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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC., FOR A LIMITED WAIVER OF THE REQUIREMENTS OF A.A.C. R14-2-801, ET SEQ., AND CERTAIN RELATED RELIEF.	DOCKET NO. W-01303A-01-0983 **NOTICE OF FILING REBUTTAL TESTIMONY**

Arizona-American Water Company hereby files the Rebuttal Testimony of B. Kent Turner and James McGivern in support of Arizona-American Water Company, Inc.'s Application for a Limited Waiver in the above-entitled docket.

DATED this 29th day of July, 2002.

FENNEMORE CRAIG

By ______________________________

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An original and 10 copies of the foregoing and Rebuttal Testimony described above was delivered this 29th day of July, 2002, to:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

A copy of the foregoing and Rebuttal Testimony described above was delivered this 29th day of July, 2002, to:

Lyn Farmer
Chief Administrative Law Judge
Arizona Corporation Commission
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REBUTTAL TESTIMONY
OF
JAMES MCGIVERN

July 29, 2002

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DIRECT TESTIMONY OF JAMES MCGIVERN

I. INTRODUCTION

Q1. Please state your name and business address.

A1. My name is James McGivern. My business address is 1025 Laurel Oak Rd., Voorhees New Jersey, 08043.

Q2. Please state by whom you are employed and what position you hold.

A2. I am employed by Thames Water Plc. ("Thames Water"), a public limited company organized under the laws of England and Wales. I am currently the Managing Director – Americas for Thames Water.

Q3. Please describe your education and work experience.

A3. From 1983 through 1986, I attended the University of Reading in England where I earned a Law (LLB Hons) Degree. In 1987, I was admitted as a Solicitor of the Supreme Court of England and Wales working through the College of Law Chancery Lane in London. From 1987 to 1991, I worked as a solicitor in legal practices located in London and Sydney, Australia.

I have been employed by Thames Water since 1991, starting in its legal department where I worked until 1997, eventually rising to head of Commercial Legal Services (International). In 1997, I moved to the business side of the company when I became the Commercial Director responsible for business development activities of all Thames Water Group Companies, both in the United Kingdom and internationally. In 1999, I was promoted to Managing Director – International Business Development. In that position, I was responsible for managing all mergers and acquisitions and overseas development and coordination of work undertaken by Thames Water's country directors. Most recently, in 2001, I was appointed Managing Director-Americas. A more detailed curriculum vitae is attached as Exhibit JM-1.

Q4. What are your current responsibilities?

A4. As Managing Director – Americas, I am responsible for all Thames business interests in North, Central and South America. That responsibility extends to accountability for profit and loss of each operating unit, strategic decisions, regional corporate development and operational performance.

Q5. What is the purpose of your testimony in this proceeding?

A5. In my testimony, I will cover the following topics: 1) a description of the corporate organization of Thames Water and its affiliates; 2) a description of the stock purchase transaction involving American Water Works Company, Inc. ("AWW"), the parent company of Arizona-American Water Company, Inc. ("Arizona-American"); 3) the rationale behind the transaction from Thames' perspective; and 4) the benefits of the transaction from the perspective of Arizona-American's ratepayers.

Q6. Have you reviewed the testimony of Mssrs. Carlson, Reiker and Chelus filed on behalf of Staff in this proceeding?

A6. Yes, I have. Mr. Turner of Arizona-American will comment more specifically on the Staff testimony and recommended conditions.

II. <u>DESCRIPTION OF THE CORPORATE ORGANIZATION OF THE ACQUIRING ENTITIES.</u>

Q7. Please describe the corporate structure of the entities that will acquire the stock of Arizona Water pursuant to the Agreement and Plan of Merger dated as of September 16, 2001 ("Agreement")

A7. Upon consummation of the transfer of stock contemplated by the Agreement, Arizona-American's parent, AWW, will be a wholly owned, direct or indirect, subsidiary of Thames Water Aqua Holdings GmbH ("Thames Holdings"), a company organized under the laws of the Federal Republic of Germany. Thames Holdings is the parent corporation of Thames Water and is a wholly owned subsidiary of RWE AG ("RWE"), a company organized under the laws of the Federal Republic of Germany.

Q8. Please describe RWE.

A8. RWE, Germany's fifth largest industrial group, is an international multi-utility service provider with core businesses in electricity, water, gas, waste management and utility-related services. RWE is active in more than 120 countries on all six continents.

RWE and its subsidiaries employ approximately 170,000 people, some 69,000 of whom work outside of Germany. As of December 31, 2001, more than 16,000 of the people employed by the RWE family of companies were based in the United States.

Q9. Please describe Thames Holdings.

A9. As mentioned previously, Thames Holdings is a wholly owned subsidiary of RWE. Thames Holdings acts as a holding company for the water and wastewater operations under the RWE corporate umbrella. Thames Holdings has delegated full power and authority to Thames Water to operate Thames Holdings' current and future subsidiaries, including AWW upon consummation of the transfer of stock contemplated by the Agreement.

Q10. Please describe Thames Water.

A10. Thames Water is the largest water/wastewater utility in the United Kingdom and the third largest water/wastewater services company in the world. Thames Water provides drinking water and wastewater treatment services to over 43 million people worldwide, including 12 million people in and around the City of London. Thames Water was a publicly owned and operated water authority prior to 1989. In the United States, Thames Water has 880 employees staffing operations or offices in Houston; Pittsburgh; Cincinnati; Westfield, New Jersey and Puerto Rico.

III. DESCRIPTION OF THE TRANSACTION AND ITS IMPACT ON ARIZONA-AMERICAN.

Q11. Please describe the transaction contemplated by the Agreement.

A11. Under the Agreement, Arizona-American's parent, AWW, will merge with a corporate shell entity, Apollo Acquisition Company, which is a direct or indirect subsidiary of Thames Holdings and which has been created solely to accommodate the acquisition of AWW. After the transaction, AWW will be the surviving corporate entity and a wholly owned indirect subsidiary of Thames Holdings. Holders of AWW common stock prior to the transaction will have their shares converted into the right to receive $46 per share in cash. The Agreement requires American to redeem, prior to the closing of the transaction, each outstanding share of Preferred Stock at a redemption price of $25.25 per share, plus full cumulative dividends thereon, and each outstanding share of Preference Stock at a redemption price of $25.00 per share, plus full cumulative dividends thereon. Arizona-American will continue to be the operating public service corporation or utility providing water utility service under this Commission's jurisdiction in the Arizona service areas where it is presently authorized to do so. Arizona-American will also continue to be a wholly owned subsidiary of AWW as it is today.

Q12. Will there be a change in management of Arizona-American as a result of the transaction?

A12. No. Operational control of Arizona-American after the transaction will remain as it is today. We recognize that water utility service by its nature is a local business that cannot be properly managed from a great distance. The transaction will not result in changes to the existing management and officers of Arizona-American that would not otherwise have occurred. However, Thames Water has extensive experience managing water and wastewater operations throughout the world and, as I'll discuss in just a moment, it does expect to provide the benefit of this experience to the capable AWW and Arizona-American management.

Q13. Please describe the impact of the proposed transaction on employees of Arizona-American.

A13. Without limiting the discretion of Arizona-American's executives to manage their employees, Thames does not anticipate any reduction of employees attributable to the transaction. Accordingly, no changes in local staffing, compensation or the value of benefits are anticipated to result from the transaction.

Q14. Please describe the impact, if any, on rates paid by Arizona-American's customers caused by the proposed transaction.

A14. The transaction itself will not result in any increase in rates. Arizona-American will continue to operate under its approved tariffs and rate structures. There are no contemplated changes in the income statement, balance sheet or financial position of Arizona-American as a result of this transaction. None of the outstanding debt owed and recorded as liabilities on the books of Arizona-American will be affected by the transaction. No request will be made to recover the acquisition premium or any costs associated with the transaction, nor will there be any use of "push down" accounting to attempt to pass such costs to Arizona-American for recovery in rates. Finally, the transaction will not cause there to be an additional layer of management overhead allocated to Arizona-American.

Q15. Please describe how the transaction will affect the day-to-day operations of Arizona-American and its ability to provide reliable service at reasonable rates.

A15. Thames Water has committed to use current Arizona-American management. Operational control of the company will remain as it is today. The transaction will not cause the relocation of any of the current Arizona offices. Following the transaction, Arizona-American will continue to provide high quality water service that meets or exceeds this Commission's regulatory requirements. Additionally, Thames Water is committed to ensuring that Arizona-American will maintain an adequate level of capital investment and best operating practices to ensure safe, reliable service at reasonable rates.

IV. THAMES' RATIONALE FOR THE TRANSACTION.

Q16. Please describe the rationale behind Thames Holdings desire to acquire AWW.

A16. As the third largest provider of water and wastewater services in the world, Thames identified North America as a market in which it should have a larger presence and desires to grow its business here. The AWW system is attractive for its potential for future growth, operations in 27 states and three Canadian provinces serving approximately 15 million people and the fact that AWW and its subsidiaries are well managed. Accordingly, the acquisition of AWW represents an excellent opportunity to substantially increase Thames Water's presence in North America consistent with its philosophy of delivering quality service to its customers.

V. BENEFITS OF MERGER FOR ARIZONA-AMERICAN'S RATEPAYERS.

Q17. Can you provide some examples of the benefits achievable through the acquisition?

A17. Certainly. As discussed in Staff witness Reiker's testimony, one major area of benefit is the lower cost of capital that RWE enjoys as compared to American Water Capital Corporation ("AWCC"), a subsidiary of AWW that is presently Arizona-American's source of debt capital. The higher credit ratings for RWE as compared to those of AWCC offer a rate differential that will impact positively the cost of capital in the future. The transaction will also for the first time make available to AWW and Arizona-American access to international capital markets. Quantification of these benefits is difficult because of the various maturity dates of existing debt, uncertainty concerning future levels of capital expenditures and how much will be financed by debt, ever-changing interest rates and potential future changes in credit ratings. But, each of these elements will have a positive impact on Arizona-American and its ratepayers.

Q18. Are there other benefits that the transaction can be expected to produce?

A18. Yes, several. Arizona-American also stands to benefit from the combination of the best practices of both the AWW system and those of Thames Water. In terms of customer support and service, we anticipate that Arizona-American customers will benefit in those instances where this partnership delivers the economies and efficiencies that are inherent when two industry leaders share such practical knowledge and experience. These benefits include the following:

Security

Since the tragic events of September 11th, a renewed emphasis on security has been underway throughout the AWW system and AWW has been reviewing the security measures in place throughout its system. Thames Water, with water operations around the globe, has considerable experience in operating water facilities and systems in regions where security concerns have been a fact of life for some time. For example, Great Britain has been subject to threat by IRA factors for decades and by Middle

Eastern terrorists since the Gulf War. Arizona-American's customers will benefit from the sharing of Thames Water's experience in developing and implementing comprehensive security measures to protect its customers and employees throughout the world.

Environmental Matters

Both companies recognize the importance of conducting their operations in an environmentally compatible manner. AWW and its subsidiaries have a strong environmental track record that will be further enhanced through their association with Thames Water. AWW consistently achieves outstanding records of annual compliance with federal and state regulations. AWW's subsidiaries have received 47 awards from the US Environmental Protection Agency Partnership for Safe Water. Thames Water is also committed to environmental protection. Numerous Thames Water sites have received the internationally recognized ISO 14001 Environmental Standard. Thames Water also works with and supports a wide range of environmental and conservation groups internationally, in part by voluntarily conducting surveys that will assist these groups in implementing biodiversity protection projects. Additionally, Thames Water utilizes "green energy" with seventeen combined heat and power plants running bio-gas and two sludge-powered generators. The transaction will allow AWW and Thames Water to join together to continue to enhance environmentally-friendly service for the company's customers.

Service Standards

In the area of service standards, AWW has earned an enviable reputation throughout the United States. It maintains its facilities in superior condition and the company continues to ensure safe, reliable and high-quality service to its customers through capital investment in its infrastructure. Similarly, Thames Water is committed to excellence in its water quality and service standards throughout the world. Thames Water's track record of compliance with drinking water standards in the UK is now 99.89%, while wastewater effluent compliance is 99.99%. Since privatization in 1989, Thames Water has invested in excess of $6 billion in enhancing the quality of its service, including construction of an advanced water treatment system and major renovations of water mains and sewage treatment works. Throughout its system, Thames has established numerous programs to improve the quality of its service, including cost-optimized network renewal and refurbishment and the development of ultra-violet disinfection of drinking water. Thames Water has every intention of maintaining the high quality service that has come to be expected of the AWW system.

Customer Service

For many years, both companies have demonstrated their strong commitment to customer service and responsiveness. AWW recently opened a state-of-the-art Customer Service Center in Alton, Illinois to assist its customers 24 hours a day. Likewise, Thames Water also has a 24-hour Customer Service Center that has won the UK Utility Industry Achievement Award for Excellence three years in a row. For example, one of the key customer service issues facing the utility industry is integration between the call center and the field service functions. Thames Water has developed and implemented an integrated approach to service management inquiries by installing the latest information technology for mobile field applications. This provides a direct, real-time link between the system in use in the Customer Service Center and the technicians in the field. This real-time connection delivers critical GIS, work management system data. The customer benefits from this arrangement by having problems ascertained, analyzed and addressed by field personnel in a more accurate and efficient manner. This new system results in a much more professional and problem-free service and reduces the need for customers to make repeated calls to different parts of the organization. AWW will take advantage of Thames Water's experience to consider implementing a similar service, if cost justified. Together, these two quality corporations will continue their commitment to enhancing customer service by utilizing the best practices of both organizations.

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Research and Development

In the area of research and development, AWW and Thames Water are both recognized industry leaders. But, the pooling of our collective expertise will make the combined entity a world leader in this area. Notably, Thames Water has an annual research and development budget of $13 million and a research staff of approximately 100 scientists, engineers and information technology professionals. Thames Water has developed cutting-edge technologies in all areas of transmission and distribution. In addition, Thames Water has a technological focus on alternative treatment solutions such as desalination and water reuse projects. This experience will be invaluable in helping Arizona-American meet future challenges and in reducing future capital expenditures as Arizona-American's infrastructure ages. After the transaction, Arizona-American's ability to access Thames' Knowledge Management network will provide information and expertise that Thames has already acquired.

Community Service

The transaction will positively impact community development in the areas served by Arizona-American. Thames Water, RWE and AWW all share a long history of service in the communities where they operate. For AWW financial contributions to the community are usually focused on environmental programs, as well as on initiatives that support the next generation of community leaders. Thames Water, as well, has a long track record of investing in local communities, particularly in support of the environment and extra-needs customers. For example, Thames Water supports its employees' involvement in community groups through a payroll program called "Give as you Earn." In this program, Thames Water matches up to $3,000 in charitable contributions raised by teams of employees. Additionally, RWE participates in numerous community-oriented projects around the globe and it sponsors a variety of projects in areas ranging from promoting arts and culture to programs modernizing the water infrastructure in developing countries. Companies such as AWW, RWE, and Thames Water understand that a good reputation must be earned.

They also understand that it takes a great deal of work and commitment to maintain such reputations. Clearly, the philosophy of corporate responsibility resides at the core of the RWE, Thames Water and AWW cultures and this philosophy will continue.

VI. EFFECT OF THE TRANSACTION ON THE FINANCIAL, TECHNICAL AND MANAGERIAL ABILITY OF ARIZONA-AMERICAN TO OPERATE ITS UTILITY SYSTEM.

Q19. Please summarize the effect this transaction will have on the financial, technical and managerial ability of Arizona-American to continue to operate its utility facilities.

A19. As I've discussed, the current employees and management of Arizona-American will continue in their present positions. This group has proven over many years the ability and commitment to provide high quality service to the public. With the addition of Thames Water's broad experience in all areas of water treatment, customer service and management, Arizona-American will be able to take advantage of these valuable resources, which have led to Thames Water being a world-wide leader in water treatment and distribution technology. From a financial perspective, Arizona-American will have the backing of a company with higher credit ratings and access to a large capital resource pool. This will allow Arizona-American to better adapt to changing economic conditions and reduce risks that it might otherwise face.

Q20. Does this conclude your testimony?

A20. Yes, it does.

CURRICULUM VITAE **EXHIBIT JM-1**

Name: McGIVERN James

Profession: Solicitor/Managing Director Nationality: British
Discipline: Commercial/Financial Date of Birth: 1/3/1965
Specialisation: Business/Operational Affairs
Years of Relevant Experience: 14 years

A. Academic & Professional

Qualification:

1986-1987 Qualified as Solicitor of Supreme Court of England and Wales
College of Law Chancery Lane London
1983-1986 Law (LLB Hons) Degree 2:1
University of Reading (1983 - 1986)

Overseas Experience: Business Experience of water and wastewater projects in Asia, Europe and the Americas. From both a UK base and Australian base.

Experience Record:

1991 to date Thames Water Plc - London

2001 to date Managing Director - Americas

After a transitional period of acting as sole managing director of Thames Water's international business, has recently been appointed as Managing Director of all of Thames Water's business interests in North and South America. This includes accountability for profit and loss, strategy, regional corporate development and operational performance. The post is located in the USA.

1999 to 2001 Managing Director - International Business Development

Responsible for International business and corporate development within Thames Water Plc, including the management of all mergers and acquisitions, overseas development and the co-ordination of the work undertaken by Thames Water's country directors. Key accountability is to develop and close opportunities for growth in those countries identified as strategically important for the Thames Water Division.

1997 - 1999 Commercial Director - Thames Water Plc

Head of multi-disciplinary commercial team (legal, financial, bid managers) with responsibility to support business development activities of all Thames Water Group Companies, both in the UK and Internationally. Specifically focused on leading the management and approval of all external tenders.

1994 - 1997 Head of Commercial Legal Services (International)

Responsible for key legal and related risk management issues for Thames Water's international business activities worldwide. Head of legal team involved in all international contracts.

1991 - 1994 Commercial Lawyer Thames Water Group

Part of legal team responsible for all legal aspects of non-regulated business (Products, Services, Contracting) in both UK and international with primary focus on International contracts, UK contracting, and Products business.

1989 - 1991 Michell Sillar - Sydney
Solicitor (Commercial)

Solicitor in medium sized Sydney commercial legal practice, dealing with a whole range of commercial legal issues from mergers and acquisitions to regulatory and competition issues.

1987 - 1989 Denton Hall - London
Solicitor (Commercial and Banking)

Solicitor in large London legal practice specialising in Commercial and Banking matters, responsible for legal advice to mainly Blue Chip clients ranging from UK footsie 100 companies to International banks. Areas of expertise included M&A, structured lending, commercial transactions.

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REBUTTAL TESTIMONY

OF

B. KENT TURNER

July 29, 2002

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REBUTTAL TESTIMONY

OF

B. KENT TURNER

I. <u>INTRODUCTION</u>

Q1. Please state your name and business address.

A1. My name is B. Kent Turner. My business address is 303 H Street, Chula Vista, CA 91910.

Q2. Please briefly describe your educational background and degrees held.

A2. I graduated from Lincoln University of Missouri, Jefferson City, Missouri in 1975 with a Bachelor of Science Degree in Accounting. In addition, I hold a Master of Science Degree in Taxation from Fontbonne College in St. Louis, Missouri. I became a Certified Public Accountant in 1981 and am licensed to practice in the State of Missouri.

Q3. Briefly describe your positions with the American Water System.

A3. I am Vice President-Finance and Chief Financial Officer of the Western Region of American Water Works Service Company. I am also Vice President and Treasurer of Arizona-American Water Company ("Arizona-American"). I have been with the American Water System for three years. Prior to assuming my present positions, I was Comptroller of the Western Region. The Western Region consists of water and wastewater utilities located in California, Arizona, Hawaii, New Mexico, and Texas, including Arizona-American.

Q4. What was your work history before joining the American Water System?

A4. Prior to my employment with the American Water System I held numerous positions with the Continental Water Company (CWC) group, which was acquired by American Water Works Company. These positions included Senior Vice President of Business Affairs of St. Louis County Water Company (SLCWC), the largest CWC holding; Vice President of Rates and Regulations of SLCWC; Manager of Corporate Accounting of SLCWC; Controller of Missouri Water Company, and Accounting Manager of CWC, to name the most significant. In total, I have 26 years of experience in the utility industry, including three years with the Missouri Public Service Commission, holding the position of Accounting Manager of the St. Louis Office at the time I left the Missouri Commission's employ.

Q5. What are your primary responsibilities in your present position at Arizona-American and American Water Works' Western Region?

A5. I am responsible for the direction and oversight of all regulatory, finance, accounting, and information systems activities within each jurisdiction as well as many other administrative functions.

Q6. Have you previously testified before any regulatory agencies?

A6. Yes. I have testified before the Missouri Public Service Commission on numerous occasions in connection with general rate case proceedings and administrative procedural matters, and I have appeared before a number of other regulatory and municipal government agencies.

Q7. What is the purpose of your testimony in these proceedings?

A7. The principal purpose of my testimony is to address certain issues raised in the Direct Testimony of Darron W. Carlson, Joel M. Reiker and John A. Chelus, dated July 8, 2002, filed on behalf of the Utilities Division ("Staff") of the Arizona Corporation Commission ("the Commission"). I will also provide background on Arizona-American and the subject stock transaction. I will begin by providing background on Arizona-American, the applicant in this proceeding, and American Water Works Company, Arizona-American's shareholder (Part II). I will next address the stock transaction that is the subject of the application and the parties to that transaction (Part III). I will then discuss Arizona-American's application and the relief being sought, and discuss the position of the Staff, as set forth in Staff's direct testimony (Part IV). Finally, in the concluding portion of my testimony, I will specifically address the conditions proposed by Staff and set forth revised conditions that Arizona-American proposes and which are intended to address the Company's concerns with Staff's recommended conditions. (Part V).

Arizona-American is also submitting rebuttal testimony from James McGivern. Mr. McGivern is the Managing Director-Americas of Thames Water PLC. He will provide additional background on the transaction and its implications and benefits for Arizona-American and its customers.

II. BACKGROUND ON ARIZONA-AMERICAN AND AMERICAN WATER WORKS COMPANY

Q8. Before addressing the Staff's direct testimony, please provide a brief summary of Arizona-American.

A8. Arizona-American is an Arizona corporation that was incorporated in 1949. For many years, Arizona-American provided water utility service in portions of the Town of Paradise Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. At that time, Arizona-American was named Paradise Valley Water Company. The Company's name was changed to Arizona-American Water Company in January 2000.

Arizona-American's common stock was purchased by American Water Works Company, Inc. ("AWW") in the late 1960s. Since that time, Arizona-American has been a wholly-owned subsidiary of AWW and, as I indicated above, has been part of the AWW Western Region. In January 2002, Arizona-American completed the acquisition of the water and wastewater utility systems and assets of Citizens Communications Company in Arizona. At present, Arizona-American provides water and wastewater utility services to approximately 140,000 customers in Maricopa, Mohave and Santa Cruz Counties.

Q9. Please provide a brief overview of AWW and its business activities.

A9. AWW is a Delaware corporation, whose headquarters is located in Voorhees, New Jersey. AWW, through its regulated and unregulated subsidiaries, has a business presence in 27 states and three Canadian provinces. AWW has operating utility subsidiaries that provide water and/or wastewater services to more than 15 million people in 23 states, including Arizona-American. In addition, AWW has a number of subsidiaries that are engaged in non-regulated business activities, including American Water Services, whose business focuses on providing contract operating and management services to municipal, industrial and military clients; American Water Resources, which offers water and wastewater-related products and services; American Water Works Service Company, Inc., which provides various professional services (e.g., accounting, administration, engineering, human resources, risk management and water quality services) to AWW subsidiaries; and American Water Capital Corp., which provides debt capital and financial management services to AWW and its utility subsidiaries. A complete list of AWW's subsidiaries is attached at Tab A.

Q10. Does AWW conduct utility operations in Arizona?

A10. No. AWW does not provide any utility services in Arizona, nor does AWW engage in other business activities in Arizona.

Q11. Are AWW's shares of common stock publicly traded?

A11. Yes. At the present time, AWW has approximately 100 million shares of common stock that have been issued and are outstanding. Those shares are publicly traded on the New York Stock Exchange (trading symbol "AWK").

III. SUMMARY OF THE APPLICATION AND UNDERLYING TRANSACTION

Q12. Mr. Turner, are you familiar with the application that was filed on December 17, 2001, in Docket No. W-01303A-01-0983 by Arizona-American?

A12. Yes. I verified the application on behalf of Arizona-American. The application requests that the Commission waive compliance with the requirements of A.A.C. R14-2-801, et seq. ("the Affiliated Interests Rules") for Arizona-American and its affiliates with respect to a pending transaction involving AWW and AWW's shareholders. The application also requests, in the alternative, that the Commission issue an order declaring that this transaction is not subject to the Affiliated Interests Rules and does not require Commission review and approval.

Q13. Is a true and correct copy of the December 17, 2001, application which you verified attached to this rebuttal testimony?

A13. Yes, the application is reproduced at Tab B.

Q14. Please summarize the transaction that is the subject of the application.

A14. The transaction, which is described on pages 3-4 of the application, concerns an agreement made by AWW with RWE AG, a company organized under laws of the Federal Republic of Germany ("RWE") and Thames Water Aqua Holdings GmbH, a company organized under the laws of the Federal Republic of Germany and a wholly-owned subsidiary of RWE ("Thames Holdings"), under which all of the outstanding shares of AWW will be acquired by Thames Holdings or a wholly owned subsidiary of Thames Holdings. A copy of the agreement made by AWW with RWE AG ("the Agreement") is attached as an exhibit to the application, reproduced at Tab B hereto.

Q15. Is Arizona-American a party to the Agreement?

A15. No. Neither Arizona-American nor any other subsidiary of AWW is a party. The transaction will not take place in Arizona and will not involve any company doing business in Arizona.

Q16. Have the shareholders of AWW approved the transaction?

Q16. The transaction was approved at a special meeting of the stockholders of AWW on January 17, 2002.

Q17. Will the transaction affect Arizona-American and its ability to provide safe and adequate utility service at a reasonable cost?

A17. No. The transaction will have no effect on Arizona-American's provision of utility service in Arizona. Following the transaction, Arizona-American will continue to be a wholly-owned subsidiary of AWW, which will continue to exist and become responsible for managing the joint operations of AWW and Thames Water in North, Central and South America. Likewise, the management of Arizona-American and its current relationship to AWW and other AWW subsidiaries will not change as a result of the transaction. Arizona-American will continue to exist as an Arizona corporation and it will continue to be subject to regulatory oversight by the Commission and other regulatory agencies in Arizona.

Q18. Will the transaction have any effect on Arizona-American's capital structure?

A18. No. Arizona-American will continue to have a capital structure, at the time of the stock acquisition, consisting of approximately 60 percent debt and 40 percent equity, as authorized in conjunction with the acquisition of Citizens' water and wastewater systems and assets in Commission Decision No. 63584 (April 24, 2001). The transaction will not cause AWW to assume any debt or other liabilities in connection with the transaction that might adversely impact Arizona-American.

