

AMERICAN WATER WORKS CO INC
Form DEFM14A
December 05, 2001

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934

Filed by the Registrant /x/
Filed by a Party other than the Registrant //

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- // Preliminary Proxy Statement
- // **Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- /x/ Definitive Proxy Statement
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AMERICAN WATER WORKS COMPANY, INC.

(Name of each Registrant as Specified in its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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AMERICAN WATER WORKS COMPANY, INC.

1025 Laurel Oak Road
Voorhees, New Jersey 08043

Dear Fellow Stockholder:

As you may know, on September 16, 2001, we entered into a merger agreement with RWE Aktiengesellschaft and Thames Water Aqua Holdings GmbH, which is RWE's holding company for its global water business, to merge with a subsidiary of RWE and become a wholly owned indirect subsidiary of RWE. A special meeting of stockholders of American Water Works will be held on Thursday, January 17, 2002 at 9:30 a.m. local time, to consider a proposal to adopt the merger agreement so that the merger can occur. The meeting will be held at the Pennsylvania Convention Center, West Concourse, 12th and Arch Streets, Philadelphia, Pennsylvania. Notice of the special meeting is enclosed.

Upon completion of the merger, you will be entitled to receive \$46.00 in cash for each share of common stock that you own. This price represents a 37.2% premium over the average closing price per share over the 30 trading days prior to September 10, 2001, and a 29.5% premium over the highest closing share price our stock ever obtained prior to the public announcement of the merger agreement. The receipt of cash in exchange for your shares of common stock in the merger will constitute a taxable transaction for U.S. federal income tax purposes.

This proxy statement gives you detailed information about the special meeting and the merger and includes the merger agreement as Annex A. We encourage you to read the proxy statement and the merger agreement carefully.

Our board of directors has, by a unanimous vote, approved the merger agreement and determined that the merger agreement and the merger are fair to and in the best interests of American Water Works and our stockholders. In connection with its evaluation of the merger, the board of directors considered a number of factors, including the written opinion of Goldman, Sachs & Co., delivered on September 16, 2001 to the board of directors to the effect that, based upon and subject to the matters set forth in that opinion, as of September 16, 2001, the \$46.00 in cash per share to be received by holders of American Water Works common stock pursuant to the merger agreement, was fair from a financial point of view to those holders. The Goldman Sachs opinion is not a recommendation as to how any holder of shares of American Water Works common stock or cumulative preferred stock, 5% series should vote with respect to the merger. The written opinion of Goldman Sachs is attached as Annex B to the enclosed proxy statement, and you should read it in its entirety.

Your vote is important. We cannot complete the merger unless holders of a majority of the voting power of our outstanding common stock (which is entitled to one vote per share) and cumulative preferred stock, 5% series (which is entitled to one-tenth of a vote per share), voting together as a single class, vote to adopt the merger agreement. Our board of directors recommends that you vote **"for"** the proposal to adopt the merger agreement. **The failure of any stockholder to vote on the merger will have the same effect as a vote against the merger.**

Stockholders owning or controlling a total of 25,989,476 shares of common stock as of the date of the merger agreement, which represents approximately 26% of all outstanding votes, have entered into a voting agreement in which they agreed to vote in favor of adopting the merger agreement. In addition, each of our directors and executive officers (including some who have entered into the voting agreement) has indicated that he or she intends to vote his or her own shares in favor of the proposal

to adopt the merger agreement. Whether or not you plan to attend the special meeting, please complete, sign and date the accompanying proxy card and return it in the enclosed prepaid envelope. You may also submit a proxy by telephone or Internet by following the instructions in the proxy statement and on the enclosed proxy card. If you attend the special meeting, you may revoke your proxy and vote in person if you wish to do so.

The board of directors and management of American Water Works appreciate your continuing interest and support of our company, and we hope you will support this exciting transaction.

Sincerely,

Marilyn Ware
Chairman of the Board of Directors

J. James Barr
Chief Executive Officer and President

**NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
TO BE HELD JANUARY 17, 2002**

TO THE HOLDERS OF:

COMMON STOCK
CUMULATIVE PREFERRED STOCK, 5% SERIES
5% CUMULATIVE PREFERENCE STOCK

We are pleased to notify you of and invite you to a special meeting of stockholders. At the meeting, holders of common stock and cumulative preferred stock, 5% series will be asked:

to vote on a proposal to adopt the Agreement and Plan of Merger, dated as of September 16, 2001, among American Water Works, RWE Aktiengesellschaft, a company organized under the laws of the Federal Republic of Germany, Thames Water Aqua Holdings GmbH, a company organized under the laws of the Federal Republic of Germany and a wholly owned subsidiary of RWE, and Apollo Acquisition Company, a Delaware corporation and a wholly owned subsidiary of Thames Water Holdings; and

to consider any other matters that are properly brought before the special meeting or any adjournments or postponements of the special meeting.

Only holders of record of common stock and cumulative preferred stock, 5% series at the close of business on December 4, 2001 may vote at the special meeting.

We urge you to read the accompanying proxy statement carefully as it sets forth details of the proposed merger and other important information related to the merger.

Under Delaware law, holders of our common stock who do not vote in favor of the merger agreement will have the right to seek appraisal of the fair value of their shares as determined by the Delaware Court of Chancery if the merger is completed, but only if they submit a written demand for such an appraisal prior to the vote on the merger agreement and they comply with the Delaware law procedures explained in the accompanying proxy statement.

Your vote is important. Whether or not you plan to attend the special meeting, please complete, sign and date the accompanying proxy card and return it in the enclosed prepaid envelope. You may also submit a proxy by telephone or Internet by following the instructions in the proxy statement and on the enclosed proxy card. If you attend the special meeting, you may revoke your proxy and vote in person if you wish to do so.

