

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California-American Water Company (U-210-W), a California Corporation, RWE Aktiengesellschaft, a Corporation Organized Under the Laws of the Federal Republic of Germany, Thames Water Aqua Holdings GmbH, a Corporation Organized Under the Laws of the Federal Republic of Germany, and American Water Works Company, Inc., for an Order Authorizing the Sale by Thames GmbH of up to 100% of the Common Stock of American Water Works Company, Inc. Resulting in a Change of Control of California-American Water Company, and For Such Related Relief as May be Necessary to Effectuate Such Transaction.

Application No. 06-05-025

(Filed May 22, 2006)

JOINT APPLICANTS' REPLY COMMENTS ON THE PROPOSED DECISION

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I. INTRODUCTION

Pursuant to Rule 14.3(d) of the California Public Utilities Commission's ("Commission") Rules of Practice and Procedure, California-American Water Company ("California American Water"), American Water Works Company, Inc. ("American Water"), Thames Water Aqua Holdings GmbH ("Thames GmbH") and RWE Aktiengesellschaft ("RWE") (collectively "Joint Applicants") hereby submit the following Reply to the April 17, 2006 comments filed by the Division of Ratepayer Advocates (DRA) on the Proposed Decision.

In its Comments, DRA scatter shots repeated arguments that the Proposed Decision contains factual and legal errors in the hope of diverting the Commission from authorizing the Proposed Transaction. DRA has lost sight of the fact that it previously recommended that the Commission approve the Proposed Transaction. DRA stated: "**It certainly would not be in the ratepayers' interest if RWE is essentially forced to keep its investment as management attention and capital contributions by RWE may decline in the future.**"¹ DRA also stated that "**if the Proposed Transaction is not approved and RWE is required to retain ownership of American Water against its desires, ratepayers in California could ultimately be harmed due to potential future lack of attention, leadership and investment.**"² For DRA to now oppose the Proposed Transaction because the Proposed Decision does not accept all of its 17 proposed conditions is disingenuous. The Proposed Decision appropriately rejects DRA's proposed conditions which are unwarranted by the record and could have negative impacts on California American Water's financial health, which in turn will lead to a higher cost of capital and ultimately even to the erosion in its inability to attract capital, with potentially severe consequences for ratepayers. While DRA attempts to re-litigate this proceeding in its Opening Comments, Joint Applicants focus this Reply on DRA's erroneous claims that the Proposed Decision contains so-called factual and legal errors.

¹ Exh. 14, DRA Report, p. 7-14:20-11 (emphasis added).

² Exh. 14, DRA Report, p. 7-7:22-25 (emphasis added).

II. DISCUSSION

A. The Factual Findings and Legal Conclusions in the Proposed Decision are Supported by Substantial Evidence.

Contrary to DRA's claims that certain findings and conclusions in the Proposed Decision are in error, the Proposed Decision carefully considers the evidence presented by all of the parties to the proceeding. The factual findings and legal conclusions in the Proposed Decision are supported by extensive evidence. As the court stated in *Lorimore v. State Personnel Board* (1965) 232 Cal. App. 2d, 183, at pp. 186-187 (emphasis added):

[i]t is well established that courts generally defer to the broad discretion vested in administrative agencies **when the evidence is conflicting, or even when reasonable men might well differ on questions of the credibility of witnesses, or upon the proper inferences to be drawn from the evidence, subject to the requirements, of course, that the finding be supported by substantial evidence.** In fact, the decisions generally have equated the review of administrative determination with the substantial evidence rule applicable to appellate review, i.e., the function of the appellate court begins and ends with a determination as to **whether there is any substantial evidence, contradicted or uncontradicted, which supports the conclusion reached,** disregarding any evidence in the record contrary to the trier's finding.³

Thus, so long as the Proposed Decision is supported by substantial evidence, which it is, its factual findings and conclusions of law are not in error.

Accordingly, the following accusations in DRA's Comments that the Proposed Decision commits factual and legal error are wrong and should be given no weight.