Q19. Will any transaction costs or other expenses associated with the transaction be allocated to Arizona-American?

A19. No transaction costs or other expenses will be allocated to Arizona-American. Mr.

McGivern confirms this point in his rebuttal testimony.

Q20. Will the transaction cause any change in the manner in which Arizona-American will be operated?

A20. No, it will not. It has been AWW's policy and practice to have each utility subsidiary operate as a stand-alone corporate entity. The transaction will not alter this policy. There will not be any cross-subsidization of any affiliates, and any transactions with an affiliate will continue to be subject to the Affiliated Interests Rules and other regulatory requirements of the Commission.

Local and regional management will not change as a result of the transaction, nor will Arizona-American's relationship with AWW and other AWW subsidiaries change as a result of the transaction. Arizona-American will continue to exist as an Arizona corporation. Its headquarters will continue to be maintained in the Phoenix metropolitan area, and its books and records will continue to be available for review in this state.

Q21. Do you consider the transaction to be "transparent" with respect to Arizona-American and its customers?

A21. Yes, that's certainly one way to put it. This is a much different transaction than, for example, Arizona-American's acquisition of Citizens' water and wastewater systems last January. When that transaction closed, a new utility company was responsible for the management and operation of Citizens' water and wastewater systems in Arizona. In this case, in contrast, Arizona-American will continue to exist and be responsible for the management and operation of its water and wastewater systems. As far as customers and the Commission are concerned, nothing will change.

IV. REBUTTAL TO STAFF'S DIRECT TESTIMONY AND RECOMMENDATIONS

Q22. Mr. Turner, let's move on to the testimony filed by Staff relating to Arizona-American's application. As a preliminary matter, I first note that there seems to be an inconsistency between the title of the application used by Arizona-American and the title used by Staff. Would you address that discrepancy?

A22. Yes. In its various filings, Staff has been using the term "complete waiver" of the Affiliated Interests Rules, while Arizona-American has been using the term "limited waiver" in its filings. We have deliberately used "limited" in describing our application to signify that the waiver that is being requested would apply only to the acquisition of AWW's common stock by Thames Holdings, by means of the merger I have described above, and not to any other transaction that may be subject to the Affiliated Interests Rules. While this may seem to be a semantic difference, I believe it is important. As we have stated in our previous filings, Arizona-American will remain subject to regulation by the Commission, and the Affiliated Interests Rules will continue to apply to transactions between Arizona-American and any affiliates, as provided in R14-2-804. For this reason, we have been referring to the waiver request as being a request for a "limited waiver."

Q23. You previously testified that, in the alternative, Arizona-American is requesting a ruling from the Commission that the transaction is not subject to the Affiliated Interests Rules. Please summarize why Arizona-American believes that this particular transaction is outside of the agency's jurisdiction.

A23. Before answering your question, I want to emphasize that I am not an attorney, and I will let the attorneys argue the finer points of the Commission's jurisdiction. I can, however, summarize the factual points that have been made in our various filings that, based on my understanding, would support a finding of no jurisdiction in this particular case.

First, none of the parties to the agreement (AWW, Thames Holdings and RWE) are Arizona corporations and none of them are doing business in Arizona. In addition, none of the parties to the transaction is a "public service corporation." As I understand this term, only corporations and other entities (excluding municipal corporations) engaged in providing certain specified utility services to members of the public are "public service corporations." None of the parties to the transaction are in the business of furnishing utility service in Arizona.

It is my understanding that the Commission does not regulate the sale or other transfer of stock that is issued and outstanding. A share of stock is property that is owned by the stockholder, who has the right to sell his or her stock on the market. This transaction is essentially a stock sale, under which the outstanding shares of AWW's common stock will be acquired by Thames Holdings or its wholly owned subsidiary. The stockholders of AWW have approved the transaction. The transaction is not an asset sale like Arizona-American's acquisition of Citizens' water and wastewater utility systems in Arizona, which must be approved under Arizona law.

Finally, it is my understanding that the Commission has previously acknowledged that it does not have authority to regulate transactions by foreign corporations engaged in interstate commerce. For example, in a recent decision involving PHASER Advanced Metering Services, Decision No. 61895 (Aug. 31, 1999), the Commission stated that if it attempted to exercise jurisdiction over the issuance of debt instruments and securities by entities engaged in multi-state business activities, such as Southwest Gas and Citizens, it would create an impermissible burden on interstate commerce in violation of the United States Constitution.

Q24. Have the Staff's witnesses addressed these points in their direct testimony?

A24. No. Staff witness Darron Carlson discusses Arizona-American's waiver request on pages 3-4 of his testimony, and Arizona-American's notice of intent to reorganize on pages 4-5 of his testimony, but does not address the basis for the Commission's assertion of jurisdiction over the transaction.

Q25. Let's move on and discuss Mr. Carlson's testimony concerning Arizona-American's alternative application for a waiver under R14-2-806 of the Affiliated Interests Rules. Does Mr. Carlson recommend approval of the waiver application?

A25. No. In his testimony, Mr. Carlson quotes from R14-2-806(A), which authorizes the Commission to "waive compliance with any of the provisions of [the Affiliated Interests Rules] upon a finding that such waiver is in the public interest." Mr. Carlson then indicates that Staff's interpretation of the term "public interest," as used in this regulation, requires that the transaction produce some sort of "benefit." Direct Testimony of Darron W. Carlson ("Carlson Direct") at 3. Mr. Carlson then testifies that Arizona-American failed to demonstrate any "measurable" or "quantifiable" benefit. Carlson Direct at 4. Although not expressly stated, Staff apparently believes that not only must a "benefit" be demonstrated, but the benefit must be "measurable" or "quantifiable." Notably, none of these terms appear in the regulation.

Q26. Does Mr. Carlson cite any authority for his interpretation of what is required under R14-2-806(A)?

A26. No. This appears to be a new standard that is being applied to Arizona-American.

Q27. Do you agree with Mr. Carlson that the transaction fails to generate any sort of benefit?

A27. No. I respectfully disagree. RWE and Thames Holdings have a substantially larger market capitalization than that available at the present time to Arizona-

American through AWW and American Water Capital Corp., and therefore have greater equity and debt financing capability. Moreover, RWE can raise capital in the European markets as well as in the United States domestic market. At present, AWW and American Water Capital Corp. do not have ready access to the European capital markets. Staff witness Joel M. Reiker, in his direct testimony, recognizes that the transaction is likely to result in certain financial benefits to Arizona-American, including improved access to capital markets. Mr. Reiker notes that multi-national corporations can enjoy reduced flotation costs due to their relatively large issues of stocks and bonds, and may receive preferential treatment from creditors, thereby reducing the cost of capital. Direct Testimony of Joel M. Reiker ("Reiker Direct") at 2-5.

Q28. However, Mr. Reiker also notes that these benefits cannot be quantified at the present time.

A28. I don't disagree with Mr. Reiker. Nevertheless, we believe that the benefits associated with being part of a substantially larger, multi-national corporation with diversified business operations throughout the world will ultimately translate to reductions in the cost of capital, particularly in regard to future debt financing. While we can't quantify the extent of those benefits at this time, these benefits are real, as Mr. Reiker recognizes in his testimony.

Even if Staff's interpretation of the term "public interest" is accepted, I am not aware of any authority for requiring that benefits be immediately "quantifiable." The bottom line is that Arizona-American will become part of a much larger, financially stable business organization, which currently has approximately than 170,000 employees worldwide and annual revenues of nearly $60 billion. Mr. McGivern also discusses several other security and service related benefits for AWW associated with the transaction. AWW and its subsidiaries, including Arizona-American, will benefit by becoming part of an organization with significant experience, capital resources, greater economies of scale and additional opportunities for business growth.

Q29. Can you identify any other benefits as a result of the transaction?

A29. Yes, the transaction will generate a substantial benefit to the shareholders of AWW. As I previously explained, there are approximately 100 million shares of AWW common stock that are issued and outstanding, and are publicly traded on the New York Stock Exchange. This transaction will reward shareholders for their investment in and support of AWW. The per-share price that will be paid by Thames Holdings represents a premium of approximately 35 percent above the closing share price at the time the transaction was announced, and a premium of approximately 29 percent above the highest all-time closing price of AWW's common shares. I believe that if a transaction is neutral in terms of its impact on the local utility and the quality of service it provides, as in this case, while providing substantial benefits to the utility's shareholders, the transaction is indeed in the public interest. We believe the Commission has an obligation in regulating utilities that are subject to its jurisdiction to consider the interests of the utility and its shareholders in addition to the interests of the utility's customers, and to balance those interests in setting rates and performing other regulatory functions.

Q30. Are there AWW shareholders in Arizona?

A30. Yes. As of June 21, 2002 there were 375 shareholders of AWW stock with addresses in Arizona holding 100,936 shares. This does not include the Arizona shareholders whose stock would be in a broker's account with an address in New York or some other state. 100,936 times $46 per share is $4,643,056 worth of direct benefit to Arizona citizens.

Q31. Has Staff recommended that the transaction be disapproved by the Commission?

A31. No. In his testimony, Mr. Carlson goes on to address Arizona-American's notice of intent to reorganize, which was filed in this docket on April 22, 2002, and he recommends, on behalf of Staff, that the transaction be approved subject to 15 conditions. Carlson Direct at 5-8.

Q32. Please explain why Arizona-American filed an amendment to its original application.

A32. Arizona-American amended its application at the request of Staff in order to provide the information required for the reorganization of a public utility holding company set forth in R14-2-803(A). Arizona-American does not believe that the transaction is subject to this regulation. However, the Company wanted to cooperate with Staff, and viewed the amendment as an opportunity to provide additional information that would support approval of the application. In addition, Arizona-American wanted to make certain that it covered all possible avenues: (1) the finding of no jurisdiction, (2) a limited waiver of the Affiliated Interests Rules pursuant to R14-2-806, or, in the alternative, (3) approval pursuant to R14-2-803.

Q33. What are the requirements for approval of the reorganization of a public utility holding company under R14-2-803?

A33. In summary, the regulation requires that a utility intending to organize or reorganize a public utility holding company provide notice to the Utilities Division (i.e., Staff) at least 120 days prior to the effective date of the organization or reorganization. Subpart (A) of the regulation sets forth certain information that must be provided to Staff with the notice. Within 30 days of its receipt of the notice of intent, Staff must notify the utility if it has any questions or requires additional information. Within 60 days, the Commission determines whether a hearing is necessary.

Q34. What is the standard by which the Commission acts in considering whether to approve the organization or reorganization of a public utility holding company?

A34. Subpart (C) authorizes the Commission to reject the proposal on three specific grounds:

(1) The transaction would impair the financial status of the public utility, i.e., Arizona-American;

(2) The transaction would prevent the public utility from attracting capital at fair and reasonable terms; or

(3) The transaction would impair the ability of the public utility to provide safe, reasonable and adequate service.

The regulation provides a "no harm" standard. If the reorganization would be neutral as far as the local utility is concerned, there would be no basis for the Commission to reject the proposed reorganization.

Q35. Does R14-2-803 require any sort of affirmative showing that the reorganization would be in the "public interest" or provide a "benefit"?

A35. No. As I testified above, subpart (C) authorizes the Commission to reject the proposed reorganization only if it finds that one of the three grounds I listed above are present.

Q36. Does Staff recognize that the three grounds you have described are the basis on which determinations are made under R14-2-803?

A36. Yes. Mr. Carlson quotes the grounds found in subpart (C) on page 5, lines 15-18 of his direct testimony. Neither Mr. Carlson nor any other Staff witness testifies that there are other criteria applicable to a notice of intent to reorganize under R14-2-803.

Q37. Does Staff maintain that the transaction "would impair the financial status of the public utility"?

A37. No.

Q38. Does Staff believe that the transaction would prevent Arizona-American "from attracting capital at fair and reasonable terms"?

A38. No. Staff, in fact, acknowledges that the transaction is likely to result in increased access to capital markets and potentially higher bond and credit ratings. Carlson Direct at 5; Reiker Direct at 3-5.

Q39. Does Staff believe that the transaction would "impair the ability of the public utility to provide safe, reasonable and adequate service"?

A39. No. The Staff engineering witness, John Chelus, testifies that he foresees no adverse impact as a result of the transaction that would impair the ability of Arizona-American to provide safe, reasonable and adequate service. Direct Testimony of John A. Chelus at 4.

Q40. It appears then that Staff agrees that there are no grounds to reject the proposed transaction under R14-2-803.

A40. That is correct. None of the criteria for rejecting the proposal are present in this case.

V. <u>ANALYSIS OF STAFF'S RECOMMENDED CONDITIONS AND ARIZONA-AMERICAN'S PROPOSED REVISED CONDITIONS</u>

Q41. After Staff filed its testimony, did Arizona-American and Thames representatives meet with Staff?

A41. Yes, we did. Several of the conditions suggested by Staff were acceptable, but others required clarification or revision. Attached as Exhibit C are the revised conditions which we have proposed as an alternative to Staff's recommended conditions. Although we continue to believe that the Commission either doesn't have jurisdiction over the transaction or should grant a limited waiver, its approval of the transaction with these revised conditions would be acceptable to Arizona-American.

Q42. Please briefly discuss the conditions where no or very little change in wording was made.

A42. Conditions 1, 2 and 4, dealing with recovery of costs associated with the stock purchase are entirely consistent with the manner in which transaction costs and the premium paid for the stock will be handled as Mr. McGivern and I have testified. Similarly, conditions 6 and 7 confirm that the transaction will not adversely impact service levels. Regarding Conditions 9 and 10, having confirmed with Staff that the conditions would not impact existing billing and information arrangements we have with the City of Surprise and its police department, we can agree to those conditions. Finally, Condition 14 is consistent with Arizona-American's position that its debt and equity costs should be judged on a stand-alone basis.

Q43. Please discuss the changes proposed by Arizona-American with respect to Conditions 12 and 13.

A43. As we've discussed, the transaction will have no impact on Arizona-American's debt/equity ratio and, for the foreseeable future, we believe that the ratio set forth in Condition 12 is sound. But, conditions and philosophies concerning appropriate capital structures can and do change. The revised Condition 13 simply clarifies that we may seek different debt/equity ratios in future cases. As to Condition 13, Staff's original proposal would have required Arizona-American to guarantee forever a particular credit rating. Obviously credit ratings can be affected by a variety of different factors, some of which are beyond the control of the utility. For example, ratings may be impacted by changes in regulatory standards, such as new or more stringent requirements imposed under the Safe Drinking Water Act. As revised, however, Condition 13 does commit to the stated standards for any rate proceedings filed within three years of the reorganization.

Q44. In the revised conditions, Condition 8, as originally proposed by Staff has been changed somewhat. Please describe the reason for that change.

A44. Because of the recent acquisition of Citizens' properties, Arizona-American is in the process of making certain operational and office changes. We will continue to have local headquarters and field offices, but their precise locations may change or be consolidated. The revised Condition 8 confirms that commitment but also gives us flexibility to make adjustments that make sense.

Q45. Please discuss the proposed revisions to Condition 3.

A45. As revised, Condition 3 confirms Arizona-American's compliance commitment with the Affiliated Interest Rules and also requires us to produce in Arizona the books and records of any affiliate with which we transact business.

Q46. Turning now to the remaining three Staff recommended conditions that Arizona-American felt would be detrimental to Arizona-American, please identify those conditions and explain Arizona-American's proposed revised conditions.

A46. The first condition was Condition 15, which would have required that Arizona-American refrain from filing for non-emergency rate increases for one year from the closing date of the reorganization. Initially, we were concerned that this condition may impair the financial status of Arizona-American, which would be contrary to the criteria set forth in R14-2-803(C). The reason for this impact is that, as I previously testified, Arizona-American recently completed the acquisition of Citizens' water and wastewater systems in Arizona. That transaction closed in January 2002. We are in the process of evaluating financial data for each of the systems that were acquired. However, our preliminary evaluation suggests that several of these systems currently have a negative net income and are earning anemic rates of return on their fair value rate bases. This situation is not altogether surprising. None of the Citizens systems have received any recent rate increases. Citizens Agua Fria Water Division, Sun City Water Company, Sun City Sewer Company, Sun City West Utilities Company and Tubac Valley Water Company last received rate increases in May 1997 based on test years ending March 31,

1995. Decision No. 60172 (May 7, 1997). Citizens Mohave Water and Wastewater Divisions last received rate increases in February 1990, based on test years ending March 31, 1988. Decision No. 56806 (Feb. 1, 1990). Likewise, Havasu Water Company last received rate increases in February 1992, based on a test year ending December 31, 1990. Decision No. 57743 (Feb. 21, 1992).

In the annual reports that were filed by Citizens with the Utilities Division earlier this year, for the twelve-month period ending December 31, 2001, Citizens reported that a number of its systems had a negative net income:

Name of System	Net Income Reported by Citizens
Citizens Water Resources Company	($1,910,682)
Havasu Water Company	($10,145)
Sun City Water Company	($3,153,228)
Sun City Sewer Company	($797,788)
Sun City West Utilities (water only)	($4,539,417)
Sun City West Utilities (sewer only)	($499,137)
Tubac Valley Water Company	($92,942)

The foregoing amounts are taken directly from the annual reports filed by Citizens.

Q47. Is Arizona-American presently evaluating the need to file applications for rate increases for some or all of the Citizens systems and, if so, where does that evaluation currently stand?

A47. We are in the process of assembling and reviewing the data necessary to complete rate applications for all the former Citizens systems in Arizona, based on the Commission's filing requirements, and we expect to complete that analysis in the very near future. Although our analysis is not complete, the preliminary results indicate that rate relief will be necessary.

Q48. Does the revised Condition 15 address this concern?

A48. Yes. The revised condition would not preclude Arizona-American from filing for rate relief before the closing date of the reorganization. Therefore, if, as I suspect will be the case, our evaluation demonstrates that rate relief is necessary, Arizona-American will be able to file for rate relief prior to that date.

Q49. What other conditions proposed by Staff did Arizona-American view as problematic?

A49. Condition 11 provided that Arizona-American "shall not use utility assets for any unregulated activity without prior Commission approval." As written, the Company was concerned that this condition would directly interfere with the existing contracts that Arizona-American assumed responsibility for in connection with its acquisition of Citizens utility operations in Arizona. In Maricopa County, these contracts include a contract with the City of Surprise governing the operation and maintenance of that municipality's water distribution system and the provision of billing services; an operating agreement with the Town of Cave Creek, under which Arizona-American operates Cave Creek's wastewater treatment plant; an agreement with Quintero Golf and Country Club under which Arizona-American operates a water pumping station located adjacent to the Central Arizona Project canal; and an agreement made with the Utilities Division under which Arizona-American has been acting as interim manager of Sabrosa Water Company. In addition, Arizona-American has the following contracts in Mohave County: Sun Lakes Village Homeowners Association, under which Arizona-American operates and maintains the association's wastewater treatment plant; Havasu Falls RV park, under which Arizona-American operates and maintains the facility's wastewater treatment plant; and is close to signing an agreement with Havasu Heights Domestic Water Improvement District, under which Arizona-American will operate and maintain the district's water system.

Q50. Does the revised condition proposed by Arizona-American address this concern?

A50. Yes. In reality, this is an accounting and recordkeeping issue that has nothing to do with the stock transaction that is the subject of Arizona-American's application. Therefore, under the revised conditions, Arizona-American must properly record revenues and expenses associated with providing such services, and in the context of a rate application, properly allocate utility assets between its regulated utility service and unregulated activities.

Q51. Arizona-American also had concerns over Condition 5, dealing with cost allocations and direct charges, correct?

A51. Yes. We were concerned that this condition could be detrimental to the company and to customers. At the present time, I am not aware of any cost allocations or other charges that will increase due to the acquisition of AWW's shareholders' stock by Thames Holdings. It is possible, however, that there may be additional costs or expenses that are allocated to Arizona-American in the future. Thus, under the revised conditions, rather than imposing a complete prohibition on future cost allocations and charges, the Commission would examine the basis for those cost allocations and other charges in the context of a rate proceeding to determine whether they are reasonable in amount and relate to services that are beneficial to the utility and to ratepayers. If Arizona-American meets its burden of demonstrating that such cost allocations are reasonable and provide a benefit to AAWC and/or its customers, they would be recoverable. I understand this is consistent with long-standing Commission policy.

Q52. Does that conclude your rebuttal testimony?

A52. Yes.

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SUBSIDIARIES OF AMERICAN WATER WORKS COMPANY, INC.

American Water Works Company, Inc.
American Water Capital Corp.
American Lake Water Company
American Water Resources, Inc.
AmericanAnglian Canada Company
American Water Services, Inc.
AAET, Inc.
AAET, L.P.
Azurix North America Corp.
Azurix North America (Canada) Corp.
Azurix North America Underground Infrastructure Corp.
Uniflo Sewer Services Inc.
Construction et Pavage Nord Americain Ltee
Canarehab Inc.
Azurix North America Engineering Corp.
Terratec Environmental Ltd.
Azurix North America Industrial Residuals Corp.
Prism-Berlie (Windsor) Limited
Uniflo Limited
Braemar Acres Limited
Trimax Residuals Management Inc.
Azurix North America Carbon Services Corp.
Horseshoe Carbons Incorporated
Rockcliffe Research Management Inc.
Azurix North America (USA), Inc.
Azurix North America Operations and Maintenance, Inc.
Azurix CDM, Inc.
Azurix North America Underground Infrastructure, Inc.
Magnolia Construction Company Inc.
National EnviroTech Group, LLC
Azurix North America Engineering, Inc.
Utility Management and Engineering, Inc.
Philip Automated Management Controls, Inc.
Azurix North America Residuals Management, Inc.
Trimax Residuals Management (USA), Inc.
Dittman-Merka Enterprises, Inc.
Walker Water Works, Inc.
Southwest Utilities, Inc.
Azurix Industrials Corp.
Azurix Industrial Operations Corp.
American Water Works Service Company, Inc.
Arizona-American Water Company
California-American Water Company
Connecticut-American Water Company
Hampton Water Works Company
Massachusetts-American Water Company
New York-American Water Company, Inc.
The Salisbury Water Supply Company
Hawaii-American Water Company
Indiana-American Water Company, Inc.
Illinois-American Water Company
Iowa-American Water Company
Kentucky-American Water Company
Long Island Water Corporation

SUBSIDIARIES OF AMERICAN WATER WORKS COMPANY, INC.
CONTINUED

Maryland-American Water Company
Massachusetts Capital Resources Company
Michigan-American Water Company
Missouri-American Water Company
New Jersey-American Resources Company
New Jersey-American Water Company, Inc.
New Mexico-American Water Company, Inc.
Ohio-American Water Company
Pennsylvania-American Water Company
Tennessee-American Water Company
Virginia-American Water Company
  United Water Virginia, Inc.
West Virginia-American Water Company
  Bluefield Valley Water Works Company

B

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF ARIZONA-AMERICAN WATER COMPANY, INC. FOR A WAIVER OF THE REQUIREMENTS OF A.A.C. R14-2-801, ET SEQ., AND RELATED RELIEF.	DOCKET NO. W-01303A-01-______ **APPLICATION**

Pursuant to A.A.C. R14-2-806, Arizona-American Water Company, Inc., an Arizona corporation ("Arizona-American" or the "Company"), hereby requests that the Arizona Corporation Commission (the "Commission") waive compliance with the requirements of A.A.C. R14-2-801, et seq. (the "Affiliated Interests Rules") for Arizona-American and its affiliates with respect to a pending transaction involving Arizona-American's parent, American Water Works Company, Inc. ("AWW"), and that corporation's shareholders. As explained below, none of the parties to this transaction are a "public service corporation," as such term is defined in the Arizona Constitution, and the transaction will have no effect on Arizona-American's provision of utility service. In the alternative, Arizona-American requests that the Commission promptly issue an order declaring that such transaction is not subject to the Affiliated Interests Rules and, therefore, may be consummated without Commission review and approval.

The nature of the transaction and the basis for the Company's requested relief are set forth hereinafter and have been verified by B. Kent Turner, a Vice President and the Treasurer of Arizona-American, in accordance with A.A.C. R14-2-806(B). For the reasons set forth below, such relief is appropriate under the circumstances herein and is in the public interest. Arizona-American therefore requests that such relief be considered and granted by the Commission within 30 days, as provided in A.A.C. R14-2-806(C).

<u>Overview of Arizona-American and Its Relationship with AWW</u>

1. Arizona-American is a public service corporation that presently provides water utility service to approximately 4,700 customers in portions of the Town of Paradise Valley, the City of Scottsdale and certain unincorporated portions of Maricopa County. During the 12-month period ending June 30, 2001, Arizona-American had revenues from its water utility operations of approximately $4.7 million. Consequently, Arizona-American is not currently classified as a "Class A" investor-owned utility.

2. Arizona-American and AWW have entered into an agreement with Citizens Communications Company, together with certain divisions and subsidiary corporations (collectively, "Citizens"), under which Arizona-American will acquire all of the water and wastewater plant and assets owned by Citizens in Arizona and immediately become responsible for providing water and wastewater utility services to Citizens' customers. The transfer of Citizens' plant and assets to Arizona-American was approved by the Commission in Decision No. 63584 (April 24, 2001). As a consequence of that acquisition, which is now expected to be completed within 45 days, Arizona-American's revenues from the provision of water and wastewater services will increase dramatically, causing Arizona-American to become a "Class A" utility. <u>See</u> A.A.C. R14-2-801(8) (definition of "utility" or "public utility"), A.A.C. R14-2-103(A)(3)(q) (definition of "utility").

3. Arizona-American is a wholly-owned subsidiary of AWW. AWW is the largest investor-owned water system in the United States, providing water, wastewater and other water resource management services to approximately 12 million people in 28 states and Canada. For the 12-month period ending June 30, 2001, AWW reported consolidated net plant of $5.1 billion and operating revenues of $1.38 billion. AWW does not provide utility service and does not

engage in any business activities in Arizona. AWW's common stock is publicly traded on the New York Stock Exchange.

4. AWW has utility subsidiaries in 23 states, 21 of which are subject to regulation by a state regulatory commission.[1] In addition to those subsidiaries, AWW also has several non-utility subsidiaries that are engaged in non-regulated business activities. These non-utility subsidiaries include American Water Services, whose business focuses on providing contract operating services to municipal, industrial and military clients, American Water Resources, which offers water and wastewater-related products and services, American Water Works Service Company, Inc. ("the Service Company"), which provides various professional services (e.g., accounting, administration, engineering, human resources, risk management and water quality services) to AWW subsidiaries, and American Water Capital Corp., which provides debt capital and financial management services to AWW and its utility subsidiaries. Other than Arizona-American, none of these AWW subsidiaries provides utility service in Arizona.

The Transaction Between AWW and RWE/Thames Holdings

5. On September 16, 2001, AWW entered into an agreement with RWE AG, a company organized under the laws of the Federal Republic of Germany ("RWE"), Thames Water Aqua Holdings GmbH, a company organized under the laws of the Federal Republic of Germany and a wholly-owned subsidiary of RWE ("Thames Holdings"), and Apollo Acquisition Company, a Delaware corporation and a wholly-owned subsidiary of Thames Holdings, under which all of the outstanding shares of AWW are subject to a purchase offer by Thames Holdings ("the Agreement"). A true copy of the Agreement is attached hereto and incorporated herein by this reference. Arizona-American is not a party to this agreement.