By Order of the Board of
Directors,

W. Timothy Pohl
General Counsel and Secretary

Voorhees, New Jersey
December 5, 2001

Please note that only stockholders of American Water Works as of the record date, December 4, 2001, or their authorized representatives, may attend the special meeting. If you plan to attend the meeting in person, please be sure to bring photo identification with you. Additionally, if you hold your stock through a broker or bank, please be sure to bring proof of your beneficial ownership as of the record date, such as a letter or account statement from your broker or bank.

AMERICAN WATER WORKS COMPANY, INC.

**1025 Laurel Oak Road
Voorhees, New Jersey 08043
856-346-8200**

PROXY STATEMENT FOR THE SPECIAL MEETING OF STOCKHOLDERS January 17, 2002

This proxy statement is being furnished to our stockholders in connection with the solicitation of proxies by our board of directors to be used at a special meeting of our stockholders to be held at the Pennsylvania Convention Center, West Concourse, 12th and Arch Streets, Philadelphia, Pennsylvania, on Thursday, January 17, 2002, at 9:30 a.m., local time, and any adjournments or postponements thereof.

At the special meeting, the stockholders will be asked to consider and vote upon a proposal to adopt the agreement and plan of merger dated as of September 16, 2001, among American Water Works, RWE Aktiengesellschaft, a company organized under the laws of the Federal Republic of Germany, Thames Water Aqua Holdings GmbH, a company organized under the laws of the Federal Republic of Germany and a wholly owned subsidiary of RWE, and Apollo Acquisition Company, a Delaware corporation and a wholly owned subsidiary of Thames Water Holdings. In the merger, Apollo will merge into American Water Works with American Water Works continuing as the surviving corporation and an indirect wholly owned subsidiary of RWE.

Subject to the terms and conditions of the merger agreement, upon consummation of the merger each issued and outstanding share of our common stock, other than shares held by stockholders who validly exercise appraisal rights (as discussed in this proxy statement), will automatically be canceled and cease to exist and will be converted into the right to receive a per share amount equal to \$46.00 in cash, without interest. Prior to the merger and as a condition to completing the merger, we will redeem (1) each issued and outstanding share of our cumulative preferred stock, 5% series for a redemption price of \$25.25 per share plus an amount equal to full cumulative dividends thereon to the redemption date and (2) each issued and outstanding share of our 5% cumulative preference stock for a redemption price of \$25.00 per share plus an amount equal to full cumulative dividends thereon to the redemption date.

Upon the consummation of the merger, stockholders of American Water Works will have no further interest in the surviving corporation. A copy of the merger agreement is attached to this proxy statement as Annex A.

In connection with the proposed merger, appraisal rights will be available to those holders of the common stock of American Water Works who do not vote in favor of adoption of the merger agreement and who otherwise comply with the requirements of Section 262 of the Delaware General Corporation Law, a copy of which is included as Annex C to this proxy statement. You should read the section entitled "Appraisal Rights" in this proxy statement for a discussion of the procedures to be followed in asserting appraisal rights under Section 262 in connection with the proposed merger and the full text of Section 262, which is included as Annex C to this proxy statement.

AMERICAN WATER WORKS' BOARD OF DIRECTORS, AFTER CAREFUL CONSIDERATION, HAS APPROVED AND DECLARED ADVISABLE THE MERGER AGREEMENT, HAS DETERMINED THAT THE MERGER IS FAIR TO, AND IN THE BEST INTERESTS OF, AMERICAN WATER WORKS AND ITS STOCKHOLDERS, AND RECOMMENDS THAT THE STOCKHOLDERS VOTE "FOR" ADOPTION OF THE MERGER AGREEMENT AT THE SPECIAL MEETING.

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Our board of directors has fixed the close of business on December 4, 2001 as the record date for the special meeting and only holders of record of common stock and cumulative preferred stock, 5% series on the record date are entitled to vote at the special meeting. On the record date, there were outstanding and entitled to vote 100,014,382 shares of common stock (one vote per share) and 101,777 shares of cumulative preferred stock, 5% series (one-tenth of a vote per share).

This proxy statement is dated December 5, 2001 and is first being mailed on or about December 7, 2001.

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SUMMARY TERM SHEET

This summary term sheet highlights important information in this proxy statement and does not contain all of the information that is important to you. You should carefully read this entire proxy statement and the other documents we refer you to for a more complete understanding of the matters being considered at the special meeting. In addition, we incorporate by reference important business and financial information about American Water Works into this proxy statement. You may obtain the information incorporated by reference into this proxy statement without charge by following the instructions in the section entitled "Where You Can Find More Information."

The Proposed Transaction

In the merger, a wholly owned indirect subsidiary of RWE will merge into American Water Works with American Water Works continuing as the surviving corporation. American Water Works will become the Americas division of RWE's water business and it will operate under the name American Water Works.

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Upon consummation of the merger each issued and outstanding share of our common stock, other than shares held by stockholders who validly exercise appraisal rights (as discussed in this proxy statement), will automatically be canceled and cease to exist and will be converted into the right to receive a per share amount equal to \$46.00 in cash, without interest.

As a result of the merger, we will cease to be an independent, publicly traded company and will become an indirect, wholly owned subsidiary of RWE.

The Companies (see page 10)

American Water Works

American Water Works is the largest publicly traded enterprise devoted exclusively to the water and wastewater business in the United States. On November 7, 2001, we completed the acquisition of Azurix North America Corp. and Azurix Industrials Corp., which expanded our presence into the southeastern and northwestern United States and three Canadian provinces. American Water Works and its subsidiaries now have approximately 6,300 employees and provide water, wastewater and other water resource management services to a population of approximately twelve million in 28 states and Canada. In addition, we have received the necessary approvals from the states of Arizona, Illinois, Indiana, Ohio and Pennsylvania for our purchase of the water and wastewater assets of Citizens Communications Company, a multi-utility holding company. The California Public Utility Commission approved our acquisition of Citizens' water and wastewater assets in that state in September 2001, but that approval is still subject to appeal. On August 30, 2001, we announced an agreement to sell our New England operations to Kelda Group Plc for approximately \$118 million in cash plus the assumption of approximately \$115 million in debt.

