss) per common share	$ 0.03	$ 0.15	$ 0.27	$ (1.47)

Amounts may not sum due to rounding.

Income (loss) from continuing operations includes impairment losses of $221.7 million, $243.3 million, $266.0 million and $750.0 million in the fourth quarter of 2006, third quarter of 2007, fourth quarter of 2007 and first quarter of 2008, respectively.

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

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have access to revolving credit facilities with aggregate bank commitments of $810.0 million that we currently utilize to fulfill our short-term liquidity needs 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 are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from the 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 September 30, 2008.

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.

We rely on our revolving credit facility and the capital markets to satisfy our liquidity needs. Disruptions in the credit markets may discourage lenders from meeting their existing lending commitments, extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt securities in the capital markets. On September 15, 2008, we sought to issue commercial paper but were unable to consummate the issuance due to adverse market conditions. In order to meet our short-term liquidity needs we are borrowing under our existing $800.0 million revolving credit facility, which was scheduled to expire on September 15, 2012. On September 15, 2008, a majority of our lenders agreed to extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. AWCC had $197.2 million of outstanding borrowings and $42.9 million of outstanding letters of credit under this credit facility as of November 13, 2008. AWCC had $120.0 million of outstanding overnight commercial paper as of November 13, 2008. We can provide no assurances that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

Cash Flows from Operating Activities

Cash flows from operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of operations, are weighted toward the third quarter of each fiscal year. 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; declining per customer usage of water; and weather and seasonality. See 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 or changes in our customer economic outlook and ability to pay for service in a timely manner. We can provide no assurance that our customers historical payment pattern will continue in the future.

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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,			For the Nine Months Ended September 30,	
	2005	2006	2007	2007	2008
			(in thousands)		
Net income (loss)	$ (325,040)	$ (162,243)	$ (342,826)	$ (108,254)	$ (598,828)
Add (subtract):					
Non-cash operating activities(1)	852,373	664,060	881,013	482,392	1,094,807
Changes in working capital(2)	51,348	(96,578)	16,770	8,936	(21,552)
Pension and postretirement healthcare contributions	(53,246)	(81,491)	(81,245)	(53,161)	(81,514)
Net cash flows provided by operations	$ 525,435	$ 323,748	$ 473,712	$ 329,913	$ 392,913

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

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

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.

The increase in cash flows from operations during the nine months ended September 30, 2008 compared to the same period in 2007 was primarily due to improvements in working capital partially offset by higher contributions to our pension and postretirement healthcare trusts.

Cash Flows from Investing Activities

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

	For the Years Ended December 31,			For the Nine Months Ended September 30,	
	2005	2006	2007	2007	2008
			(in thousands)		
Construction expenditures	$ (558,446)	$ (688,843)	$ (758,569)	$ (507,237)	$ (714,559)
Other investing activities, net(1)	28,281	(2,595)	11,991	24,287	(9,015)
Net cash flows used in investing activities	$ (530,165)	$ (691,438)	$ (746,578)	$ (482,950)	$ (723,574)

(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.

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Cash flow used in investing activities increased in 2007 compared to 2006 and in 2006 compared to 2005 and in the nine-month period ending September 30, 2008 compared to the nine-month period ending September 30, 2007 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 $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,			For the Nine Months Ended September 30,	
	2005	2006	2007	2007	2008
			(in thousands)		
Transmission and distribution	$ 238,972	$ 314,282	$ 325,333	$ 224,997	$ 356,944
Treatment and pumping	137,299	133,074	185,832	111,171	131,697
Services, meter and fire hydrants	84,148	132,610	179,933	83,799	131,335
General structures and equipment	81,516	72,892	32,336	49,179	57,830
Sources of supply	16,511	35,985	35,135	38,091	36,753
Total construction expenditures	$ 558,446	$ 688,843	$ 758,569	$ 507,237	$ 714,559

Construction expenditures for the periods noted above were partially offset by customer advances and contributions for construction (net of refunds) of $25.6 million, $3.2 million, $35.8 million, $47.4 million and $52.0 million in the nine months ended September 30, 2007 and 2008, and 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, Maricapa County, Arizona and Franklin Township, New Jersey facilities.

Construction expenditures increased by $207.4 million to $714.6 million for the nine months ended September 30, 2008 from $507.2 million for the nine months ended September 30, 2007 as a result of increased investment in regulated utility plant projects. We anticipate spending approximately $950 million on capital investment in 2008.