6. RWE is a leading international provider of electricity, gas, water, waste management and related services. Headquartered in Essen, Germany, RWE is Germany's fifth largest industrial corporation, with annual revenues in excess of $50 billion.

[1] In two states, Georgia and Michigan, private water companies are not regulated.

7. Thames Holdings is the parent of Thames Water PLC ("Thames"). Thames is a public limited corporation organized under the laws of the England and Wales with its principal office located in London. Thames operates all of the water business of Thames Holdings, and is one of the largest providers of water and wastewater services in the world. At the present time, Thames provides water and wastewater services to approximately 43 million people in 44 countries. It is the leading supplier of water and wastewater services in the United Kingdom, and presently operates E-Town Corporation, which provides water utility service to approximately one million people in New Jersey.

The Agreement and its Effect on Arizona-American

8. Under the terms of the Agreement, AWW will become a wholly-owned subsidiary of Thames Holdings by virtue of its merger with Apollo Acquisition Company, a Delaware corporation and wholly-owned subsidiary of Thames Holdings created for the sole purpose of implementing the Agreement. In conjunction with this merger, the assets and liabilities will be combined in the surviving corporation, AWW, and each outstanding share of common stock of AWW tendered will be acquired at a price of $46.00 per share.

9. The transaction will not have any impact on the existing management of AWW. The headquarters of AWW will remain at Voorhees, New Jersey, and the locations of, and the functions conducted at, AWW's regional offices will not change as a result of the transaction.

10. Arizona-American will not be affected by the transaction. Following the transaction, Arizona-American will continue to be a wholly-owned subsidiary of AWW and will continue to provide utility service to its customers in Arizona subject to the jurisdiction of the Commission and oversight by other regulatory agencies. Likewise, the management of Arizona-American and its current relationship to AWW and other AWW subsidiaries will not change as a result of the transaction.

Basis for Waiver

11. Based on the nature of the transaction described hereinabove and the lack of any impact on Arizona-American, its ownership and its jurisdictional operations, Arizona-American submits that, to the extent the Affiliated Interests Rules may apply to this transaction, a waiver of said rules is necessary and appropriate. As stated, Arizona-American will continue to exist as a wholly-owned subsidiary of AWW and will be subject to the Commission's jurisdiction following the transaction.

12. The transaction will have no effect on the capital structure of Arizona-American. Arizona-American will continue to have a debt/equity ratio of approximately 60%/40%, as authorized in conjunction with the acquisition of Citizens' plant and assets in Decision No. 63584.

13. It has been AWW's policy and practice to have each utility subsidiary operate as a stand-alone corporate entity. For example, in conjunction with setting rates and charges for service, Arizona-American's federal and state income taxes have historically been computed on a stand-alone basis. The transaction will not alter this policy.

14. The transaction will not cause any change in Arizona-American's cost of providing utility service. As stated, the transaction will not cause any change in the manner in which Arizona-American will be operated, and local and regional management will not change as a result of the transaction.

15. The transaction will not cause AWW's capital structure to change in any material respect. The transaction will not cause AWW to assume any debt or other liabilities in connection with the transaction that would adversely impact Arizona-American. Consequently, Arizona-American's ability to raise capital and its creditworthiness will not be impaired by the transaction.

16. As stated, Arizona-American's relationship with AWW and other AWW subsidiaries will not change as a result of the transaction. At present, the Service Company and

American Water Capital Corp. engage in business with Arizona-American. The Service Company provides accounting, administration, engineering, human resources, risk management, water quality and other services to Arizona-American, which services and the cost to perform them are subject to review by the Commission in the context of rate applications and similar proceedings. American Water Capital Corp. provides debt financing and cash management services to Arizona-American, which are subject to review and approval by the Commission under the Commission's authority to review and approve the issuance of bonds, notes and other debt instruments. See A.R.S. § 40-301, et seq. The transaction will not alter these relationships, nor will the transaction eliminate the Commission's existing regulatory oversight and approval authority.

17. The terms "reorganize" and the "reorganization" are broadly defined in R14-2-801(5) to include the "reconfiguration of an existing affiliate or utility's position in the corporate structure or the merger or consolidation of an affiliate or a utility." Thus, if literally applied, these definitions could conceivably subject the transaction between AWW and its shareholders and RWE and its affiliates to Commission review and approval under R14-2-803. Arizona-American respectfully submits that the Commission's jurisdiction over Arizona-American's utility operations does not permit the Commission to disapprove or otherwise regulate transactions of this nature, particularly given the lack of any adverse impact on Arizona-American's utility operations in this state. See, e.g., Arizona Corporation Comm'n v. Consolidated Stage Co., 63 Ariz. 257, 161 P.2d 110 (1945).

18. Arizona-American is fully cognizant of its responsibility to the Commission and its attendant obligations as a public service corporation to comply with the requirements of lawful regulation. Arizona-American, however, respectfully submits that its relationships with AWW and AWW subsidiaries, none of which will change as a result of the transaction, and the nature of the transaction between AWW and its shareholders and RWE and Thames Holdings are such that either the Affiliated Interests Rules do not apply or, in the alternative, the public

interest justifies a waiver of compliance with the requirements set forth in the Affiliated Interests Rules.

WHEREFORE, for the reasons set forth herein, Arizona-American hereby requests for itself and all affiliates of Arizona-American an order from the Commission that (i) declares that A.A.C. R14-2-801, et seq., do not apply or, alternatively, (ii) grants Arizona-American and its affiliates a waiver of compliance with A.A.C. R14-2-801, et seq., with respect to AWW's merger with Apollo Acquisition Company and the acquisition of AWW's outstanding shares of stock.

RESPECTFULLY SUBMITTED this 17th day of December, 2001.

FENNEMORE CRAIG, P.C.

By Norman D. James
Norman D. James
Jay L. Shapiro
Attorneys for Arizona-American Water Company, Inc.

FENNEMORE CRAIG
A PROFESSIONAL CORPORATION
PHOENIX

VERIFICATION

STATE OF ARIZONA)
) ss.
County of Maricopa)

B. KENT TURNER, being first duly sworn upon his oath, deposes and says:

1. I am a Vice President and the Treasurer of Arizona-American Water Company, Inc., an Arizona corporation, and am authorized to make this verification on behalf of the corporation.

2. I have read the foregoing Application and hereby verify that the statements contained therein are true and correct to the best of my knowledge and belief.

B. Kent Turner

SUBSCRIBED AND SWORN TO before me, the undersigned Notary Public, on this 4th day of December 2001.

Linda L. McKovich
Notary Public

My Commission Expires:

6/28/03

OFFICIAL SEAL
LINDA L. McKOVICH
Notary Public - State of Arizona
MARICOPA COUNTY
My Comm. Expires June 28, 2003

ORIGINAL and ten copies of the foregoing were hand-delivered for filing this 17th day of December, 2001, to:

Docket Control
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

COPY of the foregoing was hand-delivered this 17th day of December, 2001, to:

Christopher C. Kempley, Chief Counsel
Legal Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007

By: Mary L. [illegible]
1252012.1

EXECUTION COPY

AGREEMENT AND PLAN OF MERGER

Among

RWE AKTIENGESELLSCHAFT,

THAMES WATER AQUA HOLDINGS GMBH,

APOLLO ACQUISITION COMPANY

and

AMERICAN WATER WORKS COMPANY, INC.

Dated as of September 16, 2001

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AGREEMENT AND PLAN OF MERGER dated as of September 16, 2001, by and among RWE AKTIENGESELLSCHAFT, a company organized under the laws of the Federal Republic of Germany ("Guarantor"), THAMES WATER AQUA HOLDINGS GMBH, a company organized under the laws of the Federal Republic of Germany and a wholly owned subsidiary of Guarantor ("Parent"), APOLLO ACQUISITION COMPANY, a Delaware corporation and a wholly owned subsidiary of Parent ("Sub"), and AMERICAN WATER WORKS COMPANY, INC., a Delaware corporation (the "Company").

WHEREAS the Board of Directors of each of the Company and Sub has approved and declared advisable, the Supervisory Board of Guarantor has approved and deemed advisable, and the Managing Directors of Parent have approved and declared advisable, this Agreement and the merger of Sub with and into the Company (the "Merger"), upon the terms and subject to the conditions set forth in this Agreement, whereby each issued and outstanding share of Common Stock, par value $1.25 per share, of the Company (the "Company Common Stock") not owned by Parent, Sub or the Company, other than the Appraisal Shares (as defined in Section 2.01(d)), will be converted into the right to receive $46.00 in cash;

WHEREAS simultaneously with the execution and delivery of this Agreement, Parent and certain stockholders of the Company (the "Specified Company Stockholders") are entering into a voting agreement (the "Company Voting Agreement") pursuant to which the Specified Company Stockholders are agreeing to take certain actions in furtherance of the Merger; and

WHEREAS Guarantor, Parent, Sub and the Company desire to make certain representations, warranties, covenants and agreements in connection with the Merger and also to prescribe various conditions to the Merger.

NOW, THEREFORE, in consideration of the foregoing and the representations, warranties, covenants and agreements set forth herein, the parties hereto agree as follows:

ARTICLE I

The Merger

SECTION 1.01. The Merger. Upon the terms and subject to the conditions set forth in this Agreement, and in accordance with the Delaware General Corporation Law (the "DGCL"), Sub shall be merged with and into the Company at the Effective Time (as defined in Section 1.03). At the Effective Time, the separate corporate existence of Sub shall cease and the Company shall continue as the surviving corporation (the "Surviving Corporation") and shall succeed to and assume all the rights and obligations of Sub in accordance with the DGCL.

SECTION 1.02. Closing. Upon the terms and subject to the conditions set forth in this Agreement, the closing of the Merger (the "Closing") shall take place at 11:00 a.m., New

York time, on the second business day after the satisfaction or waiver of the conditions set forth in Article VI (other than those that by their terms cannot be satisfied until the time of the Closing), at the offices of Cravath, Swaine & Moore, 825 Eighth Avenue, New York, New York 10019, or at such other time, date or place agreed to in writing by Parent and the Company; provided, however, that if all the conditions set forth in Article VI shall not have been satisfied or waived on such second business day, then the Closing shall take place on the first business day on which all such conditions shall have been satisfied or waived. The date on which the Closing occurs is referred to in this Agreement as the "Closing Date."

SECTION 1.03. Effective Time. Upon the terms and subject to the conditions set forth in this Agreement, as soon as practicable on or after the Closing Date, a certificate of merger or other appropriate documents (in any such case, the "Certificate of Merger") shall be duly prepared and executed by the parties in accordance with the relevant provisions of the DGCL and filed with the Secretary of State of the State of Delaware. The Merger shall become effective upon the filing of the Certificate of Merger with the Secretary of State of the State of Delaware or at such subsequent time or date as Parent and the Company shall agree and specify in the Certificate of Merger. The time at which the Merger becomes effective is referred to in this Agreement as the "Effective Time."

SECTION 1.04. Effects of the Merger. The Merger shall have the effects set forth in Section 259 of the DGCL.

SECTION 1.05. Certificate of Incorporation and By-laws. (a) The Restated Certificate of Incorporation of the Company shall be amended at the Effective Time to read in the form of Exhibit A and, as so amended, such Restated Certificate of Incorporation shall be the Restated Certificate of Incorporation of the Surviving Corporation until thereafter changed or amended as provided therein or by applicable law.

(b) The By-laws of Sub as in effect immediately prior to the Effective Time shall be the By-laws of the Surviving Corporation until thereafter changed or amended as provided therein or by applicable law.

SECTION 1.06. Directors. (a) The directors of Sub immediately prior to the Effective Time shall be the directors of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

(b) Guarantor shall take all necessary action to cause J. James Barr to be elected as a director, as of the Effective Time, of Thames Water Plc ("Thames").

(c) Guarantor shall take all necessary action to cause Marilyn Ware to be elected as a member, as of the Effective Time, of the Thames Water International Advisory Council.

SECTION 1.07. Officers. The officers of the Company immediately prior to the Effective Time shall be the officers of the Surviving Corporation until the earlier of their resignation or removal or until their respective successors are duly elected and qualified, as the case may be.

ARTICLE II

Conversion of Securities

SECTION 2.01. Conversion of Capital Stock. At the Effective Time, by virtue of the Merger and without any action on the part of the holder of any shares of capital stock of the Company or Sub:

(a) Capital Stock of Sub. Each issued and outstanding share of common stock of Sub shall be converted into and become one fully paid and nonassessable share of common stock, par value $1.00 per share, of the Surviving Corporation.

(b) Cancelation of Treasury Stock and Parent-Owned Stock. Each share of Company Common Stock that is owned by the Company, as treasury stock, or by Parent or Sub immediately prior to the Effective Time shall automatically be canceled and shall cease to exist and no consideration shall be delivered or deliverable in exchange therefor.

(c) Conversion of Company Common Stock. Each share of Company Common Stock issued and outstanding immediately prior to the Effective Time (other than shares to be canceled in accordance with Section 2.01(b) and the Appraisal Shares) shall be converted into the right to receive $46.00 in cash without interest (the "Merger Consideration"). At the Effective Time all such shares shall no longer be outstanding and shall automatically be canceled and shall cease to exist, and each holder of a certificate that immediately prior to the Effective Time represented any such shares (a "Certificate") shall cease to have any rights with respect thereto, except the right to receive the Merger Consideration and any dividends declared and unpaid thereon payable to holders of record thereof as of a record date preceding the Effective Time. Following the Effective Time, upon surrender of Certificates in accordance with Section 2.02, the Surviving Corporation shall pay to the holders of Certificates as of the Effective Time any unpaid dividends declared in respect of the Company Common Stock with a record date prior to the Effective Time and which remain unpaid at the Effective Time, including the "stub period" dividend referred to in Section 4.01(a)(i)(x)(C).

(d) Appraisal Rights. Notwithstanding anything in this Agreement to the contrary, shares (the "Appraisal Shares") of Company Common Stock issued and outstanding immediately prior to the Effective Time that are held by any holder who is entitled to demand and properly demands appraisal of such shares pursuant to, and who complies in all respects with, the provisions of Section 262 of the DGCL ("Section 262") shall not be converted into the right to receive the Merger Consideration as provided in

Section 2.01(c), but instead such holder shall be entitled to payment of the fair value of such shares in accordance with the provisions of Section 262. At the Effective Time, all Appraisal Shares shall no longer be outstanding and shall automatically be canceled and shall cease to exist, and each holder of Appraisal Shares shall cease to have any rights with respect thereto, except the right to receive the fair value of such shares in accordance with the provisions of Section 262. Notwithstanding the foregoing, if any such holder shall fail to perfect or otherwise shall waive, withdraw or lose the right to appraisal under Section 262 or a court of competent jurisdiction shall determine that such holder is not entitled to the relief provided by Section 262, then the right of such holder to be paid the fair value of such holder's Appraisal Shares under Section 262 shall cease and each such Appraisal Share shall be deemed to have been converted at the Effective Time into, and shall have become, the right to receive the Merger Consideration as provided in Section 2.01(c). The Company shall serve prompt notice to Parent of any demands for appraisal of any shares of Company Common Stock, and Parent shall have the right to participate in and direct all negotiations and proceedings with respect to such demands. Prior to the Effective Time, the Company shall not, without the prior written consent of Parent, make any payment with respect to, or settle or offer to settle, any such demands, or agree to do any of the foregoing.

SECTION 2.02. Exchange of Certificates. (a) Paying Agent. Prior to the Effective Time, Parent shall designate a bank or trust company reasonably acceptable to the Company to act as agent for the payment of the Merger Consideration upon surrender of Certificates (the "Paying Agent"). Parent shall take all steps necessary to enable, and shall cause, the Surviving Corporation to provide to the Paying Agent immediately following the Effective Time all the cash necessary to pay for the shares of Company Common Stock converted into the right to receive the Merger Consideration pursuant to Section 2.01(c), plus any amounts payable in respect of unpaid dividends declared in respect of the Company Common Stock with a record date prior to the Effective Time and which remain unpaid at the Effective Time, including the "stub period" dividend referred to in Section 4.01(a)(i)(x)(C) (such cash being hereinafter referred to as the "Exchange Fund").

(b) Exchange Procedure. As soon as reasonably practicable after the Effective Time, the Paying Agent shall mail to each holder of record of a Certificate (i) a form of letter of transmittal (which shall specify that delivery shall be effected, and risk of loss and title to the Certificates held by such person shall pass, only upon proper delivery of the Certificates to the Paying Agent and shall be in customary form and have such other provisions as Parent may reasonably specify) and (ii) instructions for use in effecting the surrender of the Certificates in exchange for the Merger Consideration. Upon surrender of a Certificate for cancelation to the Paying Agent or to such other agent or agents as may be appointed by Parent, together with such letter of transmittal, duly completed and validly executed, and such other documents as may reasonably be required by the Paying Agent, the holder of such Certificate shall be entitled to receive in exchange therefor the amount of cash payable in respect of the shares formerly represented by such Certificate pursuant to Section 2.01(c), and the Certificate so surrendered shall forthwith be canceled. In the event of a transfer of ownership of Company Common Stock that is not registered in the stock transfer books of the

Company, the proper amount of cash may be paid in exchange therefor to a person other than the person in whose name the Certificate so surrendered is registered if such Certificate shall be properly endorsed or otherwise be in proper form for transfer and the person requesting such payment shall pay any transfer or other taxes required by reason of the payment to a person other than the registered holder of such Certificate or establish to the satisfaction of Parent that such tax has been paid or is not applicable. No interest shall be paid or shall accrue on the cash payable upon surrender of any Certificate.

(c) No Further Ownership Rights in Company Common Stock. All cash paid upon the surrender of a Certificate in accordance with the terms of this Article II shall be deemed to have been paid in full satisfaction of all rights pertaining to the shares of Company Common Stock formerly represented by such Certificate. At the close of business on the day on which the Effective Time occurs the stock transfer books of the Company shall be closed, and there shall be no further registration of transfers on the stock transfer books of the Surviving Corporation of the shares of Company Common Stock that were outstanding immediately prior to the Effective Time. If, after the Effective Time, Certificates are presented to the Surviving Corporation or the Paying Agent for transfer or any other reason, they shall be canceled and exchanged as provided in this Article II.

(d) Termination of Exchange Fund. Any portion of the Exchange Fund that remains undistributed to the holders of Company Common Stock for one year after the Effective Time shall be delivered to the Surviving Corporation, upon demand, and any holder of Company Common Stock who has not theretofore complied with this Article II shall thereafter look only to the Surviving Corporation for payment of its claim for Merger Consideration.

(e) No Liability. None of Parent, the Surviving Corporation or the Paying Agent shall be liable to any person in respect of any cash delivered to a public official pursuant to any applicable abandoned property, escheat or similar law. If any Certificates shall not have been surrendered prior to three years after the Effective Time (or immediately prior to such earlier date on which any Merger Consideration would otherwise escheat to or became the property of any Governmental Entity (as defined in Section 3.01(d)), any such Merger Consideration in respect thereof shall, to the extent permitted by applicable law, become the property of the Surviving Corporation, free and clear of all claims or interest of any person previously entitled thereto.

(f) Investment of Exchange Fund. The Paying Agent shall invest any cash included in the Exchange Fund, as directed by Parent, on a daily basis; provided, however, that such investments shall be in (i) obligations of or guaranteed by the United States of America and backed by the full faith and credit of the United States of America, (ii) commercial paper obligations rated A-1 or P-1 or better by Moody's Investors Service, Inc. or Standard & Poor's Corporation, respectively, (iii) certificates of deposit maturing not more than 180 days after the date of purchase issued by a bank organized under the laws of the United States or any state thereof having a combined capital and surplus of at least $500,000,000 or (iv) a money market fund having assets of at least $3,000,000,000. Any interest and other income resulting from such investments shall be paid to Parent.

(g) Lost Certificates. If any Certificate shall have been lost, stolen, defaced or destroyed, upon the making of an affidavit of that fact by the person claiming such Certificate to be lost, stolen, defaced or destroyed and, if required by the Surviving Corporation, the posting by such person of a bond in such reasonable amount as the Surviving Corporation may direct as indemnity against any claim that may be made against it with respect to such Certificate, the Paying Agent shall pay in respect of such lost, stolen, defaced or destroyed Certificate the Merger Consideration.

(h) Withholding Rights. Parent, the Surviving Corporation or the Paying Agent shall be entitled to deduct and withhold any applicable taxes from the consideration otherwise payable pursuant to this Agreement to any holder of shares of Company Common Stock.

SECTION 2.03. Redemption of Preferred Stock and Preference Stock. On or prior to the date on which the Effective Time occurs, but in any event prior to the Effective Time, the Company shall redeem (the "Stock Redemption") (i) each issued and outstanding share of its Cumulative Preferred Stock, 5% Series, par value $25.00 per share (the "Company 5% Cumulative Preferred Stock"), for a redemption price of $25.25 per share plus an amount equal to full cumulative dividends thereon (as defined in Section 6 ("Section 6") of Division A of Article Fourth of the Restated Certificate of Incorporation of the Company, as amended to the date of this Agreement) to the redemption date (as defined in Section 6) and (ii) each issued and outstanding share of its 5% Cumulative Preference Stock, par value $25.00 per share (the "Company 5% Cumulative Preference Stock" and, together with the Company 5% Cumulative Preferred Stock and the Company Common Stock, the "Company Capital Stock"), for a redemption price of $25.00 per share plus an amount equal to full cumulative dividends thereon (as defined in Section 5 ("Section 5") of Division B of Article Fourth of the Restated Certificate of Incorporation of the Company, as amended to the date of this Agreement) to the redemption date (as defined in Section 5) (the redemption price for the Company 5% Cumulative Preferred Stock and the Company 5% Cumulative Preference Stock being referred to as the "Redemption Price").

ARTICLE III

Representations and Warranties

SECTION 3.01. Representations and Warranties of the Company. The Company represents and warrants to Parent and Sub as follows:

(a) Organization, Standing and Power. Each of the Company and each of its subsidiaries (as defined in Section 8.03) (i) is duly organized, validly existing and in good standing under the laws of the jurisdiction of its organization, (ii) has all requisite corporate power and authority to carry on its business as now being conducted and (iii) except as set forth in Section 3.01(a) of the disclosure schedule delivered by the Company to Parent prior to the execution of this Agreement (the "Company Disclosure Schedule"), is duly qualified or licensed to do business and is in good standing to do business in each jurisdiction in which the nature of its business or the ownership, leasing or operation of its properties makes such qualification or licensing necessary, other than where the failure to be so qualified or licensed or in good standing individually or in the aggregate would not reasonably be expected to have a material adverse effect (as defined in Section 8.03). The Company has made available to Parent and its representatives true and complete copies of (A) the Restated Certificate of Incorporation and By-laws of the Company by reference to the Filed SEC Documents (as defined in Section 3.01(e)), in each case as amended to the date of this Agreement and (B) the minutes of all meetings of the stockholders, the Board of Directors and each committee of the Board of Directors of the Company since June 1, 1998.

(b) Subsidiaries. Section 3.01(b)(i) of the Company Disclosure Schedule contains a true and complete list of each Significant Subsidiary (as defined in Section 8.03) of the Company as of the date of this Agreement, including its jurisdiction of organization, the Company's interest therein and a brief description of the principal line or lines of business conducted by each such Significant Subsidiary. Except as set forth in Section 3.01(b)(i) of the Company Disclosure Schedule, all the issued and outstanding shares of capital stock of, or other equity or voting interests in, each subsidiary of the Company as of the date of this Agreement are owned by the Company, by another wholly owned subsidiary of the Company or by the Company and another wholly owned subsidiary of the Company, free and clear of all material pledges, claims, liens, charges, encumbrances and security interests of any kind or nature whatsoever (collectively, "Liens"), and are duly authorized, validly issued, fully paid and nonassessable. Except for the capital stock of, or other equity or voting interests in, its subsidiaries and as set forth in Section 3.01(b)(ii) of the Company Disclosure Schedule, as of the date of this Agreement, the Company does not own, directly or indirectly, any capital stock of, or other equity or voting interests in, any corporation, partnership, joint venture, association, limited liability company or other entity.