RWE

RWE is a global multi-utility company that does business, through its subsidiaries and affiliates, in over 120 countries. Its core businesses are electricity, gas, water, and waste and recycling.

Thames Water Holdings

Thames Water Aqua Holdings GmbH, which we will refer to in this proxy statement as Thames Water Holdings, is the holding company for all of RWE's global water business. In 2000, RWE acquired Thames Water Plc, the leading supplier of water and wastewater service in the United Kingdom.

Thames Water Plc is a subsidiary of Thames Water Holdings and, after the merger, American Water Works will be a subsidiary of Thames Water Holdings as well.

Apollo Acquisition Company

Apollo Acquisition Company, which we will refer to in this proxy statement as Apollo, is a Delaware corporation formed solely for the purpose of merging into American Water Works and has not conducted any unrelated activities since its organization. Apollo is a wholly owned subsidiary of Thames Water Holdings.

What You Will Be Entitled to Receive Upon Completion of the Merger (see page 31)

Upon completion of the merger, you will be entitled to receive \$46.00 in cash, without interest, for each share of common stock that you own, plus any declared but unpaid dividends, including a "stub period" dividend for the period between the immediately prior dividend record date and the date on which the merger is completed. Prior to the merger and as a condition to completing the merger, we will redeem (1) each issued and outstanding share of our cumulative preferred stock, 5% series for a redemption price of \$25.25 per share plus an amount equal to full cumulative dividends thereon to the redemption date and (2) each issued and outstanding share of our 5% cumulative preference stock for a redemption price of \$25.00 per share plus an amount equal to full cumulative dividends thereon to the redemption date.

After we complete the merger, Thames Water Holdings or one of its wholly owned subsidiaries will be the sole stockholder of American Water Works.

The Special Meeting (see page 11)

Date, Time and Place of the Special Meeting

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The special meeting is scheduled to be held as follows:

Date: January 17, 2002
Time: 9:30 a.m., local time
Place: Pennsylvania Convention Center, West Concourse, 12th and Arch Streets,
Philadelphia, Pennsylvania

Proposal to be Considered at the Special Meeting

At the special meeting, you will be asked to vote on a proposal to adopt the merger agreement. A copy of the merger agreement is attached as Annex A to this proxy statement.

Record Date

Our board of directors has fixed the close of business on December 4, 2001 as the record date for the special meeting and only holders of record of common stock and cumulative preferred stock, 5% series on the record date are entitled to vote at the special meeting. On the record date, there were outstanding and entitled to vote 100,014,382 shares of common stock (one vote per share) and 101,777 shares of cumulative preferred stock, 5% series (one-tenth of a vote per share).

Voting Rights; Vote Required for Adoption

Each share of common stock entitles its holder to one vote on all matters properly coming before the special meeting and each share of cumulative preferred stock, 5% series entitles its holder to one-tenth of a vote on all matters properly coming before the special meeting. The presence in person

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or representation by proxy of stockholders entitled to cast a majority of the votes of all outstanding shares entitled to vote on the proposal to adopt the merger agreement, considered together, shall constitute a quorum for the purpose of considering that proposal.

If you hold your shares in an account with a broker or bank, you must instruct the broker or bank on how to vote your shares. If an executed proxy card returned by a broker or bank holding shares indicates that the broker or bank does not have authority to vote on the proposal to adopt the merger agreement, the shares will be considered present at the meeting for purposes of determining the presence of a quorum, but will not be voted on the proposal to adopt the merger agreement. This is called a broker non-vote. Your broker or bank will vote your shares only if you provide instructions on how to vote by following the instructions provided to you by your broker or bank.

Under Delaware law and our certificate of incorporation, the proposal to adopt the merger agreement must be adopted by the affirmative vote of the holders of a majority of the votes represented by all of the outstanding shares of common stock and cumulative preferred stock, 5% series, voting together as a single class, with each share of common stock entitled to one vote and each share of cumulative preferred stock, 5% series entitled to one-tenth of a vote. **Abstentions and broker non-votes will have the same effect as a vote against the proposal to adopt the merger agreement.**

Some of our major stockholders (including some of our directors) holding, at the time of the signing of the merger agreement, 25,989,476 shares of our common stock representing approximately 26% of the total votes entitled to be cast at the special meeting have entered into a voting agreement with Thames Water Holdings obligating those stockholders to vote their shares in favor of the transaction. In addition, each of our directors and executive officers (including some who have entered into the voting agreement) has indicated that he or she intends to vote his or her own shares in favor of the proposal to adopt the merger agreement. If our directors and officers and the other major stockholders party to the voting agreement vote their shares for the proposal to adopt the merger agreement, approximately 28.6% of the voting power of our outstanding common stock and cumulative preferred stock, 5% series will have voted for the proposal to adopt the merger agreement. This means that holders of only an additional 21.5% of the voting power of all shares entitled to vote at the meeting would need to vote for the proposal to adopt the merger agreement in order for it to be adopted.

Voting and Revocation of Proxies

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After carefully reading and considering the information contained in this proxy statement, you should complete, date and sign your proxy card and mail it in the enclosed return envelope as soon as possible so that your shares are represented at the special meeting. You can also vote in person at the meeting, but we encourage you to submit your proxy now in any event. You can also submit your proxy by telephone by calling the number on your proxy card or over the Internet by going to the web site designated on your proxy card. Unless you specify to the contrary on your proxy card, all of your shares represented by valid proxies will be voted "for" the proposal to adopt the merger agreement.

Please do not send in your stock certificates with your proxy card. After the merger is completed, a separate letter of transmittal will be mailed to you which will enable you to receive the merger consideration.

