



AMERICAN WATER

Small System Viability

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American Water

Mid-America Regulatory Conference

June 6, 2010



Water and Wastewater Systems Require Access to Expertise Across Many Disciplines



Operators



Engineers

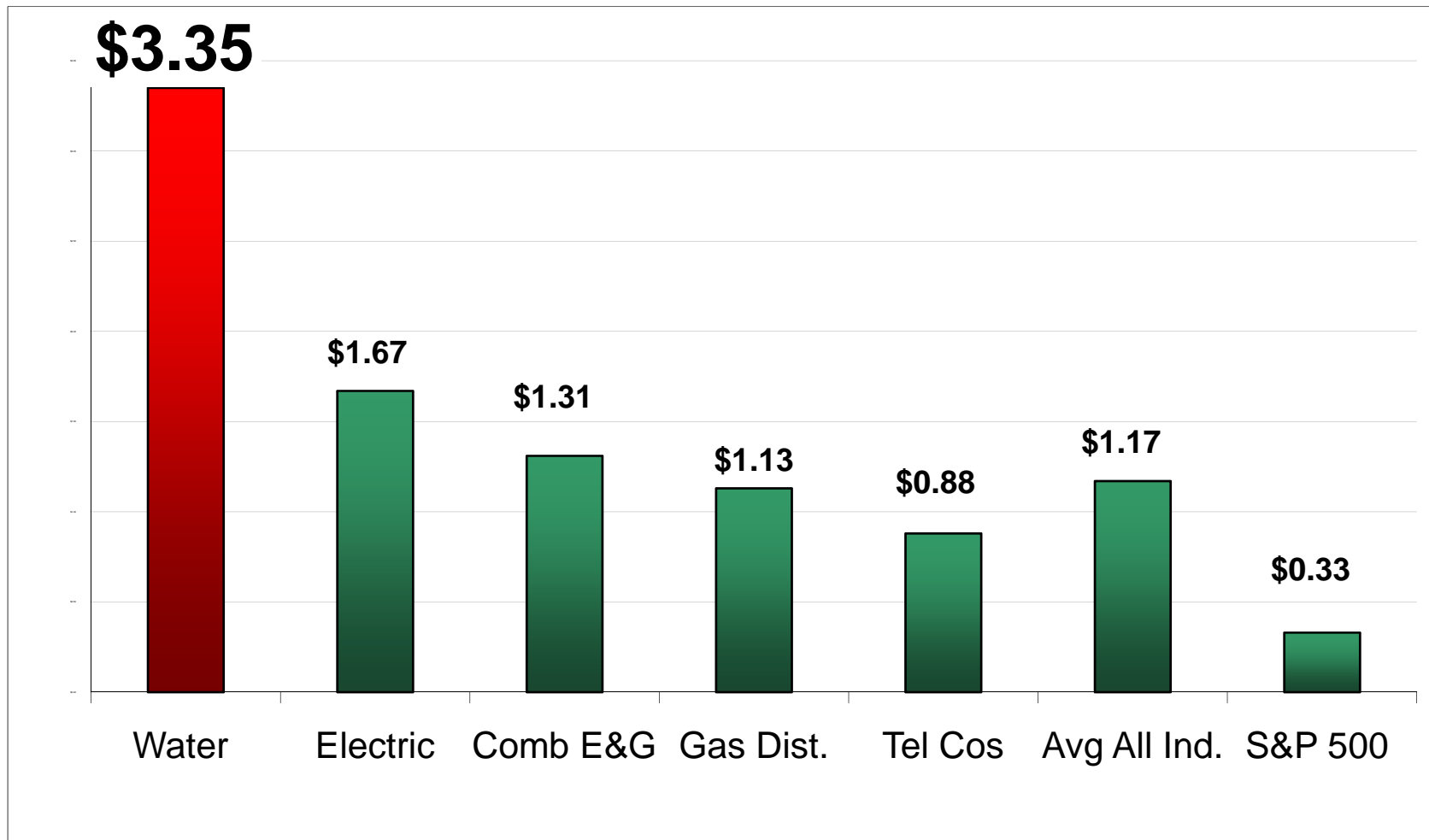


Scientists / Lab Technicians



Finance / Legal

No Utility Sector is More Capital Intensive than the Water Industry



Source: AUS Utility Reports – 2008 (based on 2007 data)

Estimated Capital Needs for U.S. Public Water and Wastewater Systems over Next 20 Years

Approximately
\$1 Trillion

USEPA estimate for U.S. water and wastewater systems

The United States Water and Wastewater Industry Remains Highly Fragmented

43,018

Number of public drinking water systems that serve populations of less than 3,300 as of 2008

The majority of water and wastewater systems in the U.S. are owned by capital and expertise-constrained entities.