(c) Capital Structure. The authorized capital stock of the Company consists of (i) 300,000,000 shares of Company Common Stock, (ii) 1,770,000 shares of Cumulative Preferred Stock, par value \$25.00 per share (the "Company Cumulative Preferred Stock"), of which 101,777 shares have been designated as Company 5% Cumulative Preferred Stock, (iii) 750,000 shares of Cumulative Preference Stock, par value \$25.00 per share (the "Company Cumulative Preference Stock"), of which 365,158 shares have been designated as Company 5% Cumulative Preference Stock and (iv) 3,000,000 shares of Cumulative Preferential Stock, par value \$35.00 per share (the "Company Cumulative Preferential Stock"). As of the close of business on September 10, 2001, (1) 99,817,628 shares of Company Common Stock (excluding shares held by the Company as treasury shares) were issued and outstanding, (2) 63,693 shares of Company Common Stock were held by the Company as treasury shares, (3) 2,232,100 shares of Company Common Stock were reserved for issuance pursuant to the Company's 2000 Stock Award and Incentive Plan and the Company's Long-Term Performance-Based Incentive Plan (such plans, collectively, the "Company Stock Plans"), of which 905,751 shares were subject to outstanding Company Stock Options (as defined below), (4) the following number of shares of Company Common Stock were reserved (or registered with the SEC (as defined in Section 3.01(d)) for issuance pursuant to each of the following Company Benefit Plans (as defined below): 876,125 shares under the Savings Plan For Employees of American Water Works Company, Inc. and its Designated Subsidiaries, 942,157 shares under the Employees' Stock Ownership Plan of American Water Works Company, Inc. and its Designated Subsidiaries, 50,000 shares under the Company's Deferred Compensation Plan, 10,000 shares under the Company's Director Deferred Compensation Plan and 1,755,049 shares under the Company's Dividend Reinvestment and Stock Purchase Plan (collectively, the "Other Company Stock Plans"), (5) 80,865,863 shares of Company Common Stock were reserved for issuance in connection with the rights (the "Company Rights") issued pursuant to the Rights Agreement dated as of February 18, 1999, as amended as of June 1, 2000 (as amended from time to time (the "Company Rights Agreement")), between the Company and BankBoston N.A. (presently known as Fleet National Bank), as Rights Agent, (6) 101,777 shares of Company 5% Cumulative Preferred Stock were issued and outstanding, (7) 365,158 shares of Company 5% Cumulative Preference Stock were issued and outstanding, (8) no shares of Company Cumulative Preferred Stock (other than the Company 5% Cumulative Preferred Stock) were issued and outstanding, (9) no shares of Company Cumulative Preference Stock (other than the Company 5% Cumulative Preference Stock) were issued and outstanding and (10) no shares of Company Cumulative Preferential Stock were issued and outstanding. There are no outstanding stock appreciation rights or other rights that are linked to the price of Company Common Stock granted under any Company Stock Plan whether or not granted in tandem with a related Company Stock Option (as defined below). No shares of Company Capital Stock are owned by any subsidiary of the Company. As of the close of business on September 10, 2001, there were outstanding options to purchase Company Common Stock granted under the Company Stock Plans (collectively, the "Company Stock Options") to purchase 905,751 shares of Company Common Stock with exercise prices on a per share basis lower than the Merger Consideration, and the weighted average exercise price of such Company Stock Options was equal to $23.65. Except as set forth above, as of the close of business on September 10, 2001, no shares of capital stock of, or other equity or voting interests in, the Company, or options, warrants or other rights to acquire any such stock or securities, were issued, reserved for issuance or outstanding. During the period from September 10, 2001 to the date of this Agreement, (x) there have been no issuances by the Company of shares of capital stock of, or other equity or voting interests in, the Company other than issuances of shares of Company Common Stock pursuant to the exercise of Company Stock Options outstanding on such date in accordance with their terms as in effect on the date of this Agreement and (y) there have been no issuances by the Company of options, warrants or other rights to acquire shares of capital stock or other equity or voting interests from the Company. All outstanding shares of capital stock of the Company are, and all shares that may be issued pursuant to the Company Stock Plans and Other Company Stock Plans will be, when issued in accordance with the terms thereof, duly authorized, validly issued, fully paid and nonassessable and not subject to preemptive rights. There are no bonds, debentures, notes or other indebtedness of the Company or any of its subsidiaries, and, except as set forth above, no securities or other instruments or obligations of the Company or any of its subsidiaries the value of which is in any way based upon or derived from any capital or voting stock of the Company, having in any such case at any time (whether actual or contingent) the right to vote (or convertible into, or exchangeable for, securities having the right to vote) on any matters on which stockholders of the Company or any of its subsidiaries may vote. Except as set forth above and except as specifically permitted under Section 4.01(a) (including as set forth in Section 4.01(a)(ii) of the Company Disclosure Schedule), there are no Contracts (as defined in Section 3.01(d)) of any kind to which the Company or any of its subsidiaries is a party or by which the Company or any of its subsidiaries is bound obligating the Company or any of its subsidiaries to issue, deliver or sell, or cause to be issued, delivered or sold, additional shares of capital stock of, or other equity or voting interests in, or securities convertible into, or exchangeable or exercisable for, shares of capital stock of, or other equity or voting interests in, the Company or any of its subsidiaries or obligating the Company or any of its subsidiaries to issue, grant, extend or enter into any such security, option, warrant, call, right or Contract. Except for the Stock Redemption and the redemption terms of any preferred stock of any of the Company's subsidiaries and as permitted by Section 4.01(a)(i)(y), there are not any outstanding contractual obligations of the Company or any of its subsidiaries to (I) repurchase, redeem or otherwise acquire any shares of capital stock of, or other equity or voting interests in, the Company or any of its subsidiaries as of the date of this Agreement or (II) vote or dispose of any shares of the capital stock of, or other equity or voting interests in, any of the Company's subsidiaries as of the date of this Agreement. The copy of the Company Rights Agreement on file with the SEC (as defined in Section 3.01(d)) as an exhibit to the Form 8-A Registration Statement of the Company filed with the SEC on March 1, 1999, as amended by the amendment thereto on file with the SEC as an exhibit to the Form 8-A Registration Statement of the Company filed on June 1, 2000, is complete and correct.

(d) Authority; Noncontravention. (i) The Company has the requisite corporate power and authority to execute and deliver this Agreement and, subject to the Stockholder Approval (as defined in Section 3.01(n)) and the Company Required Consents (as defined below), to consummate the transactions contemplated hereby. The execution and delivery of this Agreement by the Company and the consummation by the Company of the transactions contemplated hereby have been duly authorized by all necessary corporate action on the part of the Company and no other corporate proceedings on the part of the Company are necessary to approve this Agreement or the Company Voting Agreement or to consummate the transactions contemplated hereby or thereby subject, in the case of the consummation of the Merger, to obtaining the Stockholder Approval (assuming consummation of the Stock Redemption). This Agreement has been duly executed and delivered by the Company and constitutes a valid and binding obligation of the Company, enforceable against the Company in accordance with its terms. The Board of Directors of the Company, at a meeting duly called and held at which all directors of the Company were present, duly and unanimously adopted resolutions (A) approving the Stock Redemption and the Company Voting Agreement and approving and declaring advisable this Agreement, the Merger and the other transactions contemplated hereby, (B) directing that this Agreement be submitted to a vote at a meeting of the Company's stockholders and (C) recommending that the Company's stockholders adopt this Agreement. In its determination of whether the Merger is in the best interests of the Company's stockholders, the Board of Directors of the Company has complied with the provisions of Article Tenth of the Restated Certificate of Incorporation of the Company. The execution and delivery of this Agreement and the Company Voting Agreement and the consummation of the transactions contemplated hereby and thereby and compliance with the provisions hereof and thereof do not and will not conflict with, or result in any violation or breach of, or default (with or without notice or lapse of time, or both) under, or give rise to a right of, or result in, termination, cancelation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien in or upon any of the properties or assets of the Company or any of its subsidiaries under, or give rise to any increased, additional, accelerated or guaranteed rights or entitlements under, any provision of (x) the Restated Certificate of Incorporation or By-laws of the Company or the certificate of incorporation or by-laws (or similar organizational documents) of any of its subsidiaries, (y) subject to obtaining the third party consents set forth in Section 3.01(d) of the Company Disclosure Schedule, any loan or credit agreement, bond, debenture, note, mortgage, indenture, guarantee, lease or other contract, agreement, instrument, arrangement or understanding, whether oral or written (each, including all amendments thereto, a "Contract"), to which the Company or any of its subsidiaries is a party or any of their respective properties or assets is subject or (z) subject to obtaining the Company Required Consents and the receipt of the Stockholder Approval and the other matters referred to in the following sentence, any (A) statute, law, ordinance, rule or regulation applicable to the Company or any of its subsidiaries or their respective properties or assets ("Applicable Law"), (B) judgment, order or decree applicable to the Company or any of its subsidiaries or their respective properties or assets ("Judgment"), or (C) Permit (as defined in Section 3.01(h)) other than, in the case of clauses (y) and (z), any such conflicts, violations, breaches, defaults, rights, losses, Liens or entitlements that individually or in the aggregate would not reasonably be expected to have a material adverse effect. No consent, approval, order or authorization of, registration, declaration or filing with, or notice to, any domestic or foreign (whether national, federal, state, provincial, local or otherwise) government or any court, administrative agency or commission or other governmental or regulatory authority or agency (including a state public utility commission, state public service commission or similar state regulatory body (each, a "PUC")) (each a "Governmental Entity"), is required by or with respect to the Company or any of its subsidiaries in connection with (I) the execution and delivery of this Agreement by the Company, (II) the execution and delivery of the Company Voting Agreement or (III) the consummation of the transactions contemplated hereby and thereby or compliance with the provisions hereof and thereof, except for (1) the filing of a premerger notification and report form by the Company under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), and the receipt, termination or expiration, as applicable, of such other approvals or waiting periods required under any other applicable competition, merger control, antitrust or similar law or regulation, including, if the Company has completed its acquisition of Azurix North America Corp. and Azurix Industrials Corp. prior to the Closing, the competition, merger control, antitrust or similar laws or regulations of Canada or the Investment Canada Act, if applicable, (2) the filing with the Securities and Exchange Commission (the "SEC") of a proxy statement relating to the adoption by the Company's stockholders of this Agreement (as amended or supplemented from time to time, the "Proxy Statement") and such reports under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as may be required in connection with this Agreement, the Company Voting Agreement, the Merger and the other transactions contemplated hereby and thereby, (3) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware and appropriate documents with the relevant authorities of other states in which the Company or any of its subsidiaries is qualified to do business, (4) any filings required under the rules and regulations of the New York Stock Exchange ("NYSE"), (5) such consents, approvals, orders, authorizations, registrations, declarations, filings and notices required under Applicable Laws and Judgments of any PUC, (6) such consents, approvals, orders, authorizations, registrations, declarations, filings and notices required under Applicable Laws and Judgments of any state departments of public health or departments of health or similar state regulatory bodies or of any federal or state regulatory body having jurisdiction over environmental protection or environmental conservation or similar matters (collectively, "Health Agencies"), (7) such consents, approvals, orders, authorizations, registrations, declarations, filings and notices required to be obtained from or made to any non-U.S. Governmental Entity due solely to the identity or involvement of Guarantor, Parent, Sub or any of their respective subsidiaries and (8) such other consents, approvals, orders, authorizations, registrations, declarations, filings and notices the failure of which to be obtained or made individually or in the aggregate would not reasonably be expected to have a material adverse effect. Consents, approvals, orders, authorizations, registrations, declarations, filings and notices (x) described (i) in the foregoing clause (5) that are required to be obtained or made by the Company or any of its subsidiaries and (ii) in the foregoing clause (6) the failure of which to obtain or make would reasonably be expected to have a material adverse effect or (y) of any Governmental Entity that would not be required to be obtained or made by the Company or any of its subsidiaries but for an acquisition of a business or asset by the Company or any of its subsidiaries that is consummated after the date of this Agreement the failure of which to obtain or make would reasonably be expected to have a material adverse effect are hereinafter referred to as the "Company Required Consents."

(ii) The Company and the Board of Directors of the Company have taken all action necessary to (A) render the Company Rights inapplicable to the execution, delivery and performance of this Agreement and the Company Voting Agreement and to the consummation of the Merger and any acquisition of Company Common Stock contemplated by Section 4.03(b) and (B) ensure that (x) neither Parent nor any of its affiliates or associates is or will become an "Acquiring Person" (as defined in the Company Rights Agreement) by reason of the execution, delivery and performance of this Agreement or the Company Voting Agreement or by reason of the consummation of the Merger or any acquisition of Company Common Stock contemplated by Section 4.03(b), (y) neither a "Distribution Date" nor a "Triggering Event" (each as defined in the Company Rights Agreement) shall occur by reason of the execution, delivery and performance of this Agreement or the Company Voting Agreement or by reason of the consummation of the Merger or any acquisition of Company Common Stock contemplated by Section 4.03(b) and (z) except as set forth in Section 3.01(d)(ii) of the Company Disclosure Schedule, the Company Rights shall terminate or be redeemed prior to the Effective Time.

(e) SEC Documents. The Company has filed with the SEC all forms, reports, schedules, statements and other documents required to be filed with the SEC by the Company since January 1, 2000 (together with all information incorporated therein by reference, the "SEC Documents"). Except as set forth in Section 3.01(e) of the Company Disclosure Schedule, no subsidiary of the Company is required to file any form, report, schedule, statement or other document with the SEC. As of their respective dates, the SEC Documents complied in all material respects with the requirements of the Securities Act of 1933 (the "Securities Act") or the Exchange Act, as the case may be, and the rules and regulations of the SEC promulgated thereunder applicable to such SEC Documents, and none of the SEC Documents at the time they were filed contained any untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. Except to the extent that information contained in any SEC Document filed and publicly available prior to the date of this Agreement (a "Filed SEC Document") has been revised or superseded by a later filed Filed SEC Document, none of the SEC Documents contains any untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The financial statements (including the related notes) included in the SEC Documents comply as to form in all material respects with applicable accounting requirements and the published rules and regulations of the SEC with respect thereto, have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") (except, in the case of unaudited statements, as permitted by Form 10-Q of the SEC) applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present in all material respects the consolidated financial position of the Company and its consolidated subsidiaries as of the dates thereof and their consolidated results of operations and cash flows for the periods then ended (subject, in the case of unaudited statements, to normal, recurring year-end audit adjustments).

(f) Absence of Certain Changes or Events. Since December 31, 2000, the Company and its subsidiaries have conducted their respective businesses only in the ordinary course consistent with past practice and other than as set forth in the Filed SEC Documents, there has not been (i) prior to the date of this Agreement, any state of facts, change, development, effect, condition or occurrence that individually or in the aggregate constitutes, has had, or would reasonably be expected to have, a material adverse effect, (ii) prior to the date of this Agreement, any declaration, setting aside or payment of any dividend on, or other distribution (whether in cash, stock or property) in respect of, any of the Company's or any of its subsidiaries' capital stock or other equity or voting interests, except for dividends by a wholly owned subsidiary of the Company to its shareholders and except for the regular quarterly cash dividend with respect to (w) preferred stock of the Company's subsidiaries, in accordance with the terms thereof, (x) the Company Common Stock in the amount of $0.235 per share, in accordance with the Company's past dividend policy, (y) the Company 5% Cumulative Preferred Stock in the amount of $0.3125 per share, in accordance with the terms thereof, and (z) the Company 5% Cumulative Preference Stock in the amount of $0.3125 per share, in accordance with the terms thereof, (iii) prior to the date of this Agreement, any purchase, redemption or other acquisition of any shares of capital stock of, or other equity or voting interests in, the Company or any options, warrants, calls or rights to acquire such shares or other interests, (iv) prior to the date of this Agreement, any split, combination or reclassification of any of the Company's capital stock or other equity or voting interests or any issuance or the authorization of any issuance of any other securities in respect of, in lieu of or in substitution for shares of capital stock of, or other equity or voting interests in, the Company, (v) prior to the date of this Agreement, any material unfunded liability incurred as a result of any entry by the Company or any of its subsidiaries into, or any amendment of, any Company Benefit Plan (as defined in Section 3.01(k)), (vi) prior to the date of this Agreement, any change in financial or tax accounting methods, principles or practices by the Company or any of its subsidiaries, except insofar as may have been required by a change in GAAP or Applicable Law, (vii) except as set forth in Section 3.01(f)(vii) of the Company Disclosure Schedule, prior to the date of this Agreement, any material election with respect to taxes by the Company or any of its subsidiaries or any settlement or compromise of any material tax liability or refund or (viii) prior to the date of this Agreement, any revaluation by the Company or any of its subsidiaries of any of the material assets of the Company or any of its subsidiaries.

(g) Litigation. Except as set forth in the Filed SEC Documents and except as set forth in Section 3.01(g) of the Company Disclosure Schedule, there is no suit, claim, action or proceeding pending or, to the knowledge of the Company, threatened against the Company or any of its subsidiaries or any of their respective assets that individually or in the aggregate would reasonably be expected to have a material adverse effect, nor is there any Judgment of any Governmental Entity or arbitrator outstanding against, or, to the knowledge of the Company, investigation, notice of violation, order of forfeiture or complaint by any Governmental Entity against, the Company or any of its subsidiaries that individually or in the aggregate would reasonably be expected to have a material adverse effect.

(h) Compliance with Laws. Except as set forth in Section 3.01(h) of the Company Disclosure Schedule, and except with respect to Environmental Laws (as defined in Section 3.01(j)), the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and taxes, which are the subject of Sections 3.01(j), 3.01(k) and 3.01(l), respectively, or as set forth in the Filed SEC Documents, the Company and its subsidiaries are in compliance with all Applicable Laws and Judgments of any Governmental Entity applicable to their businesses or operations, except for instances of noncompliance that individually or in the aggregate would not reasonably be expected to have a material adverse effect. Neither the Company nor any of its subsidiaries has received, since January 1, 2001, a written notice or other written communication alleging a possible violation by the Company or any of its subsidiaries of any Applicable Law or Judgment of any Governmental Entity applicable to its businesses or operations, except for written notices or other written communications alleging possible violations that individually or in the aggregate would not reasonably be expected to have a material adverse effect. The Company and its subsidiaries have in effect all material permits, licenses, variances, exemptions, authorizations, franchises, orders and approvals of all Governmental Entities (collectively, "Permits"), necessary or advisable for them to own, lease or operate their properties and assets and to carry on their businesses as now conducted, except for those which the failure to obtain individually or in the aggregate would not reasonably be expected to have a material adverse effect. Neither the Company nor any of its subsidiaries is in violation of, default (with or without notice or lapse of time or both) under, or event giving to any other person any right of termination, amendment or cancelation of, with or without notice or lapse of time or both, any Permit of the Company or any of its subsidiaries, except for any such violations, defaults or events that individually or in the aggregate would not reasonably be expected to have a material adverse effect.

(i) [Intentionally omitted].

(j) Environmental Matters. Except as disclosed in the SEC Documents and as set forth in Section 3.01(j) of the Company Disclosure Schedule, and except for such matters that individually or in the aggregate would not reasonably be expected to have a material adverse effect: (i) each of the Company and its subsidiaries possesses all Environmental Permits (as defined below) necessary to conduct its businesses and operations; (ii) each of the Company and its subsidiaries is in compliance with all applicable Environmental Laws and all applicable Environmental Permits, and none of the Company or its subsidiaries has received any written communication from any Governmental Entity or other person that alleges that the Company or any of its subsidiaries has violated or is liable under any Environmental Law or Environmental Permit; (iii) there are no Environmental Claims (as defined below) pending or, to the knowledge of the Company, threatened in writing (A) against the Company or any of its subsidiaries or (B) against any person whose liability for any such Environmental Claim the Company or any of its subsidiaries has retained or assumed, either contractually or by operation of law; and (iv) to the knowledge of the Company, there have been no Releases (as defined below) of any Hazardous Materials (as defined below) that would reasonably be expected to form the basis of any Environmental Claim or any liability under any Environmental Law or Environmental Permit.

For the purposes of this Agreement: (A) "Environmental Claims" means any and all administrative, regulatory or judicial actions, orders, decrees, suits, demands, demand letters, directives, claims, liens, investigations, proceedings or notices of noncompliance or violation by any Governmental Entity or other person alleging liability arising out of, based on or related to (x) the presence, Release or threatened Release of, or exposure to, any Hazardous Materials at any location, whether or not owned, operated, leased or managed by the Company or any of its subsidiaries, or (y) any other circumstances forming the basis of any violation or alleged violation of any Environmental Law or Environmental Permit; (B) "Environmental Laws" means all laws, rules, regulations, orders, decrees, common law, judgments or binding agreements issued, promulgated or entered into by or with any Governmental Entity relating to pollution or protection of the environment (including ambient air, surface water, groundwater, soils or subsurface strata) or to health and safety as affected by the exposure to Hazardous Materials, including laws and regulations relating to the presence of, exposure to, Release of or threatened Release of Hazardous Materials or otherwise relating to the generation, manufacture, processing, distribution, use, treatment, storage, recycling, transport, handling of, or the arrangement for such activities with respect to, Hazardous Materials; (C) "Environmental Permits" means all permits, licenses, certificates, registrations, waivers, exemptions and other authorizations required under applicable Environmental Laws; (D) "Hazardous Materials" means all hazardous, toxic, explosive or radioactive substances, wastes or other pollutants, including (x) petroleum, petroleum distillates and all other hydrocarbons, asbestos or asbestos-containing material, and (y) all other substances or wastes of any nature prohibited, limited or regulated as harmful to or polluting of or in order to protect the environment; and (E) "Release" means any release, spill, emission, leaking, dumping, injection, pouring, deposit, disposal, discharge, dispersal, leaching or migration into or through the environment (including ambient air, surface water, groundwater, land surface or subsurface strata) or within any building, structure, facility or fixture.

(k) ERISA Compliance. (i) Section 3.01(k)(i) of the Company Disclosure Schedule contains a true and complete list of any benefit, employment, personal services, collective bargaining, compensation, change in control, severance, time-off or perquisite agreement, plan, policy or other similar arrangement, (A) covering one or more current or former employees or directors of, or current or former independent contractors with respect to, the Company or any of its subsidiaries (each, a "Participant"), and maintained by the Company and/or one or more of its subsidiaries or (B) with respect to which the Company and/or any of its subsidiaries has or would reasonably be expected to have any liability (collectively, "Company Benefit Plans"). The Company has provided or made available to Parent true and complete copies of (1) each Company Benefit Plan (or, in the case of any unwritten Company Benefit Plans, descriptions thereof), (2) the most recent annual report on Form 5500 required to be filed with the United States Internal Revenue Service (the "IRS") with respect to each Company Benefit Plan (if any such report was required), (3) the most recent summary plan description for each Company Benefit Plan for which such summary plan description is required and (4) each trust agreement and group annuity contract relating to any Company Benefit Plan; provided that any of the foregoing not provided to Parent as of the date of this Agreement shall be delivered to Parent promptly but in no event later than 30 days following the date of this Agreement. Each Company Benefit Plan has been administered in accordance with its terms, except where the failure so to be administered individually or in the aggregate would not reasonably be expected to have a material adverse effect. The Company and its subsidiaries and all the Company Benefit Plans are in compliance with all applicable provisions of ERISA and the Code, except for instances of possible noncompliance that individually or in the aggregate would not reasonably be expected to have a material adverse effect. Except as set forth in Section 3.01(k)(i) of the Company Disclosure Schedule, all Company Benefit Plans that are intended to be qualified under Section 401(a) of the Code have received favorable determination letters from the IRS to the effect that such Company Benefit Plans are qualified and exempt from Federal income taxes under Sections 401(a) and 501(a), respectively, of the Code, and no such determination letter has been revoked nor, to the knowledge of the Company, has revocation been threatened, and nothing has occurred since the date of such letter that would reasonably be expected to adversely affect its qualification. There is not pending or, to the knowledge of the Company, threatened any litigation relating to the Company Benefit Plans that individually or in the aggregate would reasonably be expected to have a material adverse effect.

(ii) Neither the Company nor any of its subsidiaries, nor any Company Benefit Plan which is subject to ERISA, has engaged in a "prohibited transaction" (as such term is defined in Section 406 of ERISA or Section 4975 of the Code) or any other breach of fiduciary responsibility that could subject the Company, any of its subsidiaries or any officer of the Company or any of its subsidiaries to the tax or penalty on prohibited transactions imposed by such Section 4975 or to any liability under Section 502(i) or 502(1) of ERISA, except for any such tax, penalty or liability that individually or in the aggregate would not reasonably be expected to have a material adverse effect. All contributions and premiums required to be made under the terms of any Company Benefit Plan as of the date hereof have been timely made or have been reflected on the most recent consolidated balance sheet filed or incorporated by reference in the Filed SEC Documents, except as, individually or in the aggregate, would reasonably be expected to have a material adverse effect.

(iii) Except as, individually or in the aggregate, would not reasonably be expected to have a material adverse effect, the deduction of any amount payable pursuant to the terms of the Company Benefit Plans would not reasonably be expected to be subject to disallowance under Section 162(m) (before giving effect to Section 162(m)(4)(F)) of the Code for taxable years of the Company ending prior to the date hereof.

(iv) Section 3.01(k)(iv) of the Company Disclosure Schedule contains a list of all Company Benefit Plans which, as a consequence of the consummation of the Merger, are reasonably expected to (x) entitle any Participant to severance pay and/or (y) accelerate the time of payment or vesting or trigger any payment or funding (whether through a grantor trust or otherwise) of compensation or benefits under, increase the amount payable or trigger any other material obligation.

(v) The Company has provided to Parent a true and complete copy of the Report (as hereinafter defined) given to the compensation committee of the board of directors of the Company containing the estimates of any payments and/or benefits that would reasonably be expected to be received (whether in cash or property or the vesting of property) as a result of the Merger or any other transaction contemplated by this Agreement (including as a result of termination of employment on or following the Effective Time) by any Participant who is a "disqualified individual" (as such term is defined in proposed Treasury Regulation Section 1.280G-1) (each, a "Primary Company Executive") under any Company Benefit Plan (including any additional payment from the Company or any of its subsidiaries or any other person in the event that the excise tax under Section 4999 of the Code is imposed on such individual) that would be reasonably be expected to be paid to the Primary Company Executives as a result of the Merger and the other transactions contemplated by this Agreement (including as a result of termination of employment on or following the Effective Time) under all Company Benefit Plans and (y) the "base amount" (as defined in Section 280G(b)(3) of the Code) for each Primary Company Executive, all as calculated and set forth in the report (dated August 1, 2001) prepared by the compensation consultant retained by the Company (the "Report"). To the knowledge of the Company, the information provided to the compensation consultant that prepared the Report is accurate in all material respects.

(l) Taxes. Except as would not, individually or in the aggregate with respect to clause (i), (ii), (iii) or (iv), reasonably be expected to have a material adverse effect: (i) Each of the Company and each of its subsidiaries has filed (or caused to be filed) all tax returns required to be filed by it and all such returns are true, complete and correct, or requests for extensions to file such tax returns have been timely filed, granted and have not expired. Each of the Company and each of its subsidiaries has paid (or caused to be paid) all taxes shown as due on such tax returns, and the most recent financial statements contained in the Filed SEC Documents reflect an adequate reserve (in addition to any reserve for deferred taxes established to reflect timing differences between book and tax income) of tax for all taxes payable by each of the Company and each of its subsidiaries for all taxable periods and portions thereof accrued through the date of such financial statements.

(ii) Except as set forth in Section 3.01(l)(ii) of the Company Disclosure Schedule, no tax return of the Company or any of its subsidiaries is under audit or examination by any taxing authority, and no written notice of such an audit or examination has been received by the Company or any of its subsidiaries. There is no deficiency, refund litigation, written proposed adjustment or matter in controversy with respect to any taxes due and owing by the Company or any of its subsidiaries. Each deficiency resulting from any completed audit or examination relating to taxes by any taxing authority has been timely paid, except for such deficiencies being contested in good faith and for which adequate reserves are reflected on the books of the Company. The United States Federal income tax returns of the Company and each of its subsidiaries consolidated in such tax returns have been either examined by and settled with the

IRS or closed by virtue of the applicable statute of limitations and no requests for waivers of the time to assess any such taxes are pending.

(iii) No liens for taxes (other than for current taxes not yet due and payable or for taxes being contested in good faith and for which adequate reserves are reflected on the books of the Company) exist with respect to any assets or properties of the Company or any of its subsidiaries. Neither the Company nor any of its subsidiaries is bound by any agreement with respect to the allocation, indemnification or sharing of taxes.

(iv) Neither the Company nor any of its subsidiaries has constituted either a "distributing corporation" or a "controlled corporation" in a distribution of stock qualifying for tax-free treatment under Section 355 of the Code (x) in the two years prior to the date of this Agreement or (y) in a distribution which could otherwise constitute part of a "plan" or "series of related transactions" (within the meaning of Section 355(e) of the Code) in conjunction with the Merger.

(v) As used in this Agreement, (A) "taxes" shall include (1) all forms of taxation, whenever created or imposed, and whether domestic or foreign, and whether imposed by a national, federal, state, provincial, local or other Governmental Entity, including all interest, penalties and additions imposed with respect to such amounts, (2) liability for the payment of any amounts of the type described in clause (1) as a result of being a member of an affiliated, consolidated, combined or unitary group and (3) liability for the payment of any amounts as a result of being party to any tax sharing agreement or as a result of any express or implied obligation to indemnify any other person with respect to the payment of any amount described in clause (1) or (2) and (B) "tax returns" shall mean all domestic or foreign (whether national, federal, state, provincial, local or otherwise) returns, declarations, statements, reports, schedules, forms and information returns relating to taxes and any amended tax return.