Until exercised at the special meeting, you can revoke your proxy and change your vote in any of the following ways:

by delivering written notification to American Water Works' General Counsel and Secretary at our executive offices at 1025 Laurel Oak Road, Voorhees, New Jersey 08043;

by delivering a proxy of a later date by mail, Internet or telephone in the manner described in this proxy statement;

by attending the special meeting and voting in person. Your attendance at the meeting will not, by itself, revoke your proxy you must vote in person at the meeting; or

if you have instructed a broker or bank to vote your shares, by following the directions received from your broker or bank to change those instructions.

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Questions and Additional Information

For additional information regarding the procedure for delivering your proxy see "The Special Meeting Voting and Revocation of Proxies" and "The Special Meeting Solicitation of Proxies."

If you have more questions about the merger or how to submit your proxy, or if you need additional copies of this proxy statement or the enclosed proxy card or voting instructions, you should contact Georgeson Shareholder Communications Inc. at 111 Commerce Road, Carlstadt, New Jersey 07072, or by telephone at 1-866-324-8874 or American Water Works' General Counsel and Secretary at our executive offices at 1025 Laurel Oak Road, Voorhees, New Jersey 08043, or by telephone at 856-346-8223.

Recommendations of Our Board of Directors (see page 17)

After careful consideration, our board of directors unanimously:

determined that the merger agreement, the merger and the transactions contemplated thereby are fair to, and in the best interests of, American Water Works and its stockholders;

approved and declared advisable the merger agreement; and

recommended that our stockholders vote to adopt the merger agreement.

Our board of directors recommends that you vote "**for**" the proposal to adopt the merger agreement at the special meeting.

Opinion of Financial Advisor (see page 19)

On September 16, 2001, Goldman Sachs delivered its oral opinion, which was subsequently confirmed in writing as of September 16, 2001, to the American Water Works board of directors to the effect that, based upon and subject to the matters set forth in that opinion, as of

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September 16, 2001, the \$46.00 in cash per share of American Water Works common stock to be received by the holders of American Water Works common stock pursuant to the merger agreement was fair from a financial point of view to those holders.

The full text of the written opinion of Goldman Sachs, which sets forth assumptions made, matters considered and limitations on the review undertaken in connection with the opinion, is attached as Annex B to this proxy statement. Goldman Sachs provided its opinion for the information and assistance of the American Water Works board of directors in connection with its consideration of the merger. The Goldman Sachs opinion is not a recommendation as to how any holder of shares of American Water Works common stock or cumulative preferred stock, 5% series should vote with respect to the merger. We urge you to read the opinion in its entirety.

Interests of Directors and Executive Officers in the Merger (see page 28)

In considering the recommendation of our board of directors to vote for the proposal to adopt the merger agreement so that the merger can occur, you should be aware that some of our executive officers and members of our board of directors have interests in the merger that may be in addition to or different from the interests of our stockholders generally. The members of the American Water Works board of directors were aware of these interests and considered them at the time they approved the merger. These interests include the following:

Stock options held by our officers and directors will be treated in the same manner as stock options held by other American Water Works employees. Upon the consummation of the merger, all unvested options for common stock and other stock-based rights issued under our stock incentive plans will vest and become exercisable. Also, at the time of the merger, RWE

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will cash out all the options to purchase common stock at a price equal to the excess, or the spread, of the \$46.00 in cash per share merger consideration over the per share exercise price of each option.

Each of our executive officers has entered into a change in control agreement with us. These agreements provide that, if within three years after the merger, the officer's employment terminates without cause (as defined in the agreements) or for good reason (as defined in the agreements), the officer will receive certain severance benefits.

After the merger, J. James Barr, President and Chief Executive Officer, Ellen C. Wolf, Vice President and Chief Financial Officer, Daniel L. Kelleher, Senior Vice President of our American Water Works Service Company subsidiary, W. Timothy Pohl, General Counsel and Secretary, Joseph F. Hartnett, Jr., Treasurer, and Robert D. Sievers, Comptroller (the "executive officers"), each will be entitled to receive, upon termination of their employment with American Water Works, a lump sum payment equal to the present value of each of their respective accrued benefits under either the Supplemental Executive Retirement Plan or the Supplemental Retirement Plan, as applicable.

Each of our executives and non-employee directors may elect to receive payment of his or her account under our Executive and Director Deferred Compensation Plans (subject to a 5% early withdrawal penalty) within one year after the merger.

After the merger, each of our executive officers and other key employees will be eligible to receive retention bonuses equal to a multiple of their current base salary (2, 1.50, 1.25 or .75, depending upon the level of the employee), with (1) 75% of the bonus amount payable on the date of the merger, so long as the employee continues to be employed on such date, and (2) the remaining 25% payable upon the earlier to occur of a specified date (without regard to whether or not the merger actually occurs) or six months after the date of the merger (assuming the employee continues to be employed on such date). The 25% of the bonus amount is also subject to accelerated payment upon a termination of employment by us without cause or by the employee for good reason after the merger.

Upon completion of the merger, J. James Barr, our President and Chief Executive Officer and a member of our board of directors, will become President and Chief Executive Officer of RWE's combined water operations in North and South America and be elected a director of Thames Water Plc. In addition, upon completion of the merger, Marilyn Ware, chairman of our board of directors, will be elected a member of the Thames International Advisory Council.

Material U.S. Federal Income Tax Consequences (see page 27)

The receipt of \$46.00 in cash for each share of our common stock pursuant to the merger will be a taxable transaction for U.S. federal income tax purposes. For U.S. federal income tax purposes, each of our stockholders generally will realize taxable gain or loss as a result of the merger measured by the difference, if any, between \$46.00 per share and the adjusted tax basis in that share owned by the stockholder. For additional information regarding material U.S. federal income tax consequences of the merger to our stockholders, see "The Merger Material U.S. Federal Income Tax Consequences of the Merger to our Stockholders."