Our construction program consists of both infrastructure renewal programs, where we replace infrastructure as needed, and construction of new water and wastewater treatment and delivery facilities to meet new customer growth. 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 our operations. Generally, acquisitions are funded initially with short-term debt and later refinanced with the proceeds from long-term debt or equity offerings.

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Included in 2008 are planned construction expenditures of approximately $32 million to construct a new water treatment plant on the Kentucky River. On April 25, 2008, the Kentucky Public Service Commission approved Kentucky American Water s application for a certificate of convenience and necessity to construct a 20.0 million gallon per day treatment plant on the Kentucky River and a 30.6 mile pipeline to meet Central Kentucky s water supply deficit. The Kentucky project is expected to be completed by 2010 with an estimated cost of $162 million.

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 years indicated:

For the nine months ended September 30, 2008:

- We paid approximately $8.0 million for the acquisition of water and waste water systems.
- We received approximately $10.6 million in cash from the sale of the Felton water system.

2007:

- We paid approximately $15.9 million for the acquisition of a number of water and wastewater systems, the largest of which was S.J. Services Inc., the parent company of Pennsgrove Water Supply Company, Inc. and South Jersey Water Supply Company, Inc. The purchase price, including acquisition costs, for S.J. Services Inc. was $13.5 million in cash.
- We received approximately $9.7 million in cash proceeds from the sale of a group of assets of the Residuals business.
- We received $16.3 million in cash proceeds from the sale of other assets, including $13.0 million of proceeds on a property in Mansfield, New Jersey owned by a Non-Regulated subsidiary.

2006:

- We paid approximately $12.5 million for the acquisition of water and wastewater systems.
- We received approximately $30.2 million in cash proceeds from the sale of discontinued operations, including a group of assets of the Residuals business and the Underground business.

2005:

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

Our investing activities require considerable capital resources which we have generated in operations and attained through financing activities. We can provide no assurances that these resources will be sufficient to meet our expected investment needs and may be required to delay or reevaluate our investment plans.

In September 2008, our California subsidiary completed its sale of the Felton water system to SLVWD. Under the terms of the agreement, SLVWD paid $13.4 million for the operating assets of the water system, which serves approximately 1,330 customers in Felton. The payment included a $10.6 million cash payment to California American Water and the assumption by SLVWD of $2.8 million in debt. The sale of the Felton system resulted in a loss on sale of $0.4 million.

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, including the New Jersey Board of Public Utilities. We can provide no assurances that the agreement will be approved.

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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. We intend to access the capital markets on a regular basis, subject to market conditions. In addition, we have received capital contributions from RWE and intend to issue equity in the future to maintain an appropriate capital structure, subject to any restrictions in the registration rights agreement between us and RWE. In order to finance new infrastructure, we received customer advances and contributions for construction (net of refunds) of $25.6 million and $3.2 million for the nine months ended September 30, 2007 and September 30, 2008, respectively, and $35.8 million, $47.4 million, and $52.0 million for the years ended December 31, 2007, 2006 and 2005, respectively.

AWCC issued 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 seven 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 issued $1,750.0 million of RWE redemption notes to 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.

AWCC issued additional senior notes through private placement offerings totaling $200.0 million in May 2008. Interest rates ranged from 6.25% to 6.55%, and maturities ranged from 2018 to 2023. On May 13, 2008, we received a cash equity contribution from RWE of $245.0 million which was used to reduce short-term debt.

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 fund the redemption of $1,286.0 million aggregate principal amount of RWE redemption notes and $206.0 million (including after tax gains of $2.2 million, net of $1.4 million of tax) aggregate principal amount of RWE notes. In the second quarter of 2008, the Company completed an offer to exchange fully registered 6.085% Senior Notes due 2017 and fully registered 6.593% Senior Notes due 2037 for all of its outstanding unregistered notes of the same series. The Company did not receive any proceeds from the exchange offer, nor did the Company s debt level change as a result of the exchange offer. The terms of the registered notes and the unregistered notes are substantially identical in all material respects. 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.