(m) <u>State Takeover Statutes.</u> Assuming the accuracy of the representations and warranties set forth in Section 3.02(h), the approval by the Board of Directors of the Company of this Agreement, the Company Voting Agreement and the Merger and any acquisition of Company Common Stock contemplated by Section 4.03(b) constitutes approval of this Agreement, the Company Voting Agreement and the Merger and any acquisition of Company Common Stock contemplated by Section 4.03(b) for purposes of Section 203 of the DGCL and such approval represents the only action necessary to ensure that the restrictions contained in Section 203(a) of the DGCL do not and will not apply to the performance of this Agreement, to the consummation of the Merger in accordance with the provisions of this Agreement or any acquisition of Company Common Stock contemplated by Section 4.03(b) or to the Company Voting Agreement. Assuming the accuracy of the representations and warranties set forth in Section 3.02(h), no other state takeover or similar statute or regulation (excluding, for the avoidance of doubt, any Applicable Law which requires the Company Required Consents or the Parent

Required Consents to be obtained) is applicable to this Agreement, the Company Voting Agreement or the Merger or any acquisition of Company Common Stock contemplated by Section 4.03(b).

(n) Voting Requirements. The affirmative vote at the Stockholders Meeting (as defined in Section 5.01(b)) or any adjournment or postponement thereof of the holders of a majority of the votes represented by all the outstanding shares of Company Common Stock and Company 5% Cumulative Preferred Stock, voting together as a single class, with each share of Company Common Stock entitled to one vote and each share of Company 5% Cumulative Preferred Stock entitled to 1/10th of a vote, in favor of adopting this Agreement (the "Stockholder Approval") is the only vote of the holders of any class or series of the Company's capital stock necessary to approve or adopt this Agreement or the Merger. The affirmative vote of the holders of the Company Capital Stock is not necessary to approve any other action required to be taken by this Agreement or the Company Voting Agreement (other than the consummation of the Merger).

(o) Regulation as a Utility. Except as set forth in Section 3.01(o) of the Company Disclosure Schedule , the Company is not subject to regulation as a public utility holding company, public utility or public service company (or similar designation) by any PUC. Section 3.01(o) of the Company Disclosure Schedule contains a true and complete list of each subsidiary of the Company that is subject to regulation as a public utility or public service company (or similar designation) by any PUC, including the name of each such jurisdiction in which such subsidiary is subject to such regulation. None of the Company or any of its subsidiaries is a "public utility company" or a "holding company" within the meaning of Section 2(a)(5) or 2(a)(7), respectively, of the Public Utility Holding Company Act of 1935 (the "Holding Company Act") or a "subsidiary company" or an "affiliate" (within the meaning of Section 2(a)(8) or 2(a)(11), respectively, of the Holding Company Act) of any holding company which is required to register as a holding company under the Holding Company Act. All filings required to be made by the Company or any of its subsidiaries since January 1, 2000, under any Applicable Laws or Judgments relating to the regulation of public utilities or public service companies (or similarly designated companies), have been filed with the appropriate PUC, Health Agency or other appropriate Governmental Entity, as the case may be, including all forms, statements, reports, agreements (oral or written) and all documents, exhibits, amendments and supplements appertaining thereto, including but not limited to all rates, tariffs, franchises, service agreements and related documents and all such filings complied, as of their respective dates, with all applicable requirements of all Applicable Laws or Judgments, except for such filings or such failures to comply that individually or in the aggregate would not reasonably be expected to have a material adverse effect.

(p) Title to Properties. (i) Each of the Company and each of its subsidiaries owns or has valid and enforceable right to use under existing franchises, water rights, easements or licenses, or valid and enforceable leasehold interests in, all of its properties, rights and assets necessary for the conduct of its respective business and operations as currently conducted, except where the failure to have such title, rights or interests individually or in the aggregate would not reasonably be expected to have a material adverse effect. All such properties, rights and assets, other than properties, rights and assets in which the Company or any of its subsidiaries has a leasehold interest, are free and clear of all Liens, except for Liens relating to secured indebtedness or that individually or in the aggregate would not reasonably be expected to have a material adverse effect.

(q) Brokers. No broker, investment banker, financial advisor or other person, other than Goldman, Sachs & Co., the fees and expenses of which will be paid by the Company, is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of the Company or any of its subsidiaries.

(r) Opinion of Financial Advisor. The Company has received the written opinion of Goldman, Sachs & Co. to the effect that, as of the date of this Agreement, the Merger Consideration is fair to the Company's stockholders from a financial point of view.

(s) Contracts. All material Contracts to which the Company or any of its subsidiaries is a party or any of their respective properties or assets is subject that are required to be filed as an exhibit to any Filed SEC Document have been filed as an exhibit to such Filed SEC Document (such filed Contracts, the "Filed Contracts"). All the Filed Contracts are valid and in full force and effect, except to the extent they have previously expired or terminated in accordance with their terms or they expire or terminate in compliance with the provisions of Section 4.01(a)(x)(C) and except for any invalidity or failure to be in full force and effect which would not reasonably be expected to have a material adverse effect. None of the Company or any of its subsidiaries is in violation of or default (with or without notice or lapse of time or both) under, or has waived or failed to enforce any rights or benefits under, any Filed Contract, except for violations, defaults, waivers or failures to enforce rights or benefits that individually or in the aggregate would not reasonably be expected to have a material adverse effect.

(t) Information Supplied. None of the information included or incorporated by reference in the Proxy Statement will, at the date the Proxy Statement is filed with the SEC or mailed to the Company's stockholders or at the time of the Stockholders Meeting, or at the time of any amendment or supplement thereof, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading, except that no representation or warranty is made by the Company with respect to statements made in the Proxy Statement based on information supplied by Guarantor, Parent or Sub specifically for inclusion or incorporation by reference therein. The Proxy Statement will comply as to form in all material respects with the requirements of the Exchange Act and the rules and regulations promulgated thereunder.

SECTION 3.02. Representations and Warranties of Guarantor, Parent and Sub. Guarantor, Parent and Sub jointly and severally represent and warrant to the Company as follows:

(a) Organization. Each of Guarantor and Parent is a company duly organized and validly existing under the laws of the Federal Republic of Germany. Sub is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware. Each of Guarantor, Parent and Sub (i) has all requisite corporate power and authority to carry on its business as now being conducted and (ii) is duly qualified or licensed to do business and is, if applicable, in good standing to do business in each jurisdiction in which the nature of its business or the ownership, leasing or operation of its properties makes such qualification or licensing necessary, other than where the failure to be so qualified or licensed or in good standing individually or in the aggregate would not reasonably be expected to prevent or materially impede or delay the consummation of the Merger or the other transactions contemplated hereby. Guarantor owns 100% of the outstanding capital stock of Parent and, indirectly through Parent, 100% of the outstanding capital stock of Sub.

(b) Authority; Noncontravention. Guarantor, Parent and Sub have the requisite corporate power and authority to execute and deliver this Agreement and, subject to the Parent Required Consents (as defined below), to consummate the transactions contemplated hereby and Parent has the requisite corporate power and authority to execute and deliver the Company Voting Agreement and to consummate the transactions contemplated thereby. The execution and delivery of this Agreement by Guarantor, Parent and Sub, the execution and delivery of the Company Voting Agreement by Parent and the consummation by Guarantor, Parent and Sub of the transactions contemplated hereby and thereby have been duly authorized by all necessary company or corporate action, as applicable, on the part of Guarantor, Parent and Sub and no other corporate proceedings on the part of Guarantor, Parent or Sub are necessary to approve this Agreement or the Company Voting Agreement or to consummate the transactions contemplated hereby or thereby. This Agreement has been duly executed and delivered by Guarantor, Parent and Sub and the Company Voting Agreement has been duly executed and delivered by Parent and each of this Agreement and the Company Voting Agreement constitutes the valid and binding obligation of Guarantor, Parent and Sub, as applicable, enforceable against Guarantor, Parent and Sub, as applicable, in accordance with their terms. The execution and delivery of this Agreement and the Company Voting Agreement and the consummation of the transactions contemplated hereby and thereby and compliance with the provisions of this Agreement and the Company Voting Agreement do not and will not conflict with, or result in any violation or breach of, or default (with or without notice or lapse of time, or both) under, or give rise to a right of, or result in, termination, cancelation or acceleration of any obligation or to loss of a material benefit under, or result in the creation of any Lien upon any of the properties or assets of Guarantor, Parent or Sub under, or give rise to any increased, additional, accelerated or guaranteed rights or entitlements under, any provision of (i) the Certificate of Incorporation or By-laws of Sub or equivalent organizational documents of Guarantor or Parent, (ii) any Contract applicable to Guarantor, Parent, Sub or their respective subsidiaries or their respective properties or assets or (iii) subject to obtaining the Parent Required Consents and other matters referred to in the following sentence, any (A) Applicable Law or (B) Judgment, in each case applicable to Guarantor, Parent, Sub or their respective subsidiaries or their respective properties or assets, other than, in the case of clauses (ii) and (iii), any such conflicts, violations, defaults, rights, losses or Liens that individually or in the aggregate would not reasonably be expected to prevent or materially impede or delay the consummation of the Merger or the other transactions contemplated hereby. No consent, approval, order or authorization of, registration, declaration or filing with, or notice to, any Governmental Entity is required by or with respect to Guarantor, Parent or Sub or their respective subsidiaries in connection with the execution and delivery of this Agreement and the Company Voting Agreement or the consummation by Guarantor, Parent and Sub of the transactions contemplated hereby and thereby or the compliance with the provisions of this Agreement and the Company Voting Agreement, except for (1) the filing of a premerger notification and report form under the HSR Act and the receipt, termination or expiration, as applicable, of such other approvals or waiting periods required under any other applicable competition, merger control, antitrust or similar law or regulation, including, if the Company has completed its acquisition of Azurix North America Corp. and Azurix Industrials Corp. prior to the Closing, the competition, merger control, antitrust or similar laws and regulations of Canada or the Investment Canada Act, if applicable, (2) the filing with, or furnishing to, the SEC of such reports under the Exchange Act as may be required in connection with this Agreement, the Company Voting Agreement, the Merger and the other transactions contemplated hereby and thereby, (3) the filing of the Certificate of Merger with the Secretary of State of the State of Delaware and appropriate documents with the relevant authorities of other states in which the Company is qualified to do business, (4) such consents, approvals, orders, authorizations, registrations, declarations, filings and notices required under Applicable Laws and Judgments of any PUC, (5) such consents, approvals, orders, authorizations, registrations, declarations, filings and notices required under the Applicable Laws and Judgments of any Health Agency, (6) such consents, approvals, orders, authorizations, registrations, declarations, filings and notices required to be obtained from or made to any Governmental Entity due solely to any acquisition of any business or person by the Company or any of its subsidiaries following the date of this Agreement and (7) such other consents, approvals, orders, authorizations, registrations, declarations, filings and notices the failure of which to be obtained or made individually or in the aggregate would not impair in any material respect the ability of Guarantor, Parent or Sub to perform its obligations under this Agreement or prevent or materially impede or delay the consummation of the transactions contemplated by this Agreement. Consents, approvals, orders, authorizations, registrations, declarations, filings and notices described (i) in the foregoing clause (4) that are required to be obtained or made by Guarantor, Parent or Sub or any of their respective subsidiaries and (ii) in the foregoing clause (5) the failure of which to obtain or make would impair in any material respect the ability of Guarantor, Parent or Sub to perform its obligations under this Agreement or prevent or materially impede or delay the consummation of the transactions contemplated by this Agreement, are hereinafter referred to as the "Parent Required Consents." No consent, approval, order, authorization, registration, declaration, filing or notice the failure of which to obtain or make would prevent or materially impede or delay the consummation of the transactions contemplated by this Agreement with any non-U.S. Governmental Entity is required to be made or obtained by Guarantor, Parent or Sub or any of their respective subsidiaries in connection with the execution and delivery of this Agreement and the Company Voting Agreement or the consummation by Guarantor, Parent and Sub of the transactions contemplated hereby and thereby or the compliance with the provisions of this Agreement and the Company Voting Agreement, except for such consents, approvals, orders, authorizations, registrations, declarations, filings or notices (x) required as a result of a change in Applicable Law after the date of this Agreement or (y) required to be obtained from or made to any Governmental Entity due solely to any acquisition of a business or person by the Company or any of its subsidiaries following the date of this Agreement. To the knowledge of Guarantor and Parent, as of the date of this Agreement, there exists no state of facts, condition, event or circumstance which would materially adversely affect Parent's ability to obtain the Parent Required Consents in a reasonably timely manner.

(c) Interim Operations of Sub. Sub was formed solely for the purpose of engaging in the transactions contemplated hereby and has engaged in no business other than in connection with the transactions contemplated by this Agreement.

(d) Regulation as a Utility. Except as set forth in Section 3.02(d) of the disclosure schedule delivered by Parent to the Company prior to the execution of this Agreement (the "Parent Disclosure Schedule") or as permitted in accordance with Section 4.03(a)(a), neither Guarantor, Parent, Sub nor any of their respective subsidiaries (i) is a "public utility company" or a "holding company" or a "subsidiary company" of any holding company which is required to register as a holding company under the Holding Company Act, in each case as defined in the Holding Company Act, or (ii) is otherwise subject to regulation as a public utility holding company, public utility or public service company (or similar designation) by any PUC; provided, however, the foregoing representation shall not be deemed to be breached as a result of (x) after the date hereof, any of Guarantor, Parent or Sub or any of their respective subsidiaries entering into any operation and maintenance or concession contract that would not be prohibited under Section 4.03(a)(b) or (y) changes in Applicable Law after the date of this Agreement.

(e) Capital Resources. On or prior to the Closing Date, Parent will have sufficient cash to pay the Merger Consideration and any other amounts payable under Section 2.02.

(f) Brokers. No broker, investment banker, financial advisor or other person, other than Merrill Lynch, Pierce, Fenner & Smith Incorporated and Morgan Stanley & Co. Incorporated, the fees and expenses of which will be paid by or on behalf of Parent, is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Guarantor, Parent, Sub or any of their subsidiaries.

(g) Information Supplied. None of the information supplied or to be supplied by Guarantor, Parent or Sub specifically for inclusion in the Proxy Statement will, at the date the Proxy Statement is filed with the SEC or mailed to the Company's stockholders or at the time of the Stockholders Meeting, or at the time of any amendment or supplement thereof, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading.

(h) Ownership of Company Stock. As of the date of this Agreement, neither Guarantor, Parent nor Sub nor any of their respective subsidiaries "beneficially owns" (as such term is defined for purposes of Section 13(d) of the Exchange Act) any shares of Company Common Stock.

ARTICLE IV

Covenants Relating to Conduct of Business

SECTION 4.01. Conduct of Business. (a) Conduct of Business by the Company. During the period from the date of this Agreement to the Effective Time, except as consented to in writing by Parent (which consent shall not be unreasonably withheld or delayed; and which consent shall be deemed given if the Company has not received written notice otherwise from Parent within five business days after requesting such consent of Parent as provided in Section 4.01(b)) or as specifically contemplated by this Agreement, the Company shall, and shall cause each of its subsidiaries to, carry on their respective businesses in the ordinary course consistent with past practice and use their commercially reasonable efforts to comply with all Applicable Laws and, to the extent consistent therewith, use their commercially reasonable efforts to preserve their material assets and technology, preserve their relationships with PUCs, Health Agencies, customers, suppliers and others having business dealings with them and maintain their material franchises, rights and Permits necessary to the conduct of their business. Without limiting the generality of the foregoing, during the period from the date of this Agreement to the Effective Time, except as consented to in writing by Parent (which consent shall not unreasonably be withheld or delayed; and which consent shall be deemed given if the Company has not received written notice otherwise from Parent within five business days after requesting such consent of Parent as provided in Section 4.01(b)) or as specifically contemplated by this Agreement or as set forth in Section 4.01(a) of the Company Disclosure Schedule, the Company shall not, and shall not permit any of its subsidiaries to:

(i) (x) declare, set aside or pay any dividends on, or make any other distributions (whether in cash, stock or property) in respect of, any of its capital stock or other equity or voting interests except for:

(A) dividends by a direct or indirect wholly owned subsidiary of the Company to its shareholders;

(B) regular quarterly cash dividends with respect to the Company Common Stock, not in excess of an annual rate of $0.94 per share in 2001, $0.98 per share in 2002 and $1.02 per share in 2003, in each case with usual declaration, record and payment dates and in accordance with the Company's past dividend policy;

(C) if the Effective Time occurs other than on a record date for quarterly cash dividends with respect to the Company Common Stock, a "stub period" dividend equal to an amount not to exceed 25% of the amount of the cash dividend per share permitted to be paid pursuant to the immediately preceding clause (B) during such fiscal year in which the Effective Time occurs multiplied by a fraction, the numerator of which is the number of days between the immediately preceding record date and the Effective Time and the denominator of which is the number of days between such record date and the next regularly scheduled record date;

(D) regular cash dividends with respect to outstanding shares of Company 5% Cumulative Preferred Stock in accordance with the terms thereof as in effect on the date of this Agreement;

(E) regular cash dividends with respect to outstanding shares of Company 5% Cumulative Preference Stock in accordance with the terms thereof as in effect on the date of this Agreement; or

(F) (x) cash dividends with respect to any outstanding shares of preferred stock of any of the Company's subsidiaries or (y) cash dividends with respect to any outstanding shares of non-preferred capital stock of any of the Company's non-wholly owned subsidiaries; provided, however, that in the case of subsidiaries owned as of the date of this Agreement, such dividends shall be paid only in the ordinary course of business consistent with such subsidiary's past practice; or

(y) purchase, redeem or otherwise acquire any shares of capital stock of, or other equity or voting interests in, the Company or its subsidiaries or any options, warrants, calls or rights to acquire any such shares or other interests, except (A) for the Stock Redemption, (B) purchases, redemptions or other acquisitions as required by the respective terms of any preferred stock of the Company or as required or permitted by the respective terms of any preferred stock of any of the Company's subsidiaries, (C) for the purpose of funding or providing benefits under employee benefit plans, stock option and other incentive compensation plans, directors plans and the dividend reinvestment provisions of the Company's Dividend Reinvestment and Stock Purchase Plan, (D) purchases, redemptions or other acquisitions in the ordinary course of business consistent with past practice of any voting stock of a subsidiary of the Company not held by the

Company or its subsidiaries or (E) the purchases of shares of capital stock of a wholly owned subsidiary of the Company by the Company or a wholly owned subsidiary of the Company; or

(z) split, combine or reclassify any of its capital stock or other equity or voting interests or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of its capital stock or other equity or voting interests;

(ii) issue, deliver, sell, pledge or otherwise encumber any shares of its capital stock, any other equity or voting interests or any securities convertible into, or exchangeable for, or any options, warrants, calls or rights to acquire, any such shares, interests or securities or any stock appreciation rights or other rights that are linked to the price of Company Common Stock other than:

(A) the issuance of shares of Company Common Stock (and associated Company Rights) upon the exercise of Company Stock Options and settlement of all other rights to purchase or receive Company Common Stock (collectively, the "Company Stock Issuance Rights") in accordance with the terms of such Company Stock Options and Company Stock Issuance Rights as in effect on the date of this Agreement;

(B) the delivery or sale of shares of Company Common Stock held as treasury stock of the Company as of the date hereof or thereafter purchased on the open market by the Company or one of its subsidiaries as permitted by, and for the purposes set forth in, Section 4.01(a)(i)(y)(C);

(C) the issuance of shares of capital stock to the Company or a wholly owned subsidiary of the Company by a subsidiary of the Company;

(D) the issuance of shares of Company Common Stock pursuant to the Company Rights Agreement pursuant to the terms thereof as in effect on the date hereof;

(E) to the extent permitted by Section 5.09(i), the issuance of shares of Company Common Stock pursuant to the Company's Dividend Reinvestment and Stock Purchase Plan; or

(F) issuances of shares of Company Common Stock which are necessary, in the reasonable judgment of the Company, in order to maintain the credit ratings of the Company or its subsidiaries; provided that any such issuance of shares shall be permitted only if prior to such issuance the Company shall have consulted with

Parent, and the Company and Parent shall have been unable to agree on a mutually acceptable alternative basis to maintain the credit rating of the Company or its subsidiary, as the case may be;

(iii) amend its certificate of incorporation or by-laws (or similar organizational documents) except as may be required by Applicable Law or by the rules and regulations of the New York Stock Exchange; or

(iv) (A) directly or indirectly acquire or agree to acquire, whether by merging or consolidating with, or by purchasing assets of, or by any other manner, any assets constituting a business or any corporation, partnership, joint venture, association, limited liability company or other entity or division thereof, other than:

(x) the acquisition of any business which is regulated by a PUC or owned or operated by a municipality or local Governmental Entity; provided, that all such acquisitions permitted by this clause (x) shall not involve aggregate payments (including debt assumption) by the Company and its subsidiaries of more than $300,000,000; or

(y) the acquisition of any business in or related to (1) the water services or wastewater services industry or (2) any line of business conducted by Azurix North America Corp. or Azurix Industrials Corp. on or prior to the date of consummation of the acquisition of such entities which is not regulated by a PUC or owned or operated by a municipality or local Governmental Entity; provided that all such acquisitions permitted by this clause (y) shall not involve aggregate payments (including debt assumption) by the Company or any of its subsidiaries of more than $100,000,000;

provided that, if the Company or any of its subsidiaries requests the consent of Parent for any acquisition not otherwise permitted by this clause (A) then Parent shall promptly inform the Company whether Guarantor or any of its subsidiaries is participating or intends to participate in the bidding for such acquisition and, if Parent informs the Company that Guarantor or one of its subsidiaries is participating or intends to participate in the bidding for such acquisition or if Guarantor or one of its subsidiaries does in fact so participate, then the Company shall not be subject to the provisions of this Section 4.01(a)(iv) with respect to such acquisition (provided further that, for the purposes of this Section 4.01(a)(iv), the Company may presume (absent written notice to the contrary from Parent) that Guarantor or one of its subsidiaries is participating in any competitive bidding process for an acquisition which (i) is not prohibited by Section 4.03 and (ii) has been marketed broadly to major participants in the water services or wastewater services industries and shall not be required to request the consent of

Parent or otherwise be subject to the provisions of this Section 4.01(a)(iv) with respect to any such acquisition); or

(B) any other assets that are material (unless such assets are acquired in the ordinary course of business), other than assets constituting a business the acquisition of which does not require consent or approval under Section 4.01(a)(iv)(A);

it being understood and agreed that the Company and its subsidiaries shall, reasonably in advance of the applicable meeting of the Company's Board of Directors, provide Parent with reasonable documentation describing, and consult with Parent with respect to, any acquisition which requires approval of the Company's Board of Directors; or

(v) directly or indirectly sell, lease, license, sell and leaseback, mortgage or otherwise encumber or subject to any Lien or otherwise dispose of any real property, or any other properties or assets or any interest therein that are material, individually or in the aggregate, other than:

(A) sales of real property or other properties or assets, provided that the fair market value of all such properties and assets does not exceed $100,000,000;

(B) the sale of any property or asset that the Company or one of its subsidiaries is legally required, or under bona fide threat of condemnation or similar proceedings, to sell to any Governmental Entity so long as the Company sells such property or asset to such Governmental Entity in a manner consistent with past practice;

(C) the sale of shares of capital stock or other securities which are held as passive minority investments so long as such sale is made in an arm's-length transaction; or

(D) the grant of easements, rights of way and Liens in the ordinary course of business consistent with past practice, or in connection with secured indebtedness of the Company or any of its subsidiaries permitted by Section 4.01(a)(vi) and consistent with past practice;

it being understood and agreed that the Company and its subsidiaries shall, reasonably in advance of the applicable meeting of the Company's Board of Directors, provide Parent with reasonable documentation describing, and consult with Parent with respect to, any sale, lease, license, sale/leaseback, mortgage, encumbrance or other disposition which requires approval of the Company's Board of Directors; or

(vi) (x) incur any indebtedness or guarantee any indebtedness of another person or issue or sell any debt securities or options, warrants, calls or other rights to acquire any debt securities of the Company or any of its subsidiaries, enter into any interest rate protection agreement or other hedging arrangement, guarantee any debt securities of another person, enter into any "keep well" or other agreement to maintain any financial statement condition of another person or enter into any arrangement having the economic effect of any of the foregoing (excluding for purposes of clarification, advances received as contemplated by Section 4.01(a)(vii)(B)), except for:

(A) the incurrence of short-term indebtedness in the ordinary course of business consistent with past practice;

(B) the incurrence of long-term indebtedness and interest rate protection and other hedging arrangements in respect of such long-term indebtedness so long as the aggregate amount of such long-term indebtedness outstanding as of the end of each fiscal year ended after the date of this Agreement (excluding, without duplication, long-term indebtedness otherwise permitted under this Section 4.01(a)(vi)(x), but including long-term indebtedness incurred to fund capital expenditures permitted by Section 4.01(a)(vii) to the extent the incurrence of such indebtedness is included in the Company's business plan described below), does not exceed 110% of the aggregate amount of all long-term indebtedness contemplated to be outstanding as of the end of such fiscal year by the Company's business plan for the five-year period ending on December 31, 2005, a true and complete copy of which has been provided to Parent prior to the date of this Agreement;

(C) (1) the incurrence of indebtedness or guarantees of indebtedness to finance acquisitions and the incurrence or assumption of indebtedness of the entities acquired in such acquisitions, in either case in connection with acquisitions permitted by Section 4.01(a)(iv), or (2) the incurrence of indebtedness or guarantees of indebtedness to fund capital expenditures permitted by Section 4.01(a)(vii);

(D) the incurrence of any guarantees, bid bonds, performance bonds, surety bonds, payment bonds, letters of credit and "keep well" agreements and other similar arrangements entered into in the ordinary course of business consistent with past practice between the Company and its subsidiaries or in support of the indebtedness or other obligations of the Company, the Company's subsidiaries or among the Company's subsidiaries; or

(E) the incurrence of indebtedness in an amount equal to (1) the cost of Company Common Stock purchased for issuance pursuant to Section 4.01(a)(ii)(B), plus (2) the amount of cash proceeds that would otherwise be expected to be received by the Company from the sale of Company Common Stock under the Company's Dividend Reinvestment and Stock Purchase Plan after the date, and for so long as, such plan is indefinitely suspended pursuant to Section 5.09(i); or

(y) make any material loans, advances or capital contributions to, or investments in, any other person, other than the Company or any direct or indirect subsidiary of the Company other than (A) investments made in joint ventures formed for purposes permitted pursuant to Section 4.01(a)(iv), (B) loans, advances, capital contributions and investments made in connection with actions permitted pursuant to Sections 4.01(a)(iv), (v), (vi)(x), (vii) or (x) or (C) in the ordinary course of business;

it being understood and agreed that the Company and its subsidiaries shall consult with Parent (i) on the Company's and its subsidiaries' credit ratings and (ii) prior to incurring any material long-term indebtedness (other than issuances of tax-free long-term indebtedness) of the Company or any of its subsidiaries; or