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Regulatory Approvals (see page 26)

Utilities Regulation

American Water Works and its subsidiaries have a business presence in 28 states and Canada and are regulated by state agencies in 21 of those states. Under applicable state laws, the merger may not be consummated until it is approved by certain of those state regulatory agencies in accordance with their respective laws. We currently anticipate regulatory review in Arizona, California, Connecticut, Illinois, Kentucky, Maryland, New Hampshire, New Jersey, New Mexico, New York, Pennsylvania, Virginia and West Virginia. Approval in Connecticut and New Hampshire will not be required if the sale of our properties in those states to Kelda Group Plc is completed prior to the completion of the merger. We believe that we will only be required to file advisory letters in Hawaii, Iowa, Missouri, Tennessee and Texas. We estimate that it will take at least a year to complete the required regulatory reviews and obtain the required regulatory approvals. The merger agreement may be terminated by either American Water Works or RWE if the required regulatory approvals are not obtained by September 16, 2003, subject to a 60 day extension for any regulatory waiting period that has not yet expired by September 16, 2003, if all other conditions are satisfied.

We believe that regulatory agencies with jurisdiction over the transaction will consider whether it is in the public interest, whether RWE, Thames Water Holdings and Thames Water Plc are financially, technologically and managerially suitable to control the American Water Works subsidiaries that are regulated by the particular agency and the ability of those subsidiaries to continue to provide safe, adequate and reliable service to the public through their plant, equipment and manner of operation. We believe that the large size, accompanying financial resources and technical expertise of RWE, Thames Water Holdings and Thames Water Plc, as well as their commitment to customer service, effective employee relations, strong community service and safe environmental practices, will be found adequate to permit the American Water Works subsidiaries to continue as well-run, customer-oriented water utilities and for the merger to result in benefits to their current and future customers, employees and operations. We therefore expect all state regulatory approvals necessary to consummate the transaction will be obtained. It is a condition to the closing of the merger that all such required state regulatory approvals be obtained and that these regulatory approvals not impose terms or conditions which would reasonably be expected to have a material adverse effect on us or on us and Thames Water Holdings' U.S. subsidiaries, taken as a whole. While we do not anticipate any such terms or conditions, we cannot assure you that this condition will be met.

Antitrust Regulation

Under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the rules promulgated thereunder by the Federal Trade Commission, the merger may not be completed until notifications have been given and certain information has been furnished to the FTC and the Antitrust Division of the Department of Justice and the applicable waiting period has expired or been terminated. We expect to file notification and report forms under the HSR Act with the FTC and the Antitrust Division during the spring of 2002. It is a condition to the closing of the merger that the waiting period under the HSR Act with respect to the merger expire, or the FTC and the Antitrust Division grant early termination of the waiting period under the HSR Act.

The Merger Agreement (see page 31)

Conditions to the Merger (see page 38)

Conditions to Each Party's Obligations. Each party's obligation to complete the merger is subject to the satisfaction or waiver of the following conditions:

we must obtain the adoption of the merger agreement by the affirmative vote of the holders of a majority of the votes represented by all the outstanding shares of our common stock and our cumulative preferred stock, 5% series, voting together as a single class, with each share of our

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common stock entitled to one vote and each share of cumulative preferred stock, 5% series, entitled to 1/10th of a vote;

the waiting period applicable to the completion of the merger under the Hart-Scott-Rodino Antitrust Improvements Act shall have expired or been terminated;

any other required approval or waiting period under any other similar competition, merger control, antitrust or similar law or regulation, the failure of which to obtain or comply with would reasonably be expected to have a material adverse effect on us, shall have been obtained or terminated or shall have expired;

there must not be in effect any temporary restraining order, preliminary or permanent injunction or other order or decree issued by a court of competent jurisdiction or other legal restraint or prohibition that has the effect of preventing the completion of the merger;

all required regulatory approvals under the laws and judgments of any state public utility commission, state public service commission or similar state regulatory body must have been obtained and must not have been reversed, enjoined or suspended and any waiting periods or conditions thereto must be expired or satisfied;

all material required regulatory approvals under the laws and judgments of any public health departments, environmental protection agencies or of any federal or state regulatory body having jurisdiction over similar matters shall have been obtained and must not have been reversed, enjoined or suspended and any waiting periods or conditions thereto must be expired or satisfied; and

the redemption of our outstanding cumulative preferred stock, 5% series and 5% cumulative preference stock, must be completed.

Conditions to RWE's, Thames Water Holdings' and Apollo's Obligations. The obligation of RWE, Thames Water Holdings and Apollo to complete the merger is subject to the satisfaction or waiver of the following additional conditions:

our representations and warranties must be true and correct as of the date of the merger agreement and as of the closing date, except representations and warranties that speak as of an earlier date, which must be true and correct as of that earlier date, other than any failure to be true and correct that would not reasonably be expected to have a material adverse effect on us;

we must have performed in all material respects all obligations that we are required to perform under the merger agreement prior to the closing date;

no material adverse effect on us shall have occurred and there must be no state of facts, change, development, effect, condition or occurrence that would reasonably be expected to have a material adverse effect on us; and

the required regulatory approvals for the merger and other regulatory approvals obtained between the date of the merger agreement and the closing date in connection with acquisitions by us must not impose any terms or conditions that would reasonably be expected to have a material adverse effect on us or on Thames Water Holdings' U.S. subsidiaries and us, taken as a whole.

Conditions to American Water Works' Obligations. Our obligation to complete the merger is subject to the satisfaction or waiver of the following additional conditions:

RWE, Thames Water Holdings and Apollo's representations and warranties must be true and correct as of the date of the merger agreement and as of the closing date, except representations and warranties that speak as of an earlier date which must be true and correct as of that earlier date, other than any failure to be true and correct that would not reasonably be expected to impair in any material respect the ability of RWE, Thames Water Holdings or Apollo to perform

its obligations under the merger agreement or prevent or materially delay the completion of the merger; and

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RWE, Thames Water Holdings and Apollo must have performed in all material respects all obligations that each of them are required to perform under the merger agreement prior to the closing date.