There were no dividend payments made for 2007 or the six months ended June 30, 2008. We paid a dividend of $0.20 per share on September 2, 2008. On October 17, 2008 we declared a dividend of $0.20 per share payable to holders of record on November 18, 2008, which will be paid on December 1, 2008. Our board of directors has adopted a dividend policy to distribute a portion of our net cash provided by operating activities to our stockholders as regular quarterly dividends, rather than retaining that cash for other purposes. Our policy is to distribute 50% to 70% of our annual net income, adjusted for certain non-cash items.

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The following long-term debt was issued in the first nine months of 2008:

Company	Type	Interest Rate	Maturity	Amount (in thousands)
American Water Capital Corp	Senior notes	6.25%	2018	$ 110,000
American Water Capital Corp	Senior notes	6.55%	2023	90,000
Other subsidiaries	State financing authority loans and other	1.00%	2024	1,829
Total issuances				$ 201,829

The following long-term debt and preferred stock with mandatory redemption requirements were repurchased or retired through optional redemption or payment at maturity during the first nine months of 2008:

Company	Type	Interest Rate	Maturity	Amount (in thousands)
Long-term debt:				
American Water Capital Corp	Senior notes-fixed rate	6.87%	2011	$ 28,000
Other subsidiaries	Senior notes-floating rate	6.48%-10.00%	2021-2032	144,725
Other subsidiaries	Subsidiary fixed rate bonds and notes	5.05%-9.35%	2008-2029	20,374
Other subsidiaries	State financing authority loans and other	0.00%-9.87%	2008-2034	9,276
Preferred stock with mandatory redemption requirements:				
Other subsidiaries		4.60%-6.00%	2013-2019	140
Total retirements & redemptions				$ 202,515

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.

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

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

The following long-term debt was issued in 2006:

Company	Type	Interest Rate	Maturity	Amount (in thousands)
American Water Capital Corp	Senior notes	5.39%-5.77%	2013-2018	$ 483,000
Missouri-American Water Company	Tax exempt first mortgage bonds	4.60%	2036	57,480
Indiana-American Water Company	Tax exempt first mortgage bonds	4.88%	2036	25,770
Other Subsidiaries	State financing authority loans & other	0%-5.00%	2019-2026	16,248
Loan 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	RWE preferred stock-fixed rate	4.60%-8.80%	2007-2019	538
Total extinguishments, retirements & redemptions				$ 1,832,471

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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 were as follows:

	December 31, 2007	September 30, 2008
	(in thousands)	
Commercial paper, net of discount	$ 169,627	$ 131,910
Book-overdraft	42,198	24,291
Lines of credit	9,049	170,984
Total short-term debt	$ 220,514	$ 327,185

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 November 13, 2008 and December 31, 2007 there was $6.3 million and $9.0 million, respectively, outstanding under this revolving line of credit. If this line of credit were not extended beyond its current maturity date of December 31, 2008, AWCC would continue to have access to its $800.0 million unsecured revolving credit facility described below.

On September 15, 2006, AWCC, our finance subsidiary, entered into an $800 million senior unsecured credit facility syndicated among the following group of 10 banks with JPMorgan Chase Bank, N.A. acting as administrative agent.

Bank	Commitment Amount Through September 15, 2012	Commitment Amount Through September 15, 2013
	(in thousands)	
JPMorgan Chase Bank, N.A.	$ 115,000	$ 0
Citibank, N.A.	115,000	115,000
Citizens Bank of Pennsylvania	80,000	80,000
Credit Suisse, Cayman Islands Branch	80,000	80,000
William Street Commitment Corporation	80,000	80,000
Merrill Lynch Bank USA	80,000	80,000
Morgan Stanley Bank	80,000	80,000
UBS Loan Finance LLC	80,000	80,000
National City Corporation	50,000	50,000
PNC Bank, National Association	40,000	40,000
	$ 800,000	$ 685,000

This revolving credit facility, which was originally scheduled to terminate 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. 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 September 15, 2008, a majority of the banks agreed to further extend $685.0 million of commitments under this revolving credit facility to September 15, 2013. If any lender defaults in its obligation to fund advances, the Company may request the other lenders to assume the defaulting lender s commitment or replace such defaulting lender by designating an assignee willing to assume the commitment, however the remaining lenders have no obligation to assume a defaulting lender s commitment and we can provide no assurances that we will replace a defaulting lender. AWCC had $197.2 million of outstanding borrowings and $42.9 million of outstanding letters of credit under this credit facility as of November 13, 2008.