(vii) incur or commit to incur any capital expenditures in excess of 120% of the amount budgeted in the Company's five-year capital plan, a true and complete copy of which has been provided to Parent prior to the date of this Agreement, other than:

(A) capital expenditures required by changes in or newly promulgated Applicable Laws or Judgments or applicable standards or policies of any Governmental Entity after the date of this Agreement;

(B) capital expenditures funded by customer advances or contributions in aid of construction;

(C) capital expenditures incremental to the Company's five-year capital plan as may be required to serve customers who generate sufficient revenues to fully fund the cost of such capital expenditures without adversely affecting customer rates;

(D) capital expenditures related to the operation of any business acquired through an acquisition permitted by Section 4.01(a)(iv);

(E) capital expenditures to the extent covered by insurance or as reasonably required in the Company's judgment following a catastrophic event; or

(F) capital expenditures in connection with performance by the Company or one of its subsidiaries under any Contract to the extent the Company's or such subsidiary's obligations in connection with any such capital expenditure are non-recourse to the Company or such subsidiary and funded by the United States government;

it being understood and agreed that the Company and its subsidiaries shall, reasonably in advance of the applicable meeting of the Company's Board of Directors, provide Parent with reasonable documentation describing, and consult with Parent with respect to, any capital expenditure which requires approval of the Company's Board of Directors; or

(viii) except as required by Applicable Law or any Judgment (x) pay, discharge, settle or satisfy any material claims (including claims of stockholders), liabilities or obligations (whether absolute, accrued, asserted or unasserted, contingent or otherwise), other than the payment, discharge, settlement or satisfaction of claims, liabilities or obligations (A) in the ordinary course of business consistent with past practice, (B) as required by their terms as in effect on the date of this Agreement or on the date of acquisition of the person subject thereto or (C) incurred since the date of this Agreement in the ordinary course of business consistent with past practice, (y) waive, release, grant or transfer any right of material value, other than in the ordinary course of business consistent with past practice or (z) waive any material benefits of, or agree to modify in any materially adverse respect, or fail to enforce in any material respect, or consent to any material matter with respect to which its consent is required under, any material confidentiality, standstill or similar agreement to which the Company or any of its subsidiaries is a party;

(ix) except (i) as required to comply with Applicable Law or any Judgment, any Collective Bargaining Agreement or any provision of any Company Benefit Plan or other Contract as in effect on the date of this Agreement, (ii) in the ordinary course of the Company or its subsidiaries conducting their respective businesses consistent with past practice, (iii) as would, in the discretion of the Company, be commercially reasonable in order to retain Company Employees (as defined in Section 5.09(a)) or to hire (or promote) or replace new executives, (iv) as is or would be required to give effect to acquisition agreements entered into by the Company and/or its subsidiaries or (v) as would not, individually or in the aggregate, materially increase the Company's and its subsidiaries' annual expense for compensation and benefits provided or to be provided to the Company Employees:

(A) take any action to fund or in any other way secure the payment of compensation or benefits under any Company Benefit Plan or other Contract;

(B) take any action to accelerate the vesting or payment of any compensation or benefit under any Company Benefit Plan or other Contract;

(C) grant any compensation, benefits, severance or termination pay or increases therein to any Participant; or

(D) establish, adopt, enter into, amend or terminate any Company Benefit Plan, except as required to implement grants or increases permitted under Section 4.01(a)(ix)(C); or

(x) (A) enter into any material Contract other than:

(1) any Contract related to the Company's PUC-regulated business entered into in the ordinary course of business consistent with past practice;

(2) any Contract related to the water services or wastewater services industry; provided that the average aggregate annual revenues to be received by the Company and its subsidiaries over the first three years of such Contract, together with the total average aggregate annual revenues to be received by the Company and its subsidiaries over the first three years of all such other Contracts entered into pursuant to this clause (2) during the twelve-month period beginning on the date of this Agreement or during any subsequent twelve-month period shall not exceed $60 million per year (excluding any consumer price index or other similar adjustments and without regard to any extension thereof); provided, further that (A) the average annual amounts of any payments to be made to the Company during the first three years of such Contract in respect of any capital expenditures permitted by Section 4.01(a)(vii)(F) of this Agreement and other recovered costs of capital in respect thereof shall not count against such $60 million per year limit and (B) the average annual amounts

of any associated recovery of capital improvement costs (and, in the case of any "design-build-operate" Contract, payments in respect of the "design-build" portion of such Contract to the extent that those payments are (x) guaranteed by a non-affiliate of the Company which the Company reasonably determines is sufficiently creditworthy or (y) passed through to third parties who perform the "design-build" portion of such Contract) during the first three years of such Contract shall not count against such $60 million per year limit; or

(3) any Contract providing for any transaction otherwise permitted by this Section 4.01(a);

provided that if the Company or any of its subsidiaries requests the consent of Parent to enter into any Contract not otherwise permitted by this clause (A) then Parent shall promptly inform the Company whether Guarantor or any of its subsidiaries is participating or intends to participate in the bidding for such Contract and, if Parent informs the Company that Guarantor or one of its subsidiaries is participating or intends to participate in the bidding for such Contract or if Guarantor or one of its subsidiaries does in fact so participate, then the Company shall not be subject to the provisions of this clause (A) with respect to such Contract (provided further that, for the purposes of this clause (A), the Company may presume (absent written notice to the contrary from Parent) that Guarantor or one of its subsidiaries is participating in any competitive bidding process for a Contract which has been marketed broadly to major participants in the water services or wastewater services industries and shall not be required to request the consent of Parent or otherwise be subject to the provisions of this clause (A) with respect to any such Contract);

it being understood and agreed that the Company and its subsidiaries shall, reasonably in advance of the applicable meeting of the Company's Board of Directors, provide Parent with reasonable documentation describing, and consult with Parent with respect to, any material Contract which requires the approval of the Company's Board of Directors;

(B) renew any material Contract unless such renewal (i) shall not modify the terms of such Contract, taken as a whole, in any material adverse respect or (ii) is on terms that are reasonably agreed to by the Company in carrying on its business in the ordinary course; or

(C) modify, amend, waive or terminate (x) any material Contract other than in the ordinary course of business or (y) the Filed Contracts, in either case without consulting with Parent in good faith in advance; or

(xi) authorize any of, or commit, resolve or agree to take any of, the foregoing actions.

(b) Administration of Consents. Any request for a consent of Parent under Section 4.01(a), and any correspondence between the parties with respect to those consents (including the granting or refusal to grant any such consent) and any consultation required under Section 4.01(a) shall be made solely by and between the person identified in Section 4.01(b) of the Company Disclosure Schedule, on behalf of the Company and its subsidiaries, and the person identified in Section 4.01(b) of the Parent Disclosure Schedule, on behalf of Guarantor, Parent and their respective subsidiaries.

(c) Control of the Company's Business. It is understood and agreed that Guarantor, Parent, Sub and their affiliates do not have the right to control or direct the Company's operations prior to the Effective Time. Prior to the Effective Time, the Company shall exercise, consistent with the terms and conditions of this Agreement, complete control and supervision over its operations.

(d) Certain Tax Matters. Except as set forth in Section 4.01(d) of the Company Disclosure Schedule, during the period from the date of this Agreement to the Effective Time, the Company shall, and shall cause each of its subsidiaries to, (i) not make any material tax election without Parent's consent and (ii) to the extent permitted by the applicable agreement, cause all existing tax sharing agreements to be terminated as of the Closing Date.

(e) Utility Filings. The Company shall, and shall cause each of its subsidiaries to, timely file in the ordinary course of business consistent with past practice all rate applications and all other material filings required to be made with PUCs. Except for filings in the ordinary course of business consistent with past practice that individually or in the aggregate would not reasonably be expected to have a material adverse effect, the Company shall, and shall cause each of its subsidiaries to, consult with Parent reasonably in advance of making any filing to implement any changes in any of its or any of its subsidiaries' rates or surcharges for water service, standards of service or accounting.

SECTION 4.02. No Solicitation. (a) From and after the date hereof, the Company agrees (i) that it and its subsidiaries shall not, nor shall it or its subsidiaries authorize or knowingly permit any director, officer or employee of the Company or any of its subsidiaries or any investment banker, attorney, accountant or other advisor or representative of the Company or any of its subsidiaries (collectively, the "Representatives") to, directly or indirectly, solicit, initiate or encourage, or take any other action knowingly to facilitate, any Takeover Proposal (as defined below) or engage in any discussions or negotiations regarding, or provide any nonpublic information or data to make or implement, any Takeover Proposal, in each case other than a Takeover Proposal made by Parent; (ii) that it shall immediately cease and cause to be terminated any existing discussions or negotiations with any third persons conducted heretofore with a view to formulating a Takeover Proposal; and (iii) that it shall immediately notify Parent of the receipt of any Takeover Proposal and that it shall keep Parent informed of the status of such Takeover Proposal; provided, however, that, at any time prior to obtaining the Stockholder Approval, the Company may, in response to a bona fide Takeover Proposal that the Board of Directors of the Company determines in good faith could reasonably be expected to lead to a Superior Proposal (as defined below) and which Takeover Proposal did not result from a breach of this Section 4.02, (x) furnish information with respect to the Company and its subsidiaries to the person making such Takeover Proposal (and its representatives) pursuant to a customary confidentiality agreement (except that such confidentiality agreement shall not prohibit such person from making an unsolicited Takeover Proposal), provided that all such information is provided on a prior or substantially concurrent basis to Parent, and (y) participate in discussions or negotiations with the person making such Takeover Proposal (and its representatives) regarding such Takeover Proposal.

The term "Takeover Proposal" means any inquiry, proposal or offer from any person relating to, or that is reasonably likely to lead to, any direct or indirect acquisition, in one transaction or a series of transactions, including by way of any merger, consolidation, tender offer, exchange offer, binding share exchange, business combination, recapitalization, liquidation, dissolution, joint venture or similar transaction, of (A) assets or businesses that constitute or represent 20% or more of the total revenue, operating income, EBITDA or assets of the Company and its subsidiaries, taken as a whole, or (B) 20% or more of the outstanding shares of Company Capital Stock or capital stock of, or other equity or voting interests in, any of the Company's subsidiaries directly or indirectly holding the assets or businesses referred to in clause (A) above.

(b) Neither the Board of Directors of the Company nor any committee thereof shall (i) withdraw (or modify in a manner adverse to Parent or Sub) or propose publicly to withdraw (or modify in a manner adverse to Parent or Sub) the recommendation or declaration of advisability by such Board of Directors of the Company or any such committee of this Agreement or the Merger, or recommend, or propose publicly to recommend, the approval or adoption of any Takeover Proposal (other than a Takeover Proposal made by Parent) (each such action being referred to herein as an "Adverse Recommendation Change"), unless the Board of Directors of the Company determines in good faith, based on such matters as it deems appropriate, after consulting with legal counsel, that such action is necessary for the Board of Directors of the Company to comply with its fiduciary duties to the Company's stockholders under applicable law and the Company's certificate of incorporation, (ii) adopt or approve, or publicly propose to adopt or approve, any Takeover Proposal (other than a Takeover Proposal made by Parent), or withdraw its approval of the Merger, (iii) cause or permit the Company to enter into any letter of intent, memorandum of understanding, agreement in principle, acquisition agreement, merger agreement, joint venture agreement, partnership agreement or other agreement (each, an "Acquisition Agreement") constituting or related to any Takeover Proposal (other than a confidentiality agreement referred to in Section 4.02(a)) or (iv) agree or resolve to take any of the actions prohibited by clauses (i), (ii) or (iii) of this sentence. Notwithstanding anything in this Agreement to the contrary, at any time prior to obtaining the Stockholder Approval, the Board of Directors of the Company may, in response to a Superior Proposal (as defined below) that did not result from a breach of Section 4.02(a), cause the Company to terminate this Agreement pursuant to Section 7.01(f) and concurrently or promptly thereafter enter into an Acquisition Agreement; provided, however, that the Company shall not terminate this Agreement pursuant to Section 7.01(f), unless the Company shall have complied with all the provisions of this Section 4.02 (except for any failure to comply that would not adversely affect the rights of Parent under this Section 4.02), including the notification provisions in this Section 4.02, and with all applicable requirements of Section 5.06(b) (including the payment of the Termination Fee (as defined in Section 5.06(b)) prior to or concurrently with such termination); and provided further, however, that the Company shall not exercise its right to terminate this Agreement pursuant to Section 7.01(f) until the fifth business day following Parent's receipt of written notice (a "Notice of Superior Proposal") from the Company advising Parent that the Board of Directors of the Company has received a Superior Proposal specifying the terms and conditions of the Superior Proposal, identifying the person making such Superior Proposal and stating that the Board of Directors of the Company intends to exercise its right to terminate this Agreement pursuant to Section 7.01(f) (it being understood and agreed that, prior to any such termination taking effect, any amendment to the price or any other material term of a Superior Proposal shall require a new Notice of Superior Proposal and a new five business day period).

The term "Superior Proposal" means any bona fide written offer made by a third party in respect of (i) a transaction that if consummated would result in such third party acquiring, directly or indirectly, 50% or more of the voting power of the Company Common Stock or 50% or more of the assets of the Company and its subsidiaries, taken as a whole, or (ii) a direct merger between such third party and the Company, in either case providing for consideration to the Company's stockholders consisting of cash and/or securities (it being understood that securities retained by the Company's stockholders be included for purposes of this determination), which transaction the Board of Directors of the Company determines in its good faith judgment (after consultation with a financial advisor of nationally recognized reputation) (taking into account the person making the offer, the consideration offered, the likelihood of consummation (including the legal, financial and regulatory aspects of the offer) as well as any other factors deemed relevant by the Board of Directors of the Company) to be more favorable from a financial point of view to the stockholders of the Company, taking into account any changes to the terms of this Agreement offered by Parent in response to such Superior Proposal or otherwise.

(c) Nothing contained in this Section 4.02 or elsewhere in this Agreement shall prohibit the Company from (i) taking and disclosing to its stockholders a position contemplated by Rule 14e-2(a) promulgated under the Exchange Act or (ii) making any disclosure to the Company's stockholders if, in the good faith judgment of the Board of Directors of the Company, after consultation with outside counsel, failure to make such disclosure would be inconsistent with applicable law; provided, however, that in no event shall the Company or its Board of Directors or any committee thereof take, agree or resolve to take any action prohibited by Section 4.02(b)(i) (subject to the last clause of Section 4.02(b)(i)) or Section 4.02(b)(ii).

SECTION 4.03. Certain Conduct of the Parties. (a) During the period from the date of this Agreement to the Effective Time, except as consented to in writing by the Company (which consent shall not be unreasonably withheld or delayed and which consent shall be deemed given if Parent has not received written notice otherwise from the Company within eight business days after requesting such consent of the Company), Guarantor and Parent shall not, and shall cause their subsidiaries not to, directly or indirectly (a) acquire or agree to acquire or, except as required by Applicable Law, the rules and regulations of the Frankfurt Stock Exchange or, with respect to any disclosure by any subsidiary, the rules and regulations of the principal stock exchange on which such subsidiary's securities are listed, publicly disclose any acquisition, in one transaction or a series of transactions, including by way of any merger, consolidation, tender offer, exchange offer, binding share exchange, business combination, recapitalization, liquidation, dissolution, joint venture or similar transaction, of (i) any United States water services or wastewater services business that is regulated by a PUC or is owned or operated by a municipality or local Governmental Entity (other than any such acquisition which does not involve aggregate payments (including debt assumption) by Guarantor, Parent or their subsidiaries in excess of $20 million) or (ii) (A) any business that would, upon the consummation of such acquisition, (x) cause Guarantor, Parent or any of their respective subsidiaries to be required to register as a holding company under the Holding Company Act or (y) subject Guarantor, Parent, Sub or any of their respective subsidiaries to regulation under the Holding Company Act in a manner that would raise substantive questions with respect to the ownership by any of them of any water or wastewater business or (B) any business (x) that would, upon the consummation of such acquisition, subject Guarantor, Parent or any of their respective subsidiaries to regulation under the Holding Company Act in a manner other than that described in clause (A) above or (y) that is a United States gas or electric utility, if in the case of clause (B), such business is subject to regulation as a gas or electric utility (or similar designation) by a PUC in any state which the parties agree is material or (b) take any other action that would reasonably be expected to (i) materially impede or delay obtaining any Parent Required Consent or Company Required Consent or the satisfaction of the conditions set forth in Section 6.01(c) (to the extent relating to the Holding Company Act), 6.01(d) or 6.02(d) or (ii) otherwise materially impede or delay the consummation of the Merger. In the event that Guarantor or Parent shall seek the consent of the Company to make an acquisition of the type described in Section 4.03(a)(a)(ii)(B), the sole basis on which the Company may withhold its consent shall be a determination by the Company that such acquisition would reasonably be expected to (x) materially impede or delay obtaining any Parent Required Consent or Company Required Consent or the satisfaction of the conditions set forth in Section 6.01(c) (to the extent relating to the Holding Company Act), 6.01(d) or 6.02(d) or (y) otherwise materially impede or delay the consummation of the Merger.

(b) Prior to the obtaining of the Stockholder Approval, Guarantor and Parent shall not, and shall cause their respective subsidiaries not to, acquire "beneficial ownership" (as such term is defined for purposes of Section 13(d) of the Exchange Act) of any shares of Company Common Stock. After the obtaining of the Stockholder Approval, Guarantor and Parent shall not, and shall cause their respective subsidiaries not to, acquire shares of Company Common Stock if such acquisition would result in Guarantor, Parent and their subsidiaries acquiring "beneficial ownership" (as so defined) of more than 4.9% of the shares of Company Common Stock outstanding at the time of such acquisition.

(c) During the period from the date of this Agreement to the Effective Time, except as consented to in writing by Parent (which consent shall not be unreasonably withheld or delayed and which consent shall be deemed given if the Company has not received written notice otherwise from Parent within eight business days after requesting such consent of Parent), the Company shall not, and shall cause its subsidiaries not to, directly or indirectly, take any action that would reasonably be expected to (i) materially impede or delay obtaining any Parent Required Consent or Company Required Consent or the satisfaction of the conditions set forth in Section 6.01(c) (to the extent relating to the Holding Company Act), 6.01(d) or 6.02(d) or (ii) otherwise materially impede or delay the consummation of the Merger.

ARTICLE V

Additional Agreements

SECTION 5.01. Preparation of the Proxy Statement; Stockholders Meeting. (a) As promptly as reasonably practicable following the date of this Agreement, the Company shall prepare and file with the SEC the Proxy Statement in preliminary form and the Company shall use its reasonable best efforts to respond as promptly as practicable to any comments of the SEC with respect thereto and to cause the Proxy Statement to be mailed to the Company's stockholders as promptly as practicable following the date of this Agreement. The Company shall promptly notify Parent upon the receipt of any comments from the SEC or its staff or any request from the SEC or its staff for amendments or supplements to the Proxy Statement and shall provide Parent with copies of all correspondence between the Company and its representatives, on the one hand, and the SEC and its staff, on the other hand. Parent shall promptly provide any information or responses to comments, or other assistance, reasonably requested in connection with the foregoing. Prior to filing or mailing the Proxy Statement (or any amendment or supplement thereto) or responding to any comments of the SEC with respect thereto, the Company (i) shall provide Parent an opportunity to review and comment on such document or response and (ii) shall give reasonable consideration to all comments proposed by Parent.

(b) The Company shall, as promptly as reasonably practicable following the date of this Agreement, establish a record date for, duly call, give notice of, convene and hold a meeting of its stockholders (the "Stockholders Meeting") for the purpose of obtaining the Stockholder Approval, regardless of whether an Adverse Recommendation Change has occurred at any time after the date of this Agreement. The Company shall, through its Board of Directors, recommend to its stockholders that they adopt this Agreement, and shall include such recommendation in the Proxy Statement, in each case subject to its rights under Section 4.02(b)(i). Without limiting the generality of the foregoing, the Company agrees that its obligations pursuant to this Section 5.01(b) shall not be affected by the commencement, public proposal, public disclosure or communication to the Company or any other person of any Takeover Proposal.

SECTION 5.02. Access to Information; Confidentiality; Transition Planning. (a) The Company shall, and shall cause each of its subsidiaries to, afford to Parent, and to Parent's officers, employees, investment bankers, attorneys, accountants and other advisors and representatives, reasonable access at reasonable times and during normal business hours during the period prior to the Effective Time or the termination of this Agreement, in a manner which does not unreasonably interfere with the business and operations of the Company, to all their respective properties, assets, books, contracts, commitments, directors, officers, employees, attorneys, accountants, auditors, other advisors and representatives and records and, during such period, the Company shall, and shall cause each of its subsidiaries to, make available to Parent on a prompt basis (a) access to each material report, schedule, form, statement and other document filed or received by it during such period to or from any PUC or pursuant to the requirements of applicable securities laws and (b) all other information concerning its business, properties and personnel as Parent may reasonably request; provided that such right of access shall not include sampling, testing or Phase II environmental site assessment activities. For the purposes of this Section 5.02, all communications, including requests for information or access, pursuant to this Section 5.02, shall only be made by and between a representative of each of Parent, on the one hand, and of the Company, on the other hand, which representative (a) shall initially be Jim McGivern for Parent and Ellen Wolf for the Company and (b) may be replaced with a substitute representative by either party from time to time upon reasonable written notice to the other party. The Company will promptly advise Parent of any material developments in its business. Notwithstanding the foregoing, (i) the Company and its subsidiaries shall not be required to provide any information to the extent that the Company or any of its subsidiaries is legally obligated to keep such information confidential or otherwise not to provide such information or to the extent that such access would constitute a waiver of the attorney-client privilege and (ii) the Company shall provide access to those properties, assets, books, contracts, commitments, directors, officers, employees, attorneys, accountants, auditors, other advisors and representatives and records described above of its subsidiaries that are not wholly-owned subsidiaries only to the extent that the Company has or is reasonably able to obtain such access. Parent will hold, and will direct its officers, employees, investment bankers, attorneys, accountants and other advisors and representatives to hold, any and all information received from the Company, directly or indirectly, in confidence in accordance with the Confidentiality Agreement dated June 26, 2001, among Guarantor, Thames and the Company (as it may be amended from time to time, the "Confidentiality Agreement").

(b) The Company and Parent shall, and shall cause each of their respective subsidiaries to, reasonably cooperate to obtain an orderly transition and integration process in connection with the Merger in order to minimize the disruption to, and preserve the value of, the business of the Surviving Corporation and its subsidiaries during the period from and after the Effective Time. The Company and Parent agree that such cooperation shall include the development as soon as reasonably practicable following the date hereof of a mutually acceptable integration plan on a business-by-business and region-by-region basis with reasonable provisions for visitation by employees.

SECTION 5.03. Reasonable Best Efforts; Notification. Upon the terms and subject to the conditions set forth in this Agreement, each of the parties agrees to use its reasonable best efforts to take, or cause to be taken, all actions that are necessary, proper and advisable to consummate and make effective the Merger and the other transactions contemplated by this Agreement and the Company Voting Agreement, including using its reasonable best efforts to accomplish the following as promptly as reasonably practicable following the date of this Agreement: (a) the taking of all acts necessary to cause the conditions precedent set forth in Article VI to be satisfied, (b) the obtaining of all necessary actions or nonactions, waivers, consents, approvals, orders and authorizations from Governmental Entities and the making of all necessary registrations, declarations and filings and the taking of all steps as may be necessary to obtain an approval (including the Company Required Consents and the Parent Required Consents) or waiver from, or, to the extent any approval or waiver cannot be obtained, to avoid the need to obtain an approval (including the Company Required Consents and the Parent Required Consents) or waiver from, or to avoid an action or proceeding by, any Governmental Entity and (c) the obtaining of all necessary consents, approvals or waivers from third parties. In connection with and without limiting the foregoing, the Company shall, if any state takeover statute or similar statute or regulation is or becomes applicable to this Agreement, the Company Voting Agreement, the Merger or any of the other transactions contemplated hereby or thereby, use its reasonable best efforts to allow the Merger and the other transactions contemplated by this Agreement and the Company Voting Agreement to be consummated as promptly as practicable on the terms contemplated by this Agreement and the Company Voting Agreement and otherwise to minimize the effect of such statute or regulation on this Agreement, the Company Voting Agreement, the Merger and the other transactions contemplated hereby and thereby. The Company, Guarantor and Parent shall provide such assistance, information and cooperation to each other as is reasonably requested in connection with the foregoing and, in connection therewith, shall notify the other person promptly following the receipt of any comments from any Governmental Entity and of any request by any Governmental Entity for amendments, supplements or additional information in respect of any registration, declaration or filing with such Governmental Entity and shall supply the other person with copies of all correspondence between such person or any of its representatives, on the one hand, and any Governmental Entity, on the other hand. In addition, the Company, Guarantor and Parent shall cooperate to promptly develop a mutually acceptable plan to obtain the Company Required Consents and the Parent Required Consents as expeditiously as reasonably practicable and without undue expense. To the extent that either party or any of its subsidiaries is required to make any registration, declaration or filing with any PUC in connection with obtaining the Company Required Consents or the Parent Required Consents, such party shall use its reasonable best efforts to (i) provide the other party an opportunity to review and comment on such registration, declaration or filing reasonably in advance of making any such registration, declaration or filing, (ii) give reasonable consideration to all comments proposed by the other party and (iii) if applicable, coordinate the submission of such registration, declaration or filing with the other party. Neither the Company nor any of its subsidiaries shall enter into or agree to any terms or conditions in connection with obtaining the Company Required Consents without the prior written consent of Parent (which consent shall not be unreasonably withheld or delayed). None of Guarantor, Parent, Sub or any of their respective subsidiaries shall enter into or agree to any terms or conditions in connection with obtaining the Parent Required Consents without the prior written consent of the Company (which consent shall not be unreasonably withheld or delayed).

SECTION 5.04. Company Stock Options. (a) As soon as practicable following the date of this Agreement, the Company shall ensure that the Board of Directors of the Company (or, if appropriate, any committee administering the Company Stock Plans) shall adopt such resolutions or take such other actions (if any) as may be required to provide that:

(i) each Company Stock Option outstanding immediately prior to the Effective Time (whether vested or unvested) shall be converted at the Effective Time into the right to receive an amount of cash equal to (A) the excess, if any, of (1) the Merger Consideration over (2) the exercise price per share of Company Common Stock subject to such Company Stock Option, multiplied by (B) the number of shares of Company Common Stock for which such Company Stock Option shall not theretofore have been exercised;

(ii) each Company Stock Issuance Right outstanding immediately prior to the Effective Time (whether vested or unvested) shall be converted at the Effective Time into the right to receive an amount of cash equal to the product of (A) the Merger Consideration and (B) the number of shares of Company Common Stock subject to such Company Stock Issuance Right; and

(iii) make such other changes to the Company Stock Plans as the Company and Parent may agree are appropriate to give effect to the Merger.