Termination of the Merger Agreement (see page 41)

The merger agreement may be terminated at any time prior to the completion of the merger, whether before or after stockholder approval has been obtained:

by mutual written consent of American Water Works, Thames Water Holdings and Apollo;

by either American Water Works or Thames Water Holdings, if:

the merger is not completed on or before March 16, 2003, except that:

- (i) this right to terminate will not be available to any party whose failure to comply with the merger agreement has been the primary reason the merger has not been completed by that date;
- (ii) the date will be extended to September 16, 2003, if all conditions are satisfied other than obtaining the required regulatory approvals, and the date will be further extended up to an additional 60 days for any waiting period in respect of a regulatory approval that has not yet expired if all other conditions are satisfied; and
- (iii) neither party may terminate if all other conditions are satisfied other than the consummation of the redemption of our cumulative preferred stock, 5% series and 5% cumulative preference stock and American Water Works has mailed the notices of redemption;

any order, injunction or other legal restraint or prohibition that prevents the completion of the merger is in effect and has become final and nonappealable; or

our stockholders do not approve the merger agreement at the special meeting;

by Thames Water Holdings if:

our board of directors withdraws or modifies in a manner adverse to RWE its recommendation for approval of the merger agreement or recommends to our stockholders any takeover proposal by a third party; or

we have breached any of our representations or warranties, other than any failures of our representations and warranties to be true and correct that individually or in the aggregate would not reasonably be expected to have a material adverse effect, or materially breached any covenants in the merger agreement and the breach is not cured within 20 business days after written notice of the breach is delivered; or

by us if:

Thames Water Holdings has breached any of its representations or warranties, other than any failures of its representations and warranties to be true and correct that individually or in the aggregate would not reasonably be expected to have a material adverse effect, or materially breached any covenants in the merger agreement and the breach is not cured within 20 business days after written notice of the breach is delivered; or

prior to obtaining stockholder approval, our board of directors authorizes us to enter into an agreement with respect to a takeover proposal from a third party concurrently with such termination, provided that we have complied with the provisions of the merger agreement described below under "The Merger Agreement No

Solicitation of Other Offers," including the payment to Thames Water Holdings of the \$138 million termination fee described below.

Termination Fees (see page 42)

The merger agreement provides that upon termination in specified circumstances we must pay to Thames Water Holdings a termination fee of \$138 million. In addition, upon termination in certain other specified circumstances, Thames Water Holdings must pay to us a termination fee of \$138 million. See "The Merger Agreement Termination Fees."

Appraisal Rights (see page 45)

Stockholders who do not wish to accept the \$46.00 per share cash consideration payable pursuant to the merger may seek, under Delaware law, judicial appraisal of the fair value of their shares by the Delaware Court of Chancery. This value could be more or less than or the same as the merger consideration of \$46.00 in cash per share. This right of appraisal is subject to a number of restrictions and technical requirements. Generally, in order to exercise appraisal rights, among other things:

you must not vote in favor of the proposal to adopt the merger agreement;

you must make a written demand on us for appraisal in compliance with Delaware law before the vote on the proposal to adopt the merger agreement at the special meeting; and

you must hold your shares of record continuously from the time of making a written demand for appraisal until the effective time of the merger.

Merely voting against the merger agreement will not preserve your right of appraisal under Delaware law. Also, because a submitted proxy not marked "against" or "abstain" will be voted for the proposal to adopt the merger agreement, the submission of a proxy not marked "against" or "abstain" will result in the waiver of appraisal rights. If you hold shares in the name of a broker or other nominee, you must instruct your nominee to take the steps necessary to enable you to assert appraisal rights. If you or your nominee fails to follow all of the steps required by the statute, you will lose your right of appraisal.

Annex C to this proxy statement contains the relevant provisions of the Delaware statute relating to your right of appraisal.

THE COMPANIES

American Water Works Company, Inc.

American Water Works is the largest publicly traded enterprise devoted exclusively to the water and wastewater business in the United States. The core business of American Water Works is the ownership of common stock of utility companies providing water and wastewater services. American Water Works refers to the combination of it and its utility subsidiaries as the "American Water System." The American Water System has functioned for over 50 years. Each subsidiary operates independently, yet shares in the benefits of size and identity afforded by the American Water System. In addition to its utility subsidiaries, some of American Water Works' subsidiaries engage in non-regulated businesses. For example, American Water Services, Inc. is focused on the growing contract operations segment of the water and wastewater market, and American Water Resources is a subsidiary formed to invest in water and wastewater-related products and services.

On November 7, 2001, we completed the acquisition of Azurix North America Corp. and Azurix Industrials Corp., which expanded our presence into the southeastern and northwestern United States and three Canadian provinces. American Water Works and its subsidiaries now have approximately 6,300 employees and provide water, wastewater and other water resource management services to a population of approximately twelve million in 28 states and Canada. In addition, we have received the necessary approvals from the states of Arizona, Illinois,

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Indiana, Ohio and Pennsylvania for our purchase of the water and wastewater assets of Citizens Communications Company, a multi-utility holding company. The California Public Utility Commission approved our acquisition of Citizens' water and wastewater assets in that state in September 2001, but that approval is still subject to appeal. On August 30, 2001, we announced an agreement to sell our New England operations to Kelda Group Plc for \$118 million in cash plus the assumption of \$115 million in debt.

Each utility subsidiary is subject to the rules of both federal and state environmental protection agencies, particularly with respect to the quality of water distributed. In addition, with one exception, the utility subsidiaries function under economic regulations prescribed by state regulatory commissions.