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On December 31, 2007 and September 30, 2008, AWCC had the following sub-limits and available capacity under the revolving credit facility and indicated amounts of outstanding commercial paper:

	Credit Facility Commitment (in thousands)	Available Credit Facility Capacity (in thousands)	Letter of Credit Sublimit (in thousands)	Available Letter of Credit Capacity (in thousands)	Outstanding Commercial Paper (Net of Discount) (in thousands)
December 31, 2007	$ 810,000	$ 711,611	$ 150,000	$ 60,659	$ 169,267
September 30, 2008	$ 810,000	$ 595,500	$ 150,000	$ 106,484	$ 131,910

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 September 30, 2008, our ratio was 0.55 and therefore we were in compliance with the ratio.

The average interest rate on short-term borrowings for the nine months ended September 30, 2008 was approximately 3.3%.

Capital Structure

Our capital structure was as follows:

	At December 31, 2005	At December 31, 2006	At December 31, 2007	At September 30, 2008
Common stockholder equity and preferred stock without mandatory redemption rights	29%	40%	48%	45%
Long-term debt and redeemable preferred stock at redemption value	50%	50%	49%	51%
Short-term debt and current portion of long-term debt	21%	10%	3%	4%
	100%	100%	100%	100%

As a condition to some PUC approvals of the RWE Divestiture, we agreed to maintain a capital structure with a minimum of 45% common equity at the time of the consummation of our initial public offering on April 28, 2008. As a result of the impairment charges recorded for the three months ended March 31, 2008, our capital structure did not meet this minimum requirement and we received a cash equity contribution from RWE of $245.0 million on May 1, 2008. This cash was used to repay $243.4 million of short-term debt. Contributions from RWE were $801.1 million for the nine months ended September 30, 2007. RWE is not obligated to make any additional capital contributions.

The changes to our capital resource mix during 2006 and 2007 were accomplished through the various financing activities noted above. The capital structure at September 30, 2008 more closely reflects our expected future capital structure.

Debt Covenants

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance, we or our subsidiaries may be restricted in our ability to pay dividends, issue debt or access our

revolving credit lines. We were in compliance with our covenants as of September 30, 2008. See Risk Factors Risks Related to Our Industry and Business Our failure to comply with restrictive covenants under our credit facilities could trigger repayment obligations.

Security Ratings

Our access to the capital markets, including the commercial paper market, and their respective financing costs in those markets depend on the securities ratings of the entity that is accessing the capital markets. 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 our overall cost of debt. The following table shows the Company s securities ratings as of September 30, 2008:

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

On June 19, 2008, Standard & Poor s Ratings Services, which we refer to as S&P, downgraded the senior unsecured issuer rating of AWCC to BBB+ (stable outlook) from A- (negative outlook). In addition, S&P assigned a BBB+ corporate credit rating to American Water and affirmed AWCC s A-2 short-term rating.

On August 28, 2007, Moody s Investors Service, which we refer to as 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. Security ratings are highly dependent upon our ability to generate cash flows from financing and operating activities in an amount sufficient to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flow is sufficient to maintain our existing ratings.

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. We do not expect to post any collateral which will have a material adverse impact on the Company s results of operation, financial position or cash flows.

Current Credit Market Position

Due to recent market developments, including a series of rating agency downgrades of subprime U.S. mortgage-related assets, a decline in the fair value of subprime-related investments, increased volatility in the

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capital markets and severe liquidity crises at major financial institutions, the Company performed an assessment to determine the impact, if any, of current market conditions on the Company s financial position. As of September 30, 2008 there were no direct investments in subprime mortgage-related assets within the Company s short-term investment balances.

The Company 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 determined that a *de minimis* portion of the holdings within the trusts are directly invested in subprime mortgage-related assets, auction rate debt securities or securities of weakened financial institutions. The Company does not believe that any decline in the fair value of these and other assets will have a material impact on its results of operations or its future cash funding requirements.

The Company s retirement trust assets are exposed to the market prices of debt and equity securities. Changes to the retirement trust asset value can impact the Company s pension and other benefits expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover pension and other benefit costs through rates. In addition, pension and other benefits liabilities decrease as fixed income asset values decrease (fixed income yields rise) since the rate at which we discount pension and other retirement trust asset future obligations is highly correlated to fixed income yields.