(b) All amounts payable pursuant to Section 5.04(a) shall be subject to any required withholding of taxes or proof of eligibility of exemption therefrom, and shall be paid as soon as practicable following the Effective Time, without interest.

(c) The Company shall take all actions determined to be necessary to effectuate the provisions of this Section 5.04 as mutually agreed by Parent and the Company. Prior to the Effective Time, the Company shall ensure that the Board of Directors of the Company (or, if appropriate, any committee administering the Company Stock Plans) shall take or cause to be taken such actions as are required to cause (i) the Company Stock Plans to terminate as of the Effective Time and (ii) the provisions in any other Company Benefit Plan providing for the issuance, transfer or grant of any capital stock of the Company or any interest on or following the Effective Time in respect of any capital stock of the Company to be deleted as of the Effective Time.

SECTION 5.05. Indemnification, Exculpation and Insurance. (a) To the extent, if any, not provided by an existing right of indemnification or other agreement or policy, from and after the Effective Time, Guarantor and Parent shall, to the fullest extent permitted by applicable law, indemnify, defend and hold harmless each person who is now, or has been at any time prior to the date hereof, or who becomes prior to the Effective Time, an officer or director of the Company or any of its subsidiaries (each an "Indemnified Party" and, collectively, the "Indemnified Parties") against (i) all losses, expenses (including reasonable attorney's fees and expenses), claims, damages or liabilities or, subject to the proviso of the next succeeding sentence, amounts paid in settlement, arising out of actions or omissions occurring at or prior to the Effective Time (and whether asserted or claimed prior to, at or after the Effective Time) that are, in whole or in part, based on or arising out of the fact that such person is or was a director or officer of the Company or any of its subsidiaries ("Indemnified Liabilities"), and (ii) all Indemnified Liabilities to the extent they are based in whole or in part on or arise in whole or in part out of or pertain to this Agreement or the transactions contemplated hereby. In the event of any such loss, expense, claim, damage or liability (whether or not arising before the Effective Time), Guarantor and Parent shall pay or cause to be paid the reasonable fees and expenses of counsel selected by the Indemnified Parties, which counsel shall be reasonably satisfactory to Parent, promptly after statements therefor are received and otherwise advance to such Indemnified Party upon request reimbursement of documented expenses reasonably incurred; provided, however, that Guarantor and Parent shall not be liable for any settlement effected without its written prior consent (which consent shall not be unreasonably withheld or delayed). In the event any Indemnified Party is required to bring any action against Guarantor or Parent to enforce rights or to collect money due under this Agreement and such action results in a final, non-appealable judgment in favor of such Indemnified Party, Guarantor and Parent shall reimburse such Indemnified Party for all of its reasonable expenses in bringing and pursuing such action. Each Indemnified Party shall be entitled to the advancement of expenses to the full extent contemplated in this Section 5.05(a) in connection with any such action; provided, however, that any person to whom expenses are advanced provides an undertaking, if and to the extent required by the DGCL, to repay such advances if it is ultimately determined that such person is not entitled to indemnification.

(b) For six years after the Effective Time, Guarantor and Parent shall maintain in effect (i) the Company's current directors' and officers' liability insurance covering each person currently covered by the Company's directors' and officers' liability insurance policy for acts or omissions occurring prior to the Effective Time on terms with respect to such coverage and amounts no less favorable in the aggregate to such directors and officers than those of such policy as in effect on the date of this Agreement; provided that Guarantor or Parent may substitute therefor policies of a reputable insurance company the terms of which, including coverage and amount, are no less favorable in the aggregate to such directors and officers than the insurance coverage otherwise required under this Section 5.05(b); provided however, that in no event shall Guarantor and Parent be required to pay aggregate annual premiums for insurance under this Section 5.05(b) in excess of 200% of the amount of the aggregate premiums paid by the Company for the year from July 22, 2001 through July 22, 2002 for such purpose (which premiums for the year from July 22, 2001 through July 22, 2002 are hereby represented and warranted by the Company to be $327,500), provided that Guarantor and Parent shall nevertheless be obligated to provide a policy with the best coverage available as may be obtained for such 200% amount and (ii) in the Restated Certificate of Incorporation and By-Laws of the Surviving Corporation the provisions regarding elimination of liability of directors and indemnification of, and advancement of expenses to, officers or directors contained in the Restated Certificate of Incorporation attached as Exhibit A and the current By-Laws of the Company.

(c) In the event that Guarantor or Parent or any of their successors or assigns (i) consolidates with or merges into any other person and is not the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers or conveys all or substantially all its properties and assets to any person, then, and in each such case, Guarantor and Parent shall cause proper provision to be made so that the successors and assigns of Guarantor or Parent, as the case may be, assume the obligations set forth in this Section 5.05.

(d) To the fullest extent permitted by law, from and after the Effective Time, all rights to indemnification as of the date hereof in favor of the directors and officers of the Company and its subsidiaries with respect to their activities as such prior to the Effective Time, as provided in, with respect to the Company, the Restated Certificate of Incorporation attached as Exhibit A and the current By-Laws of the Company, or, with respect to the Company's subsidiaries, their respective certificates of incorporation and by-laws (or similar organizational documents) in effect on the date hereof, or otherwise in effect on the date hereof, shall survive the Merger and shall continue in full force and effect for a period of not less than six years from the Effective Time; provided, however, that in the event any claim or claims are asserted or made within such six-year period, all such rights to indemnification in respect of such claim or claims shall continue until the final disposition thereof.

(e) The provisions of this Section 5.05 are intended to be for the benefit of, and will be enforceable by, each Indemnified Party, his or her heirs and his or her representatives.

SECTION 5.06. Fees and Expenses. (a) Except as provided below, all fees and expenses incurred in connection with this Agreement, the Company Voting Agreement, the Merger and the other transactions contemplated hereby and thereby shall be paid by the party incurring such fees or expenses, whether or not the Merger is consummated.

(b) In the event that (i) (A) a Takeover Proposal shall have been made to the Company or its stockholders or any person has publicly announced an intention (which has not been withdrawn) to make a Takeover Proposal, (B) thereafter this Agreement is terminated by either Parent or the Company pursuant to Section 7.01(b)(i) (but only if the Stockholders Meeting has not been held by the date that is five business days prior to the date of such termination due to a breach of Section 5.01 by the Company) or 7.01(b)(iii) and (C) within 12 months after such termination, the Company or any of its subsidiaries enters into a definitive agreement to consummate, or consummates, any Takeover Proposal (solely for purposes of this Section 5.06(b)(i)(C), the term "Takeover Proposal" shall have the meaning set forth in the definition of Takeover Proposal contained in Section 4.02(a) except that all references to 20% shall be deemed references to 50%), (ii) this Agreement is terminated by the Company pursuant to Section 7.01(f) or (iii) this Agreement is terminated by Parent pursuant to Section 7.01(c), then the Company shall pay Parent a fee equal to $138 million (the "Termination Fee") by wire transfer of same day funds to an account in the United States designated by Parent (x) in the case of a termination by the Company pursuant to Section 7.01(f), concurrently with such termination, (y) in the case of a termination by Parent pursuant to Section 7.01(c), within two business days after such termination and (z) in the case of a payment as a result of any event referred to in Section 5.06(b)(i)(C), upon the first to occur of such events. The Company acknowledges that the agreements contained in this Section 5.06(b) are an integral part of the transactions contemplated by this Agreement, and that, without these agreements, Parent would not enter into this Agreement; accordingly, if the Company fails promptly to pay the amounts due pursuant to this Section 5.06(b), and, in order to obtain such payment, Parent commences a suit that results in a final, non-appealable judgment against the Company for the amounts set forth in this Section 5.06(b), the Company shall pay to Parent interest on the amounts set forth in this Section 5.06(b) from and including the date payment of such amount was due to but excluding the date of actual payment at the prime rate of The Chase Manhattan Bank in effect on the date such payment was required to be made, together with reasonable legal fees and expenses incurred in connection with such suit.

(c) If this Agreement is terminated (i) by the Company pursuant to Section 7.01(e) (other than on account of a breach of Section 3.02(d), Section 4.03 or Section 5.03) or (ii) by Parent pursuant to Section 7.01(d), then the non-terminating party shall promptly (but not later than five business days after receipt of notice of the amount due from the other party) pay to the terminating party an amount equal to all documented out-of-pocket expenses and fees incurred by such terminating party or its affiliates (including fees and expenses payable to all legal, accounting, financial, public relations and other professional advisors) arising out of, in connection with or related to the Merger or the other transactions contemplated by this Agreement ("Out-of-Pocket Expenses") not to exceed $20 million in the aggregate; provided, however, that if this Agreement is terminated under the circumstances described in clauses (i) or (ii) above by a party as a result of a willful breach by the non-terminating party, the terminating party may pursue any remedies available to it at law or in equity and such party's Out-of-Pocket Expenses shall not be limited to $20 million.

SECTION 5.07. [Intentionally omitted].

SECTION 5.08. Collective Bargaining Agreements. From and after the Effective Time, Parent shall cause the Surviving Corporation and its subsidiaries to honor and continue to be bound by the terms of all collective bargaining agreements to which the Company or any of its subsidiaries is a party (the "Collective Bargaining Agreements").

SECTION 5.09. Benefits Matters. (a) For purposes hereof, "Company Employees" shall mean those individuals who are employees of the Company and its subsidiaries (including those employees who are on vacation, leave of absence, disability or maternity leave) as of the Effective Time.

(b) Subject to Applicable Law and Judgments and obligations under Collective Bargaining Agreements, Parent shall, and shall cause the Surviving Corporation to, give the Company Employees full credit, for all purposes, under any employee benefit plans or arrangements maintained by Parent's (or one of its subsidiaries') water business in the United States, the Surviving Corporation and their respective subsidiaries, and in which Company Employees may become eligible to participate for the Company Employees' service with the Company and its subsidiaries to the same extent recognized by the Company and its subsidiaries immediately prior to the Effective Time, except for purposes of benefit accrual under defined benefit pension plans in which the Company Employees do not participate immediately prior to the Effective Time, so long as credit for past service under any such pension plan is also not given to other employees employed in Parent's (or one of its subsidiaries') water businesses in the United States or to the extent giving such credit would result in a duplication of benefits (including in respect of benefit accrual under defined benefit pension plans) for the same period of service.

(c) Subject to Applicable Law and Judgments and obligations under Collective Bargaining Agreements, Parent shall, and shall cause the Surviving Corporation to, (i) waive all limitations as to preexisting conditions, exclusions and waiting periods with respect to participation and coverage requirements applicable to the Company Employees and, to the extent applicable, any retired employee constituting a member of the Retiree Group (as defined below) (any such employee a "Retired Employee") under any welfare benefit plans in which such employees may be eligible to participate after the Effective Time to the extent waived under the applicable Company Benefit Plan immediately prior to the Effective Time and (ii) provide each Company Employee (and each Retired Employee) with credit for any co-payments and deductibles paid prior to the Effective Time in the calendar year in which the Effective Time occurs (or, if later, the year in which such Company Employee (and each Retired Employee) commences participation) in satisfying any applicable deductible or out-of-pocket requirements under any welfare plans in which such Company Employee (and each Retired Employee) is eligible to participate after the Effective Time.

(d) Parent agrees to honor, and shall cause the Surviving Corporation to honor, the Company Benefit Plans disclosed in the Filed SEC Documents or Section 3.01(k)(i) of the Company Disclosure Schedule in accordance with their current terms. Subject to Applicable Law and Judgments and obligations under Collective Bargaining Agreements, for a period of 18 months immediately following the Effective Time, Parent shall, or shall cause the Surviving Corporation to, provide to the Company Employees compensation (including base pay and annual and long term incentive opportunities) and employee benefits (including health, welfare, pension, vacation, savings and severance) that are no less favorable in the aggregate than those provided to the Company Employees immediately prior to the Effective Time; provided, that for a period of 12 months immediately following the Effective Time, Parent shall, or shall cause the Surviving Corporation to, maintain the Company Benefit Plans in accordance with their terms as in effect immediately prior to the Effective Time (other than equity or equity-based plans) without any adverse amendment thereto or termination thereof (except as required by Applicable Law and Judgments or any Collective Bargaining Agreement). Notwithstanding the foregoing, following the Effective Time, there shall be no obligation to provide Company Employees with awards of capital stock of any entity or awards of options or other rights of any kind to acquire capital stock of any entity); provided, however, that the value of any equity-based compensation provided to Company Employees immediately prior to the Effective Time shall be taken into account in determining whether compensation and benefits provided during the 18 months after the Effective Time are no less favorable in the aggregate than those provided to Company Employees immediately prior to the Effective Time.

(e) Subject to Applicable Law and Judgments and obligations under Collective Bargaining Agreements, Parent shall, or shall cause the Surviving Corporation to, provide to the Retiree Group (as defined below), without adverse amendment, the post-retirement medical and life insurance benefits as in effect immediately prior to the Closing Date (at the same levels, and at the same cost (if any), as in effect immediately prior to the Closing Date), provided to Company Employees who are not covered by a Collective Bargaining Agreement and their dependents as set forth in the retiree medical plan listed in Section 3.01(k)(i) of the Company Disclosure Schedule (the "Retiree Medical Plan"). The "Retiree Group" means each Company Employee who is not (or was not while employed) covered by a Collective Bargaining Agreement and who, as of the Closing Date, (i) is either retired under the terms of the Retiree Medical Plan as in effect on the date hereof or (ii) has satisfied all applicable eligibility requirements (under the terms of the Retiree Medical Plan as in effect on the date hereof) necessary to commence receiving benefits if his or her employment were terminated at the Effective Time.

(f) Subject to Applicable Law and Judgments and obligations under Collective Bargaining Agreements, in the event and to the extent that Guarantor or one of its subsidiaries maintains a qualified employer stock ownership plan for the benefit of employees employed in Parent's or one of its subsidiaries' (or one of their respective successors') water business in the United States (a "Guarantor ESOP"), Guarantor shall allow all current non-union Company Employees to participate in such Guarantor ESOP as soon as practicable after the Effective Time.

(g) Between the date of this Agreement and the Closing Date, the Company shall provide Parent commercially reasonable access to the Company Employees for purposes of implementing this Agreement.

(h) The Company shall use its reasonable best efforts to cause the Board of Directors of the Company not to exercise any discretion it possesses solely in respect of the transactions contemplated by this Agreement, to expressly set the date when a "change in control" occurs for the purposes of any applicable individual agreement covering a Participant (other than to deem such "change in control" to occur no earlier than the Effective Time).

(i) The Company shall take all action necessary (i) to provide that the component of the Company's Dividend Reinvestment and Stock Purchase Plan permitting independent monthly purchases of Company Common Stock (other than purchases of Company Common Stock funded solely by reinvestment of Company dividends) (the "DRSPP Stock Purchase Component") shall be indefinitely suspended as promptly as reasonably practicable following the date of this Agreement (but in no event later than immediately following the second stock purchase effected following the date of this Agreement under the DRSPP Stock Purchase Component) and (ii) to cause all amounts not yet applied as of the date of termination of the DRSPP Stock Purchase Component to purchase Company Common Stock under the DRSPP Stock Purchase Component to be returned as promptly as practicable following such suspension.

SECTION 5.10. Public Announcements. Subject to each party's disclosure obligations imposed by law or any applicable securities exchange, and except with respect to any Adverse Recommendation Change, Parent and Sub, on the one hand, and the Company, on the other hand, shall, to the extent reasonably practicable, consult and cooperate with each other before issuing, and give each other a reasonable opportunity to review and comment upon, any press release or other public statements (other than routine employee communications) with respect to this Agreement, the Company Voting Agreement, the Merger and the other transactions contemplated hereby and thereby. The parties agree that the initial press release to be issued with respect to the transactions contemplated by this Agreement shall be in the form heretofore agreed to by the parties.

SECTION 5.11. Rights Agreement. The Board of Directors of the Company shall take all action necessary in order to render the Company Rights inapplicable to the Merger, the Company Voting Agreement and the performance of this Agreement.

SECTION 5.12. Stockholder Litigation. The Company agrees that it shall not settle or offer to settle any litigation commenced prior to or after the date hereof against the Company or any of its directors by any stockholder of the Company relating to this Agreement, the Company Voting Agreement, the Merger, any other transaction contemplated hereby or thereby, without the prior written consent of Parent (not to be unreasonably withheld or delayed).

SECTION 5.13. Director Resignations. On the Closing Date, the Company shall cause to be delivered to Parent duly executed resignations, effective as of the Effective Time, of each member of the Board of Directors of the Company and shall take such other action as is necessary to accomplish the foregoing.

ARTICLE VI

Conditions Precedent

SECTION 6.01. Conditions to Each Party's Obligation to Effect the Merger. The obligation of each party to effect the Merger is subject to the satisfaction or waiver on or prior to the Closing Date of the following conditions:

(a) Stockholder Approval. The Stockholder Approval shall have been obtained.

(b) Antitrust. Any waiting period (and any extension thereof) applicable to the Merger under the HSR Act shall have been terminated or shall have expired and any other required approval or waiting period under any other similar competition, merger control, antitrust or similar law or regulation or the Investment Canada Act, if applicable, the failure of which to obtain or comply with which would be reasonably expected to have a material adverse effect, shall have been obtained or terminated or shall have expired.

(c) No Injunctions or Legal Restraints. No temporary restraining order, preliminary or permanent injunction or other order or decree issued by any court of competent jurisdiction or other legal restraint or prohibition that has the effect of preventing the consummation of the Merger shall be in effect (collectively, "Legal Restraints").

(d) Required Consents. The Company Required Consents and the Parent Required Consents shall have been obtained prior to the Effective Time and shall have become Final Orders. Any reference in this Agreement to the "obtaining" of any such Company Required Consents or Parent Required Consents shall mean making such declarations, filings, registrations, giving such notice, obtaining such authorizations, orders, consents or approvals and having such waiting periods expire as are, in each case, necessary to avoid a violation of law. A "Final Order" for purposes of this Agreement means action by the relevant regulatory authority (i) which has not been reversed, stayed, enjoined, set aside, annulled or suspended and (ii) with respect to which any waiting period prescribed by Applicable Law or Judgment before the Merger and the other transactions contemplated hereby may be consummated has expired, and as to which all conditions to be satisfied before the consummation of such transactions prescribed by Applicable Law or Judgment have been satisfied.

(e) Stock Redemption. The Stock Redemption shall have been consummated.

SECTION 6.02. Conditions to Obligations of Guarantor, Parent and Sub. The obligations of Guarantor, Parent and Sub to effect the Merger are further subject to the satisfaction or waiver on or prior to the Closing Date of the following conditions:

(a) Representations and Warranties. The representations and warranties of the Company contained herein shall be true and correct as of the date of this Agreement and as of the Closing Date with the same effect as though made as of the Closing Date (except that the accuracy of representations and warranties that by their terms speak as of a specified date will be determined as of such date), other than for such failures to be true and correct that individually or in the aggregate would not reasonably be expected to have a material adverse effect. Parent shall have received a certificate signed on behalf of the Company by the chief financial officer of the Company to such effect. For the purposes of determining the satisfaction of this condition, the representations and warranties of the Company shall be deemed not qualified by any references therein to materiality generally or to a material adverse effect.

(b) Performance of Obligations of the Company. The Company shall have performed in all material respects all obligations required to be performed by it under this Agreement at or prior to the Closing Date, and Parent shall have received a certificate signed on behalf of the Company by the chief financial officer of the Company to such effect.

(c) Material Adverse Effect. No material adverse effect shall have occurred and there shall be no state of facts, change, development, effect, condition or occurrence that would reasonably be expected to have a material adverse effect.

(d) Required Consents. The Final Orders relating to the Company Required Consents and the Parent Required Consents, together with any consents, approvals, orders, authorizations and declarations that shall have been obtained following the date of this Agreement and prior to the Effective Time in connection with any acquisition of any business or person by the Company or any of its subsidiaries, shall not individually or in the aggregate impose any terms or conditions, excluding any terms and conditions that may be imposed with respect to the acquisitions contemplated by the agreements dated as of October 15, 1999 between the Company and certain of its subsidiaries on one hand, and Citizens Communications Company ("Citizens") and certain of its subsidiaries, on the other hand, to acquire certain water and wastewater assets of those Citizens subsidiaries, to the extent reflected or referred to in the Proposed Decision of ALJ McVicar dated as of September 6, 2001 and excluding any terms and conditions that may be imposed to the extent attributable to any acquisition of any business or person by Guarantor or any of its subsidiaries with respect to which an acquisition agreement is entered into or that is publicly announced or consummated after the date of this Agreement, that would reasonably be expected to have a material adverse effect, or a material adverse effect on the combined business, assets, properties, condition (financial or otherwise) or results of operations of the Company and Thames Water Holdings, Inc. and their respective subsidiaries taken as a whole.

SECTION 6.03. Conditions to Obligation of the Company. The obligation of the Company to effect the Merger is further subject to the satisfaction or waiver on or prior to the Closing Date of the following conditions:

(a) Representations and Warranties. The representations and warranties of Guarantor, Parent and Sub contained herein shall be true and correct, as of the date of this Agreement and as of the Closing Date with the same effect as though made as of the Closing Date (except that the accuracy of representations and warranties that by their terms speak as of a specified date will be determined as of such date), other than for such failures to be true and correct that individually or in the aggregate would not reasonably be expected to impair in any material respect the ability of Guarantor, Parent or Sub to perform its obligations under this Agreement or prevent or materially delay the consummation of any of the transactions contemplated by this Agreement. The Company shall have received a certificate signed on behalf of Guarantor and Parent by a senior officer of each of Guarantor and Parent to such effect. For the purposes of determining the satisfaction of this condition, the representations and warranties of Guarantor, Parent and Sub shall be deemed not qualified by any references therein to materiality generally or to a material adverse effect.

(b) Performance of Obligations of Parent and Sub. Guarantor, Parent and Sub shall have performed in all material respects all obligations required to be performed by them under this Agreement at or prior to the Closing Date, and the Company shall have received a certificate signed on behalf of Guarantor and Parent by a senior officer of each of Guarantor and Parent to such effect.

SECTION 6.04. Frustration of Closing Conditions. None of the Company, Guarantor, Parent or Sub may rely on the failure of any condition set forth in Section 6.01, 6.02 or 6.03, as the case may be, to be satisfied if such failure was caused by such party's failure to use reasonable best efforts to consummate the Merger and the other transactions contemplated by this Agreement, as required by and subject to Section 5.03.

ARTICLE VII

Termination, Amendment and Waiver

SECTION 7.01. Termination. This Agreement may be terminated, and the Merger contemplated hereby may be abandoned, at any time prior to the Effective Time, whether before or after the Stockholder Approval has been obtained:

(a) by mutual written consent of Parent, Sub and the Company;

(b) by either Parent or the Company:

(i) if the Merger shall not have been consummated by March 16, 2003; provided, however, (A) that the right to terminate this Agreement pursuant to this Section 7.01(b)(i) shall not be available to any party whose breach of this Agreement has been the primary reason the Merger has not been consummated by such date, (B) that neither Parent nor the Company may terminate pursuant to this clause (b)(i) if on such date all conditions in Article VI shall have been satisfied or be capable of being satisfied other than the condition set forth in Section 6.01(e), and the Company shall have mailed a notice of redemption to effect the Stock Redemption, and (C) that if on such date a condition set forth in Section 6.01(d) or 6.02(d) shall not have been satisfied but all other conditions set forth in Article VI shall have been satisfied or be capable of being satisfied, then such date shall be extended to September 16, 2003; and provided, further, that if on such date (or such extended date pursuant to the immediately preceding proviso, as applicable), a condition set forth in Section 6.01(d) or 6.02(d) shall not have been satisfied solely because the period described in clause (ii) of the definition of Final Order set forth in Section 6.01(d) shall not have expired, but all of the other conditions set forth in Article VI shall have been satisfied or be capable of being satisfied, such date shall be extended to the date of expiration of such period (up to a maximum of 60 days for such extension);

(ii) if any Legal Restraint of the type referred to in Section 6.01(c) shall be in effect and shall have become final and nonappealable (provided that the party seeking to terminate this Agreement pursuant to this Section 7.01(b)(ii) shall have used its reasonable best efforts to resist, resolve or lift, as applicable, such Legal Restraint); or

(iii) if, upon a vote at a duly held meeting to obtain the Stockholder Approval, the Stockholder Approval shall not have been obtained;

(c) by Parent in the event an Adverse Recommendation Change has occurred;

(d) by Parent if the Company shall have breached any of its representations, warranties or covenants contained in this Agreement, which breach (A) would give rise to the failure of a condition set forth in Section 6.02(a) or 6.02(b), and (B) has not been cured by the Company within twenty business days after its receipt of written notice thereof from Parent;

(e) by the Company if Parent shall have breached any of its representations, warranties or covenants contained in this Agreement, which breach (i) would give rise to the failure of a condition set forth in Section 6.03(a) or 6.03(b), and (ii) has not been cured by Parent within twenty business days after its receipt of written notice thereof from the Company; or

(f) by the Company in accordance with the terms and subject to the conditions of Section 4.02(b).

Notwithstanding the foregoing, in no event shall Parent terminate this Agreement unless prior to the date of such termination Parent shall have complied with Section 7.03 (including paying to the Company the Reverse Fee) if applicable.

SECTION 7.02. Effect of Termination. In the event of termination of this Agreement by either the Company or Parent as provided in Section 7.01, this Agreement shall forthwith become void and have no effect, without any liability or obligation on the part of Parent, Sub or the Company, other than the provisions of the last sentence of Section 5.02(a), Section 5.06, this Section 7.02, Section 7.03 and Article VIII; provided, however, that no such termination shall relieve any party hereto from any liability or damages resulting from a wilful breach by a party of any of its representations, warranties or covenants set forth in this Agreement.