➤ "It is legal error for the PD to inconsistently apply the 'ratepayer indifference' standard in reviewing the Proposed Transaction." (DRA's Comments, p. 14.) The Proposed Decision does not inconsistently apply the appropriate legal standard. Administrative Law Judge (ALJ) Galvin's finding that the Proposed Transaction will benefit California American Water's customers is consistent with the conclusion that the Proposed Transaction meets the applicable legal standard because it will not adversely affect ratepayers and the public interest. DRA does not dispute that "ratepayer indifference" is the appropriate legal standard.⁴ Rather, DRA wrongly suggests that the "ratepayer indifference" standard

³ See also D.06-01-045, *Application of Pacific Gas and Electric Company for Recovery of Pre-Deployment Costs of the Advanced Metering Infrastructure (AMI) Project (U 39 M)*, 2006 Cal. PUC LEXIS 26, citing *Lorimore v. State Personnel Board* (1965) 232 Cal. App. 2d, 183, at pp. 186-87.

⁴ The applicable legal standard was set forth in the Assigned Commissioner's Scoping Memo and Ruling (dated October 6, 2006), p. 3. The Proposed Decision correctly finds that the "ratepayer indifference standard should be used to determine whether the proposed transaction will benefit the ratepayers of Cal-Am" (Proposed Decision, p. 35, Conclusion of Law No. 1) and that the Proposed Transaction is in the public interest (Proposed Decision, p. 37, Conclusion of Law No. 18).

somehow precludes the Commission from finding that the Proposed Transaction will result in customer benefits.

➤ “It is factual error for the PD to state DRA does not oppose the Proposed Transaction.” (DRA’s Comments, p. 14.) DRA’s claim contradicts DRA’s very own testimony in this proceeding. As discussed above, DRA recommended that the Commission approve the Proposed Transaction because forcing RWE to keep its investment in American Water would potentially harm California American Water’s customers.

➤ “It is factual error for the PD to describe RWE’s choice to divest as a change in its core business.” (DRA’s Comments, p. 15.) Even if RWE’s decision to divest itself of American Water was relevant, which it is not, DRA’s claim should be disregarded because the Proposed Decision’s finding is based upon evidence that the primary reason for RWE’s decision to divest American Water is RWE’s need to refocus on its core energy business in Europe.⁵ DRA’s assertions regarding RWE’s decision to divest itself of American Water are based entirely upon sections of the RWE Supervisory Board meeting minutes that were taken out of context.

➤ “It is legal error for the PD to conclude a rate increase deferral will harm ratepayers.” (DRA’s Comments, p. 15.) The Proposed Decision’s conclusion (p. 26) that a rate case deferral will harm California American Water’s customers in the long-term is based upon extensive evidence demonstrating that the proposed rate deferral will negatively impact California American Water’s cash flows and drive up its cost of debt. The Proposed Decision (p. 26) correctly finds that “[e]ven DRA acknowledges that its proposed deferral of rate charges may impact the credit rating of American Water, result in rate shock to the ratepayers of Cal-Am when the authorized but delayed rates go into effect, and adversely affect the ability of Cal-Am to continue paying its operating costs.” Contrary to DRA’s claim, DRA’s own expert witness conceded that the proposed rate deferral could result in rate shock to ratepayers.⁶

Similarly, DRA’s assertion that the estimated impact of DRA’s proposed rate stay-out (the loss of an estimated \$26.8 million of California American Water’s authorized revenue, approximately 24% of its 2011 projected revenues, and eliminating more than its authorized earnings for one entire year) is inaccurate lacks any merit. California American Water’s estimates are the only evidence in the record regarding the impact of DRA’s proposed rate stay-out and demonstrate that the rate stay-out would have a potentially devastating effect on California American Water’s financial health and harm California American Water customers in the long-term.

B. The Proposed Transaction Will Benefit California American Water and Its Customers.

DRA contends that the Proposed Decision “overestimates” the benefits of the Proposed Transaction,⁷ yet ignores the key benefit of the Proposed Transaction to California American Water and

⁵ See Reply Brief, pp. 33-34; Exh. 6, Rebuttal Testimony of John Bigelow (Joint Applicants), p. 4:12-13, 18-20.

⁶ RT 295:16-19 (Woolridge/DRA) (in response to ALJ Galvin’s question: “If in fact that proposal is implemented, would it result in rate shock to the general ratepayers?” Mr. Woolridge responded “I don’t think that you can say that it definitely will...”).