The Company also assessed the impact of the severe liquidity crises at major financial institutions on the Company s ability to access capital markets on reasonable terms. On September 15, 2008, the Company was unable to access short-term liquidity through its A-2/P-2 rated commercial paper program. The Company therefore utilized its credit facilities to repay maturing commercial paper and fund its short-term liquidity needs. Although the Company s credit facility syndicate banks are currently meeting all of their lending obligations, there can be no assurance that these banks will be able to meet their obligations in the future if the liquidity crises intensify or are protracted. The current adverse market conditions have also temporarily delayed the Company s plans to issue long-term debt, and the Company expects future long-term debt issuances to be at higher interest rates than incurred on its most recently issued long-term debt.

As of September 30, 2008, the Company had issued, through its subsidiaries, $120.3 million of variable rate demand bonds, which are periodically remarketed. We can provide no assurances that the bonds will be remarketed successfully or at reasonable interest rates. Bonds totaling $24.9 million are issued by Illinois American Water, bonds totaling $8.6 million are issued by Arizona American Water and the remaining $86.9 million of bonds are issued by AWCC. On March 28, 2008, the Company, through its subsidiary, entered into a standby bond purchase agreement with JPMorgan Chase Bank, N.A. (successor to Bank One, N.A.), which agreed to purchase the bonds issued by Illinois American Water if remarketing funds are unavailable. As of November 13, 2008, $24.2 million of bonds were held by JPMorgan Chase Bank, N.A. These bonds bear interest at a rate of up to the prime rate plus 1.0%. The standby bond purchase agreement with JPMorgan Chase Bank, N.A. expires on March 28, 2009, and we can provide no assurances that this agreement will be extended. The variable rate demand debt is classified as long-term since the Company expects the debt to remarket successfully and the Company expects to extend the maturity of the standby purchase agreement. The Company can provide no assurances that it will continue to remarket the bonds successfully or extend the standby bond purchase agreement. If the Company cannot remarket the bonds or extend the maturity of the standby bond purchase agreement, the bonds will be classified as short-term debt.

At this time the Company does not believe recent market disruptions will impact its long-term ability to obtain financing. The Company expects to have access to liquidity in the capital markets on favorable terms before the maturity dates of its current credit facilities and the Company does not expect a significant number of its lenders to default on their commitments thereunder. In addition, the Company can delay major capital investments or pursue financing from other sources to preserve liquidity, if necessary. The Company believes it can rely upon cash flows from operations to meet its obligations and fund its minimum required capital investments for an extended period of time.

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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.

Contractual Obligations and Commitments

We enter into obligations with third parties in the ordinary course of business. These financial 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
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

Note: The above table only reflects financial obligations and commitments. Therefore, performance obligations associated with our Non-Regulated Businesses are not included in the above amounts.

(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 approximately $162.0 million at December 31, 2007.

Market Risk

We are exposed to market risk associated with changes in commodity prices, equity prices and interest rates. We use a combination of fixed-rate and variable-rate debt to reduce interest rate exposure. As of September 30, 2008, a hypothetical 10% increase in interest rates associated with variable-rate debt would result in a $0.2 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. Non-performance by these commodity suppliers could have a material impact on our results of operations, cash flows and financial position.

Our common stock began trading on the New York Stock Exchange on April 23, 2008. The market price of our common stock may experience fluctuations, many of which are unrelated to our operating performance. In particular, our stock price may be affected by general market movements as well as developments specifically related to the water and wastewater industry. These could include, among other things, interest rate movements, quarterly variations or changes in financial estimates by securities analysts and governmental or regulatory actions. This volatility may make it difficult for us to access the capital markets in the future through additional offerings of our common stock, regardless of our financial performance, and such difficulty may preclude us from being able to take advantage of certain business opportunities or meet business obligations.

We are exposed to credit risk through our water, wastewater and other water-related activities for both our Regulated and Non-Regulated Businesses. Our Regulated Businesses serve residential, commercial, industrial and municipal customers while our Non-Regulated Businesses engage in business activities with developers, government entities and other customers. Our primary credit risk is exposure to customer default on contractual obligations and the associated loss that may be incurred due to the non-payment of customer account receivable balances. Our credit risk is managed through established credit and collection policies which are in compliance with applicable regulatory requirements and involve monitoring of customer exposure and the use of credit risk mitigation measures such as letters of credit or prepayment arrangements. Our credit portfolio is diversified with no significant customer or industry concentrations. In addition, our Regulated Businesses are generally able to recover all prudently incurred costs including uncollectible customer accounts receivable expenses and collection costs through rates.