SECTION 7.03. Certain Breaches. If (a) this Agreement is terminated by either party pursuant to Section 7.01 (other than (w) the termination of this Agreement by either Parent or the Company pursuant to Section 7.01(a) or (b)(iii), (x) the termination of this Agreement by Parent pursuant to Section 7.01(c) or (y) the termination of this Agreement by the Company pursuant to Section 7.01(f)) at a time when any of the conditions set forth in Section 6.01(c) (to the extent relating to the Holding Company Act), 6.01(d) or 6.02(d) have not been satisfied and (b) at the time of such termination either (i) Section 3.02(d)(i) is not true and correct such that Guarantor, Parent, Sub or any of their respective subsidiaries (A) would be required to register as a holding company under the Holding Company Act or (B) would be subject to regulation under the Holding Company Act in a manner that would raise substantive questions with respect to the ownership by any of them of any water or wastewater business or Guarantor or Parent is in breach of Section 4.03(a)(a)(i) or 4.03(a)(a)(ii)(A) or (ii) Section 3.02(d)(i) (other than as set forth above) or 3.02(d)(ii) is not true and correct or Guarantor or Parent is in breach of Section 4.03(a)(a)(ii)(B), 4.03(a)(b)(i), 5.03(a) (to the extent relating to Section 6.01(c) (to the extent relating to the Holding Company Act), 6.01(d) or 6.02(d)) or 5.03(b) (to the extent relating to the Company Required Consents and the Parent Required Consents) and, in the case of clause (ii), such failure to be true and correct or such breach is the primary cause of the failure of the conditions set forth in Section 6.01(c) (to the extent relating to the Holding Company Act), 6.01(d) or 6.02(d) to be satisfied, then Parent shall pay the Company an amount equal to $138 million (the "Reverse Fee") by wire transfer of same day funds in U.S. dollars to an account in the United States designated by the Company within two business days after (or, in the case of a termination by Parent, concurrently with) such termination. Guarantor and Parent acknowledge that the agreements contained in this Section 7.03 are an integral part of the transactions contemplated by this Agreement, and that, without these agreements, the Company would not enter into this Agreement; accordingly, if Parent fails promptly to pay the amounts due pursuant to this Section 7.03, and, in order to obtain such payment, the Company commences a suit that results in a final, non-appealable judgment against Guarantor or Parent for the amounts set forth in this Section 7.03, Parent and Guarantor shall pay to the Company interest on the amounts set forth in this Section 7.03 from and including the date payment of such amount was due to but excluding the date of actual payment at the prime rate of The Chase Manhattan Bank in effect on the date such payment was required to be made, together with reasonable legal fees and expenses incurred in connection with such suit. The parties acknowledge and agree that, notwithstanding any other provision in this Agreement to the contrary, the Company's sole and exclusive remedy with respect to any and all claims based on or with respect to any failure of Section 3.02(d) to be true and correct or any breach of Section 4.03(a)(a), 4.03(a)(b)(i), 5.03(a) (to the extent set forth above) or 5.03(b) (to the extent set forth above), in circumstances where the Company is entitled to payment of the Reverse Fee (other than any claims resulting from a willful breach by Guarantor or Parent or any of their respective subsidiaries of Section 3.02(d), 4.03(a)(a), 4.03(a)(b)(i), 5.03(a) (to the extent set forth above) or 5.03(b) (to the extent set forth above)) shall be the payment of the Reverse Fee pursuant to this Section 7.03.

SECTION 7.04. Amendment. This Agreement may be amended by the parties hereto at any time prior to the Effective Time, whether before or after the Stockholder Approval has been obtained; provided, however, that after the Stockholder Approval has been obtained, there shall be made no amendment that by law requires further approval by stockholders of the parties without the further approval of such stockholders. This Agreement may not be amended except by an instrument in writing signed on behalf of each of the parties hereto.

SECTION 7.05. Extension; Waiver. At any time prior to the Effective Time, the parties may (a) extend the time for the performance of any of the obligations or other acts of the other parties, (b) waive any inaccuracies in the representations and warranties contained herein or in any document delivered pursuant hereto or (c) waive compliance with any of the agreements or conditions contained herein; provided, however, that after the Stockholder Approval has been obtained, there shall be made no waiver that by law requires further approval by stockholders of the parties without the further approval of such stockholders. Any agreement on the part of a party to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party. The failure or delay by any party to this Agreement to assert any of its rights under this Agreement or otherwise shall not constitute a waiver of such rights nor shall any single or partial exercise by any party to this Agreement of any of its rights under this Agreement preclude any other or further exercise of such rights or any other rights under this Agreement.

ARTICLE VIII

General Provisions

SECTION 8.01. Nonsurvival of Representations and Warranties. None of the representations and warranties in this Agreement or in any instrument delivered pursuant to this Agreement shall survive the Effective Time. This Section 8.01 shall not limit any covenant or agreement of the parties which by its terms contemplates performance after the Effective Time.

SECTION 8.02. Notices. All notices, requests, claims, demands and other communications hereunder shall be in writing and shall be deemed given if delivered personally or one business day after being sent by overnight courier (providing proof of delivery) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

if to Guarantor, Parent or Sub, to:

Thames Water Plc
Clearwater Court
Vastern Road
Reading RG1 8DB
United Kingdom

Attention: Bill Alexander

Janet Ravenscroft

with a copy to:

RWE Aktiengesellschaft
Opernplatz 1, 45128
Essen, Germany

Attention: General Counsel

with a copy to:

Cravath, Swaine & Moore
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019

Attention: Peter S. Wilson, Esq.
Mark I. Greene, Esq.

if to the Company, to:

American Water Works Company, Inc.
1025 Laurel Oak Road
Voorhees, NJ 08043

Attention: W. Timothy Pohl

with a copy to:

Simpson Thacher & Bartlett
425 Lexington Avenue
New York, NY 10017

Attention: Caroline B. Gottschalk, Esq.
Peter S. Malloy, Esq.

SECTION 8.03. Definitions. For purposes of this Agreement:

(a) an "affiliate" of any person means another person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, such first person;

(b) "knowledge of the Company" means the actual knowledge of those individuals set forth in Section 8.03(b) of the Company Disclosure Schedule;

(c) "knowledge of Guarantor and Parent" means the actual knowledge of those individuals set forth in Section 8.03(c) of the Parent Disclosure Schedule;

(d) "material adverse effect" means any material adverse change or effect (i) on the business, assets, properties, condition (financial or otherwise) or results of operations of the Company and its subsidiaries, taken as a whole, or (ii) which would reasonably be expected, directly or indirectly, to prevent or materially impede or delay the consummation of the Merger or the other transactions contemplated by this Agreement, except in the case of either (i) or (ii) for any change or effect (w) set forth in Section 8.03(d) of the Company Disclosure Schedule, (x) relating to financial markets or the economy in general, (y) affecting the water services or wastewater services industries generally and not specifically relating to the Company or its subsidiaries, or (z) to the extent attributable to or resulting from the public announcement of the transactions contemplated by this Agreement or the identity of Guarantor or Parent or their subsidiaries as the acquiring person in the Merger including any loss of customers or employees or condemnation proceedings resulting therefrom;

(e) "person" means an individual, corporation, partnership, joint venture, association, trust, limited liability company, Governmental Entity, unincorporated organization or other entity;

(f) a "Significant Subsidiary" of any person means any subsidiary of such person that constitutes a significant subsidiary within the meaning of Rule 1-02 of Regulation S-X of the SEC;

(g) a "subsidiary" of any person means another person (i) of which 50% or more of the capital stock, voting securities, other voting ownership or voting partnership interests having voting power under ordinary circumstances to elect directors or similar members of the governing body of such corporation or other entity (or, if there are no such voting interests, 50% or more of the equity interests) are owned or controlled, directly or indirectly, by such first person or (ii) of which such first person is a general partner; and

(h) a "wholly owned subsidiary" of any person means a subsidiary of which 99% or more of the common equity securities having voting power under ordinary circumstances to elect directors or similar members of the governing body of such corporation or other entity (or, if there are no such equity securities having such voting power, 99% or more of the equity interests) are owned or controlled, directly or indirectly, by such first person.

SECTION 8.04. Interpretation. When a reference is made in this Agreement to a Section, Subsection or Schedule, such reference shall be to a Section or Subsection of, or a Schedule to, this Agreement unless otherwise indicated. The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. Whenever the words "include," "includes" or "including" are used in this Agreement, they shall be deemed to be followed by the words "without limitation." The words "hereof," "herein" and "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement. The term "or" is not exclusive. The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms. Any agreement or instrument defined or referred to herein or in any agreement or instrument that is referred to herein means such agreement or instrument as from time to time amended, modified or supplemented. References to a person are also to its permitted successors and assigns.

SECTION 8.05. Guarantee. In connection with the Merger and the other transactions contemplated by this Agreement, Guarantor hereby irrevocably, absolutely and unconditionally guarantees the due, punctual and complete performance and payment (and not merely collection) in full of all obligations and liabilities of Parent, Sub and the Surviving Corporation under this Agreement, and of any other person to whom any of their obligations shall be assigned in accordance with Section 8.09, as and when due and payable or required to be performed pursuant to any provisions of this Agreement, subject to the terms and conditions thereof (the "Guaranteed Obligations") and agrees that the Company shall be entitled to enforce directly against Guarantor any of the Guaranteed Obligations. To the fullest extent permitted by Applicable Law, Guarantor waives presentment to, demand of payment from and protest to any other person of any of the Guaranteed Obligations, and also waives notice of acceptance of its guarantee and notice of protest for nonpayment. The obligations of Guarantor hereunder shall not be subject to any reduction, limitation, impairment or termination for any reason, including any claim of waiver, release, surrender, alteration or compromise, and shall not be subject to any defense or setoff, counterclaim, recoupment or termination whatsoever by reason of the invalidity, illegality or unenforceability of the Guaranteed Obligations, or otherwise. Notwithstanding any of the foregoing, nothing herein shall be deemed to waive or limit Guarantor's ability to assert any claims, defenses or other rights that Parent or Sub may have under this Agreement.

SECTION 8.06. Counterparts. This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties.

SECTION 8.07. Entire Agreement; No Third-Party Beneficiaries. This Agreement, together with the Company Disclosure Schedules, the Parent Disclosure Schedules and the Exhibits (a) constitutes the entire agreement, and supersedes all prior agreements and understandings, both written and oral, (other than the Confidentiality Agreement), among the parties with respect to the subject matter hereof and thereof and (b) except for the provisions of Section 5.05, are not intended to confer upon any person other than the parties hereto and thereto (and their respective successors and assigns) any rights or remedies.

SECTION 8.08. Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of Delaware, regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof.

SECTION 8.09. Assignment. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned or delegated, in whole or in part (except by operation of law), by any of the parties hereto without the prior written consent of the other parties hereto, and any attempt to make any such assignment without such consent shall be null and void. Notwithstanding the foregoing, Parent or Sub may assign, in its sole discretion, any of or all its respective rights, interests and obligations under this Agreement to Guarantor or to any direct or indirect wholly owned subsidiary of Guarantor with written notice to the Company and upon taking of any actions required by the DGCL with respect thereto (including amending this Agreement if necessary), provided that the Company agrees to provide reasonable assistance to Parent with any such actions and agrees to execute any such amendments to this Agreement, but no such assignment shall relieve Parent or Sub of any of their respective obligations hereunder; provided, however, that Parent and such substitute subsidiary shall represent and warrant to the Company, on the day such substitution is to be effective, the representations and warranties set forth in Section 3.02; provided, further, that no action shall be taken that would require the Company to amend or supplement in any material respect the Proxy Statement at any time after the Proxy Statement has first been mailed to the Company's stockholders or materially delay or impede the consummation of the Merger. Subject to the preceding sentence, this Agreement shall be binding upon, inure to the benefit of and be enforceable by, the parties hereto and their respective successors and assigns.

SECTION 8.10. Enforcement. The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed that the parties shall be entitled to an injunction or injunctions to prevent breaches of this Agreement and to enforce specifically the terms and provisions of this Agreement in any court of the United States located in the State of Delaware or in any Delaware state court, this being in addition to any other remedy to which they are entitled at law or in equity. In addition, each of the parties hereto (a) consents to submit itself to the personal jurisdiction of any court of the United States located in the State of Delaware or of any Delaware state court in the event any dispute arises out of this Agreement or the transactions contemplated by this Agreement, (b) agrees that it will not attempt to deny or defeat such personal jurisdiction by motion or other request for leave from any such court and (c) agrees that it will not bring any action relating to this Agreement or the transactions contemplated by this Agreement in any court other than a court of the United States located in the State of Delaware or a Delaware state court. By the execution and delivery of this Agreement, each of Guarantor and Parent appoints CT Corporation System, Corporation Trust Center, 1209 Orange Street, Wilmington, DE 19801, as its agent upon which process may be served in any such legal action or proceeding. Service of process upon such agent, together with notice of such service given to Guarantor or Parent in the manner specified in Section 8.02 shall be deemed in every respect effective service of process upon Guarantor or Parent in any legal action or proceeding.

SECTION 8.11. Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule or law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner to the end that transactions contemplated hereby are fulfilled to the extent possible.

SECTION 8.12. Waiver of Jury Trial. Each party waives, to the fullest extent permitted by law, any right it may have to a trial by jury in respect of any action, suit or proceeding arising out of or relating to this Agreement or the transactions contemplated by this Agreement.

IN WITNESS WHEREOF, Guarantor, Parent, Sub and the Company have caused this Agreement to be signed by their respective officers thereunto duly authorized, all as of the date first written above.

RWE AKTIENGESELLSCHAFT,

By: ___________________________
Name:
Title:

By: ___________________________
Name:
Title:

THAMES WATER AQUA HOLDINGS GMBH,

By: ___________________________
Name:
Title:

By: ___________________________
Name:
Title:

APOLLO ACQUISITION COMPANY,

By: ___________________________
Name:
Title:

AMERICAN WATER WORKS COMPANY, INC.,

By: ___________________________
Name:
Title:

[Draft—September 14, 2001]

Project Apollo
Summary of Merger Agreement

Parties

- Regal, Parent (the holding company for Trident and for Regal's other water subsidiaries), Sub (a wholly-owned subsidiary of Parent established for purposes of the merger) and Apollo.

Structure

- The agreement is a binding commitment to acquire Apollo in a single step merger following which Apollo will become a wholly-owned subsidiary of Parent.

- Regal will unconditionally guarantee all Parent's obligations under the agreement.

- Certain significant stockholders of Apollo will agree to vote in favor of the transaction.

- In the merger, stockholders will receive $[•] per share in cash and option holders will receive an amount in cash equal to the spread between the cash merger consideration and the exercise price of their options.

- Apollo's outstanding preferred stock and preference stock will be redeemed in accordance with their terms prior to the merger.

Representations and Warranties

- The agreement contains representations and warranties by Apollo that are customary for a transaction of this nature. Representations and warranties relating to Apollo's business are generally limited to those matters which would have a material adverse effect on Apollo and its subsidiaries, taken as a whole.

- The determination of a material adverse effect will exclude effects attributable to changes in the economy or industry generally and effects attributable to the public announcement of the merger or the identity of the purchaser.

- The agreement contains customary representations and warranties by Regal. In addition, Regal will represent as to
  - Regal and its subsidiaries not being regulated as a public utility holding company or public utility under U.S. federal or state law.
  - Regal and its subsidiaries not owning any shares of Apollo common stock as of the date of the merger agreement.
  - Regal not being aware of any facts which would materially adversely affect Regal's ability to obtain the required regulatory consents.

Conduct of Business by Apollo

- The agreement contains a customary covenant of Apollo to operate its business in the ordinary course between signing and closing.
- The agreement also contains provisions limiting certain actions by Apollo between signing and closing, including (1) paying dividends, (2) issuing capital stock, (3) making acquisitions, (4) selling assets, (5) incurring indebtedness, (6) making capital expenditures, (7) making certain changes in employee compensation or benefits or (8) entering into certain contracts, in each case with agreed exceptions.
- In the area of acquisitions
  - Apollo is free to make acquisitions of regulated businesses and businesses owned by municipal or local governmental entities without seeking Regal's approval so long as such acquisitions are less than $300,000,000 in the aggregate.
  - Apollo is free to make any other acquisitions without seeking Regal's approval so long as such acquisitions are less than $100,000,000 in the aggregate.
  - Apollo is free to make any acquisition if Regal or any of its subsidiaries are also bidding on the target.

Covenants Relating to Closing

- Both parties have agreed to use reasonable best efforts to obtain the required state public utility commission approvals and otherwise close the transaction.

- Both parties will agree not to take any action which would materially impede or delay obtaining the required state public utility commission approvals or the consummation of the merger. In addition, Regal has agreed not to make certain acquisitions, as described in more detail in Annex A.

- Regal has agreed to pay to Apollo $140 million if the transaction is terminated at a time when the required regulatory approvals have not been received and Regal is in breach of its representation regarding its regulatory status, its agreement to use reasonable best efforts to obtain the required state public utility commission approvals or its agreement not to take any action which would materially impede or delay obtaining the required state public utility commission approvals. This provision is described in more detail in Annex B.

Deal Protection

- The agreement contains customary provisions restricting Apollo's ability to seek another transaction ("no shop"), as well as exceptions which allow its Board to accept a superior proposal ("fiduciary out"), but only if Parent has not matched the superior proposal within five business days notice of Apollo's intention to accept it.

- The agreement contains a customary provision requiring Apollo to pay to Regal $140 million if the transaction is terminated by Apollo to take a competing offer or in certain other limited circumstances where Apollo agrees to another transaction or does not recommend this transaction.

Additional Covenants

- The agreement contains a provision allowing Regal and its subsidiaries to acquire up to 4.9% of Apollo's common stock, but only after Apollo's shareholders meeting has occurred.

- The agreement contains a customary provision requiring Apollo to prepare a proxy statement, with Regals's assistance, and convene a meeting of Apollo's shareholders as soon as reasonably practicable.
- The agreement contains a customary provision allowing Regal to obtain information from Apollo and requiring both parties to cooperate in developing a plan for the orderly integration of their businesses between signing and closing.
- The agreement contains a customary provision requiring Regal to indemnify Apollo's officers and directors for past acts and to keep in place Apollo's current D&O insurance for 6 years.
- The agreement contains Regal's commitment to keep in place all of Apollo's benefit plans (other than stock based plans) for 12 months after the closing without any change and to provide benefits for 18 months to Apollo's employees that are no less favorable in the aggregate than those they received prior to closing.

Closing Conditions

- The agreement contains the following closing conditions:
  - Neither party is required to close if there is a failure to obtain state public utility commission approvals that are required or a failure to obtain certain other governmental approvals which would have a material adverse effect.
  - Regal is not required to close if the terms and conditions imposed in connection with the receipt of required state public utility commission approvals would have a material adverse effect.
  - There are other customary conditions such as the approval of Apollo's stockholders, required antitrust approvals, no legal restraints preventing the transaction and no material breaches of covenants or breaches of representations and warranties which would result in a material adverse effect.

<u>Termination</u>

- The agreement will terminate after eighteen months if all closing conditions other than required state public utility commission approvals are not received by such date (an extension of no more than eight months is permitted to obtain these approvals and to allow them to become final orders).

- The agreement also contains other customary termination provisions allowing termination:

  - by mutual agreement of the parties;

  - by Regal if Apollo's Board withdraws its recommendation for the transaction or recommends an alternate transaction;

  - by either Regal or Apollo if the other party materially breaches its representations, warranties or covenants and does not cure such breach; and

  - by Apollo if its Board accepts a superior proposal prior to the stockholder vote on the transaction.

ANNEX A

Project Apollo
Agreements Relating to Certain Acquisitions

Without Apollo's consent, Regal and its subsidiaries (50% or more owned companies) may not take any action which would materially impede or delay obtaining the required state public utility commission approvals or the consummation of the merger. It has also been specifically agreed that Regal and its subsidiaries may not directly or indirectly make the following types of acquisitions without Apollo's consent:

1. The acquisition of any U.S. water or wastewater services company that is regulated by a state public utility commission or is owned or operated by a municipality or local governmental entity for more than $20 million (including the assumption of debt).

2. The acquisition of any business that would cause Regal or any of its subsidiaries to be required to register as a holding company under PUHCA or subject any of them to regulation under PUHCA in a manner that would raise substantive questions with respect to the ownership by any of them of any water or wastewater business.

3. The acquisition of (a) any business that would subject Regal or any of its subsidiaries to regulation under PUHCA in any manner other than as described in point 2 above or (b) any U.S. gas or electric utility, in the case of either (a) or (b), if such business is subject to regulation as a gas or electric utility by a state public utility commission in certain states that the parties agree are important from a business or regulatory standpoint. These states are Pennsylvania, Missouri, New Jersey, Indiana, Illinois, West Virginia, California, Kentucky, New York, Arizona, Connecticut, New Mexico, Ohio, Virginia and New Hampshire and possibly Tennessee, Iowa, Massachusetts, Hawaii, Maryland and Michigan.

If Regal requests Apollo's consent for any of the acquisitions covered by points 1 through 3 above, Apollo may not unreasonably withhold or delay its consent. In the case of any acquisition by Regal or its subsidiaries that is covered by point 3 above, Apollo may only withhold its consent if it determines that such acquisition would reasonably be expected to materially impede or delay the consummation of the merger.

Note: Since the limitations on acquisitions described above apply both to direct and indirect acquisitions by Regal or its subsidiaries, these provisions could impact Regal's ability to do a transaction with another non-U.S. company that has some business in the United States that is of the type described in points 1 through 3 above.

ANNEX B

Project Apollo
Reverse Break-Up Fee

If the merger agreement is terminated (i) by either Regal or Apollo because twenty four months have passed and the required state public utility commission approvals have not been received by such date, (ii) by either Regal or Apollo because Apollo's stockholders have not approved the merger, (iii) by Apollo because Regal has materially breached its representations, warranties or covenants and not cured such breach or (iv) by Regal because Apollo has materially breached its representations, warranties or covenants and not cured such breach, and at the time of such termination the required state public utility commission approvals have not been obtained or the terms and conditions imposed in connection with obtaining such approvals would have a material adverse effect, then Regal has agreed to pay to Apollo $140 million if at such time

1. Regal is in breach of its representation regarding the public utility operations of Regal and its subsidiaries and as a result Regal or any of its subsidiaries is required to register as a holding company under PUHCA or is subject to regulation under PUHCA in a manner that would raise substantive questions with respect to the ownership by any of them of any water or wastewater business.

2. Regal is in breach of its agreement not to acquire or permit any of its subsidiaries to acquire any U.S. water or wastewater services company that is regulated by a state public utility commission or is owned or operated by a municipality or local governmental entity for more than $20 million (including the assumption of debt), without Apollo's consent.

3. Regal is in breach of its agreement not to acquire or permit any of its subsidiaries to acquire any business that would cause Regal or any of its subsidiaries to be required to register as a holding company under PUHCA or subject any of them to regulation under PUHCA in a manner that would raise substantive questions with respect to the ownership by any of them of any water or wastewater business, without Apollo's consent.

4. Regal is in breach of its representation regarding the public utility operations of Regal and its subsidiaries in any manner other than as described in point 1 above or its representation regarding regulation as a public utility by public utility commissions.

5. Regal is in breach of its agreement not to acquire or permit any of its subsidiaries to acquire (a) any business that would subject Regal or any of its subsidiaries to regulation under PUHCA in any manner other than as described in point 3 above or (b) any U.S. gas or electric utility, in the case of either (a) or (b), if such businesses is subject to regulation as a gas or electric utility by a state public utility commission in the states that the parties agree are important from a business or regulatory standpoint, without Apollo's consent.

6. Regal is in breach of its agreement to use its reasonable best efforts to obtain the required state public utility commission approvals.

7. Regal is in breach of its agreement not to take any action which would materially impede or delay obtaining the required state public utility commission approvals.

Regal will not be required to pay the $140 million fee to Apollo with respect to any of the breaches described in points 4 through 7 above unless such breach is the primary cause of the failure to obtain the required state public utility commission approvals or the terms and conditions imposed in connection with obtaining such approvals having a material adverse effect.

C

PROPOSED CHANGES IN CONDITIONS
RECOMMENDED BY STAFF

1. AAWC shall not seek recovery of any excess of cost over book value paid pursuant to the reorganization at anytime in the future from this Commission.
2. AAWC shall not seek recovery of any costs associated with the reorganization, including internal corporate costs, in any future Arizona rate proceeding.
3. AAWC and its affiliates will comply with R14-2-801 et seq. pertaining to affiliated interests, or seek Commission authorization for any waivers thereof, including the provisions of R14-2-804 relating to transaction of business with and access to the books and records of any affiliate, including the production of records upon request at AAWC's local business headquarters or elsewhere in the Phoenix metropolitan area.
4. AAWC shall not adjust any existing account amounts as a result of the reorganization. AAWC may make normal accounting adjustments that would have occurred absent the reorganization.
5. In future rate proceedings filed after the effective date of the reorganization, AAWC shall have the burden of demonstrating that any cost overhead allocations and direct charges resulting from the reorganization including, but not limited to, the addition of layers of management, are reasonable and provide a benefit to AAWC and/or its customers.
6. AAWC shall not allow the reorganization to diminish local (Arizona) staffing that would result in service degradation.
7. AAWC shall not allow its quality of service to diminish; the number of service complaints should not increase, the response time to service complaints should not increase, and service interruptions should not increase as a result of the reorganization.
8. AAWC shall continue to maintain its business headquarters in Arizona and fully operational local (Arizona) field offices, as appropriate to maintain the quality of its service. However, AAWC is not precluded from making local operational changes in connection with

integrating the water and wastewater systems acquired from Citizens Communications and any future acquisitions into AAWC's local operations.

9. If AAWC ever plans to share with affiliates, or other entities, any information made available to AAWC solely by virtue of the company/customer relationship, such as billing information and services received by a customer, it shall notify the Commission at least 180 days in advance. Such notice shall, at a minimum, identify the intended use of the information. AAWC shall also, at the time of the filing of the 180-day notice, file a tariff setting forth appropriate customer notification procedures to inform customers about the sharing.
10. If AAWC ever shares any customer information with affiliates, or other entities, it shall maintain accurate records of revenues earned as a result and make those records available to Staff upon request with ten days notice. For the purpose of this condition and Condition 9 above, customer information that is prohibited from disclosure does not include a customer's name, address or service location, telephone number and other information available by means of sources to which the general public may have access.
11. AAWC shall not use any utility plant or other property, that is used or necessary for the provision of utility service, for any unregulated activity unless AAWC maintains appropriate books and records of account detailing the nature of such unregulated activity and providing appropriate allocations of plant, revenue and expenses between activities relating to AAWC's provision of utility service and the unregulated activity. AAWC's books and records concerning all unregulated activities shall be subject to the Commission's review on reasonable notice and will be made available in the Phoenix metropolitan area.
12. AAWC shall maintain a minimum common equity ratio of 35 percent of total capital. AAWC's total capital is defined as common equity, preferred equity, and long-term debt. AAWC shall not make remittances or pay dividends to AWW unless AAWC's common equity is at least 35 percent of total capital. If AAWC's common equity falls to 30 percent of total capital, AWW shall provide a cash infusion of equity sufficient to bring AAWC's common equity ratio back to a minimum of 35 percent of total capital. AAWC shall not be

prohibited from requesting that the foregoing equity percentages be decreased based on changes in capital markets or other conditions that make it prudent to alter AAWC's capital structure.

13. The cost of debt for purposes of setting rates in AAWC's rate proceedings, filed within three years from the effective date of the reorganization, shall reflect a rating of A- (S&P) / Baa1 (Moody's) or higher. For the purposes of this condition, the cost of debt shall be determined as of the date on which the interest rate or other debt cost is actually fixed by the lender.
14. AAWC and its affiliates agree that in future Commission proceedings, they shall not seek a higher cost of capital than that which AAWC would have been authorized on its as a stand-alone entity. Specifically, no capital financing costs (either debt or equity) should increase by virtue of the reorganization.
15. AAWC shall refrain from filing any non-emergency rate increase requests for one year from the closing date of the reorganization; provided, however, that AAWC may file rate increase requests prior to the reorganization's closing date, and any such requests will not be subject to the conditions set forth herein.