The executive offices of American Water Works are located at 1025 Laurel Oak Road, P.O. Box 1770, Voorhees, New Jersey 08043, telephone 856-346-8200.

RWE Aktiengesellschaft

RWE is a global multi-utility company that does business, through its subsidiaries and affiliates, in over 120 countries. Its core businesses are electricity, gas, water, and waste and recycling. RWE's worldwide water activities are managed through RWE's wholly owned subsidiary, Thames Water Holdings. RWE, which was founded in 1898, is a company organized under the laws of the Federal Republic of Germany. RWE's executive offices are located at Opernplatz 1, 45128 Essen, Germany, telephone 49-201-1200.

Thames Water Aqua Holdings GmbH

Thames Water Holdings is a wholly owned subsidiary of RWE. Thames Water Holdings is the holding company for all of RWE's global water business. In 2000, RWE acquired Thames Water Plc, the leading supplier of water and wastewater services in the United Kingdom. Thames Water Plc is a subsidiary of Thames Water Holdings and, after the merger, American Water Works will be a subsidiary of Thames Water Holdings as well. Thames Water Holdings is a company organized under the laws of the Federal Republic of Germany. Its executive offices are located at Opernplatz 1, 45128 Essen, Germany, telephone 49-201-1200.

Apollo Acquisition Company

Apollo Acquisition Company is a Delaware corporation formed solely for the purpose of merging into American Water Works and has not conducted any unrelated activities since its organization. Apollo is a wholly owned subsidiary of Thames Water Holdings. The executive offices of Apollo are located at Clearwater Court, Vastern Road, Reading RG1 8DB, United Kingdom, telephone 44-118-373-8420.

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THE SPECIAL MEETING

This proxy statement is furnished in connection with the solicitation of proxies by our board of directors in connection with a special meeting of our stockholders.

Date, Time and Place of the Special Meeting

The special meeting is scheduled to be held as follows:

Date: January 17, 2002

Time: 9:30 a.m., local time

Place: Pennsylvania Convention Center, West Concourse, 12th and Arch Streets,
Philadelphia, Pennsylvania

Proposal to be Considered at the Special Meeting

At the special meeting, you will consider and vote upon a proposal to adopt an agreement and plan of merger, dated as of September 16, 2001, among American Water Works, RWE, Thames Water Holdings and Apollo. A copy of the merger agreement is attached as Annex A to this

proxy statement.

Record Date

Our board of directors has fixed the close of business on December 4, 2001 as the record date for the special meeting and only holders of record of common stock and cumulative preferred stock, 5% series on the record date are entitled to vote at the special meeting. On the record date, there were outstanding and entitled to vote 100,014,382 shares of common stock (one vote per share) and 101,777 shares of cumulative preferred stock, 5% series (one-tenth of a vote per share).

Voting Rights; Vote Required for Adoption

Each share of common stock entitles its holder to one vote on all matters properly coming before the special meeting and each share of cumulative preferred stock, 5% series entitles its holder to one-tenth of a vote on all matters properly coming before the special meeting. The presence in person or representation by proxy of stockholders entitled to cast a majority of the votes of all outstanding shares entitled to vote on the proposal to adopt the merger agreement, considered together, shall constitute a quorum for the purpose of considering that proposal.

If you hold your shares in an account with a broker or bank, you must instruct the broker or bank on how to vote your shares. If an executed proxy card returned by a broker or bank holding shares indicates that the broker or bank does not have authority to vote on the proposal to adopt the merger agreement, the shares will be considered present at the meeting for purposes of determining the presence of a quorum, but will not be voted on the proposal to adopt the merger agreement. This is called a broker non-vote. Your broker or bank will vote your shares only if you provide instructions on how to vote by following the instructions provided to you by your broker or bank.

Under Delaware law and our certificate of incorporation, the proposal to adopt the merger agreement must be adopted by the affirmative vote of the holders of a majority of the votes represented by all of the outstanding shares of common stock and cumulative preferred stock, 5% series, voting together as a single class, with each share of common stock entitled to one vote and each share of cumulative preferred stock, 5% series entitled to one-tenth of a vote.

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Abstentions and broker non-votes will have the same effect as a vote against the proposal to adopt the merger agreement.

Some of our major stockholders (including some of our directors) holding 25,989,476 shares of our common stock representing approximately 26% of the total votes entitled to be cast at the special meeting have entered into a voting agreement with Thames Water Holdings obligating those stockholders to vote their shares in favor of the transaction. In addition, each of our directors and executive officers (including some who have entered into the voting agreement) has indicated that he or she intends to vote his or her own shares in favor of the proposal to adopt the merger agreement. If our directors and officers and the other major stockholders party to the voting agreement vote their shares for the proposal to adopt the merger agreement, 28.6% of the voting power of our outstanding common stock and cumulative preferred stock, 5% series will have voted for the proposal to adopt the merger agreement. This means that holders of only an additional 21.5% of the voting power of all shares entitled to vote at the meeting would need to vote for the proposal to adopt the merger agreement in order for it to be adopted. Votes will be tabulated by our transfer agent, Equiserve Trust Company, N.A.

Voting and Revocation of Proxies

Stockholders of record may submit proxies by mail, by Internet, or by telephone. Stockholders who wish to submit a proxy by mail should mark, date, sign and return the proxy card in the envelope furnished. Stockholders of record who wish to submit a proxy by Internet may do so by going to the website, www.eproxyvote.com/awk. Stockholders of record who wish to submit a proxy by telephone may do so by calling 1-877-PRX-VOTE (1-877-779-8683). Telephone and Internet proxy submission procedures are designed to verify stockholders through use of a voter control number that is provided on each proxy card. Stockholders who hold shares beneficially through a nominee (such as a bank or broker) may be able to submit a proxy by telephone or the Internet if those services are offered by the nominee. If you hold your shares through a nominee, please check the proxy card provided by your nominee to determine whether telephone and/or Internet voting are available to you.