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We are also exposed to a potential national economic recession or further deterioration in local economic conditions in the markets in which we operate. The credit quality of our customer accounts receivable is dependent on the economy and the ability of our customers to manage through unfavorable economic cycles and other market changes. In addition, as a result of the downturn in the economy and heightened sensitivity of the impact of additional rate increases on certain customers, there can be no assurances that regulators will grant sufficient rate authorizations. Therefore our ability to fully recover operating expense, recover our investment and provide an appropriate return on invested capital made in our Regulated Businesses may be adversely impacted.

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 $236.1 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

At September 30, 2008, the Company s goodwill totaled $1,704.3 million. The Company s annual goodwill impairment test is conducted at November 30 of each calendar year and interim reviews are performed when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

The market price of the Company s common stock at September 30, 2008 was below its consolidated carrying value. Subsequent to September 30, 2008, the Company s market price has experienced a high degree of volatility. As a result, management considered whether the Company s market capitalization being below the consolidated carrying value of its reporting units represented an interim triggering event.

Having considered both qualitative and quantitative factors, management concluded that no interim triggering event has occurred. As such, an interim impairment test was not performed, as management believes there were no significant adverse changes in its business. Further, the Company s methodology is not based purely on stock price but adjusts for other valuation techniques and relevant market information, as described in the testing methodology below, including the expected impact to the share price once RWE divests a substantial portion of its ownership.

The Company may be required to recognize an impairment as a result of this year s annual test or at other times in the future. This depends on other factors identified below in the description of the Company s test approach. These include market price declines such as levels experienced during October 2008, a decline over a period of time of the Company s stock price, a decline over a period of time in valuation multiples of comparable water utilities and the lack of an increase in the Company s market price consistent with increases in the carrying value or to a level consistent with its peer companies. A decline in the 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 the Company s reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to secure financing on attractive terms and maintain compliance with debt covenants.

In light of the initial public offering price and trading levels in our common stock since the date of the initial public offering, the Company performed an interim impairment test and, on May 9, 2008, concluded that the current carrying value of the Company s goodwill was impaired as a result of the current market price at that time and trading levels of the Company s common stock. The Company believes the initial public offering price was indicative of the value of the Company at March 31, 2008, and accordingly, based on those factors, recorded an impairment charge to goodwill related to its Regulated Businesses in the amount of $750.0 million in the financial statements as of and for the fiscal quarter ended March 31, 2008. The impairment charge was primarily due to the market price of the Company s common stock (both the initial public offering price and the price during subsequent trading) being less than that implied by the trading value of peer companies during the 2007 annual test. Also contributing to the impairment was a decline in the fair value of the Company s debt (due to increased market interest rates). As a result of the impairment charge RWE Aqua Holdings GmbH transferred $245.0 million to the Company on May 13, 2008. This cash was used to reduce short-term debt. RWE is not obligated to make any additional capital contributions.

During the third quarter of 2007, as a result of the Company s debt being placed on review for a possible downgrade and the proposed sale of a portion of the Company in the initial public offering, management determined at that time it was appropriate to update its valuation analysis before the next scheduled annual test. Based on this assessment, the Company performed an interim impairment test and recorded an impairment charge to goodwill related to its 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.

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The Company uses a two-step impairment test to identify potential goodwill impairment and measure the amount of a goodwill impairment loss to be recognized (if any) in accordance with Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets. The step 1 calculation used to identify potential impairment compares the fair value for each of the Company s reporting units to their respective net carrying values (book values), including goodwill, on the measurement date. If the fair value of any reporting unit is less than such reporting unit s carrying value, then step 2 shall be performed to measure the amount of the impairment loss (if any) for such reporting units.

The step 2 calculation of the impairment test compares, by reporting unit, the implied fair value of the goodwill to the carrying value of goodwill. The implied fair value of goodwill is equal to the excess of net fair value of each reporting unit s assets and liabilities above the carrying value of such reporting unit s assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill for any reporting unit, an impairment loss shall be recognized in an amount equal to the excess (not to exceed the carrying value of goodwill) for that reporting unit.