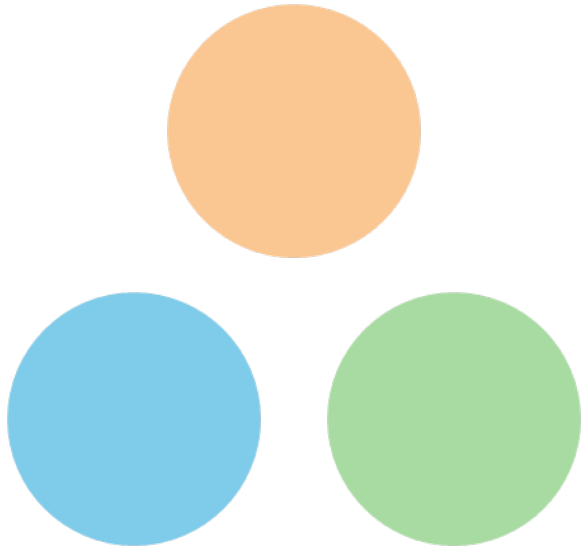
The Public has a Low Tolerance for Issues with Water and Wastewater Services

1

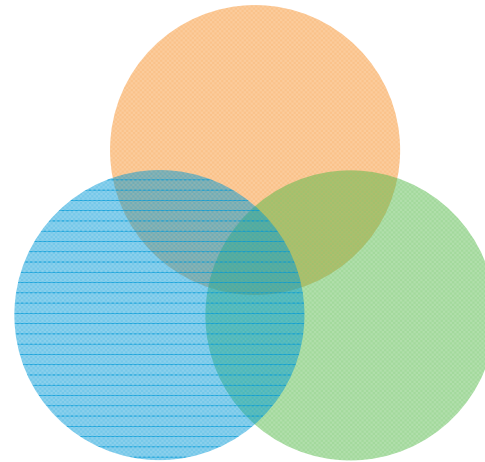
Number of failed systems it takes to pollute the environment or cause a major public health issue

Many economic and social externalities are tied to the ability of water and wastewater systems to perform as intended.

Types of Solutions to Small System Viability



Support as
Stand Alone
Systems



Consolidate

Both solutions involve bolstering the expertise and access to capital that are critical to operating a viable water or wastewater system.



Win – Win – Win Situation

- **Regulators Benefit**
 - Fewer systems to regulate
 - Improved stability of expertise and resources within regulated systems
- **Public Benefits**
 - Improved environment to support public health and recreation
 - Higher-skilled operators and better infrastructure create opportunity to support economic growth within communities
- **Investor-Owned Utilities Benefit**
 - Improved capacity to meet growth expectations of market



Economic and Environmental Regulatory Environment Impacts Ability for Seller and Buyer to Come to Terms

Seller

Buyer

Price Paid

Not familiar with “Rate Base”; need to be able to explain to constituency

Not willing to make investment that it will not be able to recover in rates

Rates Charged

Concerned with impact to customers; particularly if publicly owned

Concerned with impact to customers; particularly if it has had previous complaints or disallowances for high rates

Deal Costs

Generally not concerned

Not willing to incur expenses that it will not be able to recover in rates

Recovery Timing

Generally not concerned

Not willing to take chance that it will substantially under-earn on its investment due to lags in regulatory process



Economic Regulatory Practices that Work

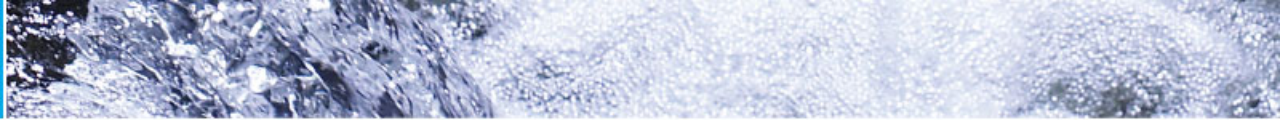
Price Paid = **Appraised Value**

Rates Charged = **Consolidate with Other Districts**

Deal Costs = **Include as Rate Base**

Recovery Timing = **Adjust for Under or Over Earnings**

Pennsylvania and Indiana have addressed many of these areas, either by statute or by regulatory precedent.



Final Thoughts

- **Small systems that fail or under invest can cause many issues.**
 - Health and/or environmental problems
 - Public safety concerns (fire protection)
 - Slow local and regional economic growth due to insufficient infrastructure
 - Damage to tourist industry associated with waterways and lakes
- **States need to review economic and environmental regulations to best utilize private company solutions.**
 - Treatment of price paid
 - Policies for how rates are charged
 - Treatment of transaction costs
 - Treatment of over or under earnings before system is in base rates.



Final Thoughts (continued)

- **Look to establish stakeholder groups to facilitate planning and coordination of efforts to solve small system viability concerns.**



Questions?

We care about water. It's what we do.

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NYSE.