⁷ DRA’s Comments, p. 15.

its customers (which DRA concedes)⁸, namely, that the Proposed Transaction will provide American Water with full access to the U.S. public debt and equity markets, allowing it to continue to provide cost-effective capital to California American Water, as opposed to the risks of continued ownership by RWE, a foreign multinational corporation which has refocused its core business on the European energy markets.⁹ The Proposed Decision (p. 29) further explains the benefit that will flow to customers as a result of the ability of California American Water and American Water “to obtain new capital without competing against the capital needs of RWE’s core companies.”

Contrary to DRA’s Comments, the other benefits identified in the Proposed Decision (p. 28) will in fact benefit California American Water and its customers, including: a more transparent corporate structure and no change in the name of the companies, terms and conditions of service, or employees. The Proposed Decision (p. 16) correctly finds that California American Water customers will benefit “through public disclosure of financial reporting, accounting, internal controls, general business practices, corporate governance, executive compensation reporting, issuance of securities, and related financial business matters.” DRA persists in ignoring the fundamental nature of the Proposed Transaction, which is a change of ownership at the parent level having no impact on the utility.¹⁰

C. The Administrative Law Judge Considered and Rejected DRA’s Arguments that the Proposed Transaction Will Cause Alleged Harms to California American Water Ratepayers.

DRA, displeased with the Proposed Decision’s rejection of certain disputed conditions, claims that the Proposed Transaction will negatively impact ratepayers and the public interest.¹¹ However, ALJ Galvin fully considered and rejected each of DRA’s claims that the Proposed Transaction will negatively impact California American Water customers. The Proposed Decision (p. 18) correctly rejected DRA’s

⁸ See Section I, and footnotes 1 and 2, *supra*, regarding DRA’s recommendation for approval of the Proposed Transaction because it would be adverse to the ratepayers’ interest if RWE is essentially forced to keep its investment.

⁹ See Proposed Decision, p. 28; Exh. 6, Rebuttal Testimony of John Bigelow (Joint Applicants), p. 4:12-13, 18-20.

¹⁰ See DRA’s Comments, p. 11 (stating that the benefit of a solid capital structure is not actually a benefit because it already exists without the Proposed Transaction.).

¹¹ DRA’s Comments, p. 14.

claim that the Proposed Transaction will increase the cost of debt because “[t]here is no assurance that the credit ratings of American Water, or even RWE, will remain unchanged .. into the future. While DRA claims that the Proposed Transaction has already impacted the debt rating of American Water and the cost at which debt can be obtained, the fact of the matter is American Water’s credit rating has already been downgraded while American Water is still owned by RWE. This downgrading occurred because of RWE’s announcement that water is no longer a core business and further exemplifies the adverse consequences that could result from requiring American Water to remain a subsidiary of RWE. As noted in the Proposed Decision (p. 19), the Commission will continue to have oversight of rates and California American Water’s recovery of reasonable and prudent business costs, including the cost of debt, can and will be appropriately addressed in future general rate case proceedings.

ALJ Galvin considered and rejected DRA’s arguments that California American Water’s customers will be harmed by the increased costs of American Water becoming a publicly-traded company. Importantly, Joint Applicants will not seek recovery of the costs of the Proposed Transaction through rates; and to the extent that American Water has paid for costs related to the Proposed Transaction with its own funds, such funds will effectively be repaid when RWE infuses capital into American Water to achieve a 45% common equity ratio at the time of the proposed Initial Public Offering.¹²

III. CONCLUSION

The Proposed Decision correctly concludes that the Proposed Decision is demonstrably in the public interest and will not adversely affect California American Water customers. For all of the reasons discussed above, the Commission should adopt the Proposed Decision, with the minor clarifications proposed by Joint Applicants in their Opening Comments.

¹² See Proposed Decision, pp. 14-15.

Dated: April 23, 2007

Respectfully submitted,

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By: /s/ Sarah E. Leeper
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PROOF OF SERVICE

I, Michelle Chavez, declare as follows:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to this action. My business address is STEEFEL, LEVITT & WEISS, One Embarcadero Center, 30th Floor, San Francisco, California 94111-3719. On April 23, 2007, I served the within:

Joint Applicants' Reply Comments on the Proposed Decision

on the interested parties in this action addressed as follows:

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I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on April 23, 2007, at San Francisco, California.

/s/ Michelle Chavez

Michelle Chavez

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A. 06-05-025
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