If step 2 is required, the determination of the fair value of each reporting unit and the fair value of each reporting unit s assets and liabilities will be performed as of the measurement date using observable market data before and after the measurement date (if that subsequent information is relevant to the fair value on the measurement date). The step 2 fair value determination will use a combination of the following valuation techniques:

- quoted market prices of the Company s securities;
- observable market prices of comparable equity of publicly-traded water utilities considered by us to be peers; and
- discounted cash flow models developed from the Company s internal forecasts.

Each of the Company s reporting unit s fair value is determined by weighting, according to relevance, the results of three valuation techniques. The first, and primary, valuation is based upon the observable market price of the Company s common equity as adjusted for control premiums and other relevant market conditions.

The second model-based valuation technique applies an average peer multiple to the Company s historic and forecasted cash flows. The cash flow multiple is calculated using the quoted market equity prices of comparable publicly-traded water utilities, and their published cash flows. This market multiple is then applied to the applicable reporting unit s internal historic and forecasted cash flows as adjusted to remove non-recurring items and forecast acquisitions.

The third model-based valuation technique discounts the five-year business plan forecast cash flows, as adjusted to remove non-recurring items and forecast acquisitions, at the Company s weighted average cost of capital.

If step 2 of the impairment test is required, the Company will determine the fair value of the applicable reporting unit s assets and liabilities. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions at the measurement date. For the step 2 calculations of the fair value of debts, the Company will use observable prices of instruments and indices which share similar risk to those instruments being valued, adjusted to compensate for different credit profile, collateral, tax treatment and call features, to calculate the fair value of each reporting unit s debts.

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 compare 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.

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Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities on the balance sheet until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Accounting for Income Taxes

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

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

Accounting for Pension and Postretirement Benefits

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

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

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

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

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

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 6.27% and 7.9%, respectively, for estimating our 2008 pension costs. Additionally, we will use a discount rate and expected return on plan assets of 6.20% and 7.75%, respectively, for estimating our 2008 other postretirement benefit costs.

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

Recent Accounting Pronouncements

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

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

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115, which we refer to as SFAS 159. This standard permits entities to choose to measure many financial instruments and certain other items 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. SFAS 159 is effective for years beginning January 1, 2008. The Company has not elected to exercise the fair value irrevocable option. Therefore, the adoption of SFAS 159 did not have an impact on the Company s results of operations, financial position or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132(R), which we refer to as SFAS 158. This statement requires the recognition of the 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. SFAS 157 establishes a common definition for fair value to be applied to U.S. generally accepted accounting principles guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements.
In February 2008, the FASB issued FASB Staff Position SFAS 157-2 which allows a one-year deferral of the adoption of SFAS 157 for nonfinancial assets and nonfinancial liabilities (such as intangible assets, property, plant and equipment and goodwill) that are required to be measured at fair value on a periodic basis (such as at acquisition or impairment). The Company elected to use this deferral option and accordingly, only partially adopted SFAS 157 on January 1, 2008. SFAS 157 will be adopted for the Company s nonfinancial assets and liabilities valued on a non-recurring basis on January 1, 2009.

On January 1, 2008, the Company adopted the provisions of SFAS 157 for financial assets and liabilities, and nonfinancial assets and liabilities with recurring measurements. The Company s assets and liabilities measured at fair value on a recurring basis during the period were cash and cash equivalents, restricted funds and short-term debt. These assets and liabilities were measured at fair value on the balance sheet date using quoted prices in active markets (level 1 inputs, as defined by SFAS 157). The adoption of SFAS 157 for the Company s financial assets and liabilities did not have a material effect on the Company s results of operations, financial position or cash flows. The Company will be required to measure the assets of its defined benefit pension and other postretirement welfare plans pursuant to SFAS 157 at the next measurement date, which will be December 31, 2008.

On October 10, 2008, the FASB issued Staff Position No. 157-3, Determining the Fair Value of a Financial Asset When a Market for That Asset Is Not Active , which we refer to as FSP 157-3 and which clarifies the application of SFAS 157 in an inactive market and provides an example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is inactive. FSP 157-3 was effective upon

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issuance, including prior periods for which financial statements had not been issued. The adoption of this standard as of September 30, 2008 did not have an impact on the Company s results of operations, financial position or cash flows.

The Company is evaluating the effect, if any, that the adoption of SFAS 157 for the Company s nonfinancial assets and liabilities will have on its results of operations, financial position or cash flows.

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

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

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

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

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