Proxies received at any time before the special meeting, and not revoked or superseded before being voted, will be voted at the special meeting. Where a specification is indicated by the proxy, it will be voted in accordance with the specification. Where no specification is indicated, the proxy will be voted "for" the proposal to adopt the merger agreement and in the discretion of the persons named in the proxy with respect to any other business that may properly come before the meeting or any adjournment of the meeting. Our board of directors is not currently aware of any business to be brought before the special meeting other than that described in this proxy statement.

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Please do not send in your stock certificates with your proxy card. If the merger is completed, a separate letter of transmittal will be mailed to you which will enable you to receive the merger consideration.

Until your proxy is exercised at the special meeting, you can revoke your proxy and change your vote in any of the following ways:

by delivering written notification to American Water Works' General Counsel and Secretary at our executive offices at 1025 Laurel Oak Road, Voorhees, New Jersey 08043;

by delivering a proxy of a later date by mail, Internet or telephone in the manner described herein;

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by attending the special meeting and voting in person. Your attendance at the meeting will not, by itself, revoke your proxy; you must vote in person at the meeting; or

if you have instructed a broker or bank to vote your shares, by following the directions received from your broker or bank to change those instructions.

Solicitation of Proxies

We will bear the expenses in connection with the solicitation of proxies. Arrangements will also be made with brokerage houses and other custodians, nominees and fiduciaries for the forwarding of solicitation material to the beneficial owners of common stock held of record by such persons, and we may reimburse them for their reasonable transaction and clerical expenses. Solicitation of proxies will be made principally by mail. Proxies may also be solicited in person, or by telephone, facsimile, telegram or other means of communication, by our officers and regular employees. These people will receive no additional compensation for these services, but will be reimbursed for any transaction expenses incurred by them in connection with these services. We have retained Georgeson Shareholder Communications Inc., a proxy solicitation firm, for assistance in connection with the solicitation of proxies for the special meeting at an anticipated cost of approximately \$10,000 plus reimbursement of reasonable out-of-pocket expenses.

Questions and Additional Information

If you have more questions about the merger or how to submit your proxy, or if you need additional copies of this proxy statement or the enclosed proxy card or voting instructions, you should contact Georgeson Shareholder Communications Inc. at 111 Commerce Road, Carlstadt, New Jersey 07072, or by telephone at 1-866-324-8874 or our General Counsel and Secretary at our executive offices at 1025 Laurel Oak Road, Voorhees, New Jersey 08043, or by telephone at 856-346-8223.

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THE MERGER

Background

American Water Works has over the years implemented a growth strategy by participating in the increasing trend toward consolidation in the water industry in the United States. This strategy has helped make American Water Works the largest and most geographically diverse investor-owned water utility business in the United States. American Water Works has also been aware of the increasing trends of privatization of global water industry assets and multi-national acquisition and ownership of water utilities.

American Water Works first learned of RWE's interest in a possible transaction on May 21, 2001, when William Alexander, the Chief Executive Officer of Thames Water Plc (a subsidiary of Thames Water Holdings), contacted J. James Barr, President and Chief Executive Officer of American Water Works. This initial contact was followed by a meeting on May 25, 2001 between Mr. Barr, Ellen C. Wolf, Vice President and Chief Financial Officer of American Water Works, Mr. Alexander and Christopher Bunker, Chief Financial Officer of Thames

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Water Plc. At that meeting, Messrs. Alexander and Bunker discussed with Mr. Barr and Ms. Wolf the potential acquisition of American Water Works by RWE through Thames Water Holdings. During these discussions, Mr. Alexander indicated that RWE was considering a proposed cash price of \$41.00 per share of American Water Works common stock. Mr. Barr stated that American Water Works would consider the offer and respond to RWE.

On June 7, 2001, the American Water Works board of directors held a special meeting to receive management's report concerning RWE's proposal at which its legal advisors, Simpson Thacher & Bartlett, were present. Representatives of Simpson Thacher & Bartlett advised the members of the American Water Works board of directors regarding their fiduciary duties in connection with their consideration of the transaction proposed by RWE. American Water Works' senior management then made various presentations concerning RWE's proposal. At that meeting, the American Water Works board of directors was of the view that RWE's \$41.00 proposal was not attractive, given American Water Works' business strategies and growth prospects. The American Water Works board of directors considered the strategic alternatives available to American Water Works and authorized Mr. Barr to engage in further exploratory discussions with RWE to determine if RWE would be willing to offer a higher price. Mr. Barr informed the board of directors that American Water Works intended to retain Goldman, Sachs & Co. as financial advisor to American Water Works in connection with RWE's proposal. Subsequently, American Water Works executed an engagement letter with Goldman Sachs, dated as of June 14, 2001, to act as its financial advisor in connection with a potential transaction with RWE.

On June 8, 2001, Mr. Barr contacted Mr. Alexander by telephone and indicated that the American Water Works board of directors was not interested in a proposal for an acquisition at \$41.00 per share and that any offer must reflect American Water Works' full value as the leading publicly owned water and water services company in the United States. On June 11, 2001, Mr. Alexander contacted Mr. Barr to indicate that RWE would be willing to consider an increase in the price offered if RWE were permitted to conduct a due diligence investigation to better understand American Water Works' performance and prospects.

On June 26, 2001, RWE, Thames Water Plc and American Water Works entered into a confidentiality agreement. Thereafter, management of American Water Works and its legal and financial advisors met with management of Thames Water Plc and its legal and financial advisors to provide limited additional information about American Water Works. On July 11, 2001, Mr. Alexander informed Mr. Barr by telephone and in writing that RWE was pleased with what it had learned about American Water Works to date and had increased its offer to \$45.00 per share of American Water Works common stock. Mr. Alexander also added that the offer was subject to completion of satisfactory due diligence, approval by the supervisory board of RWE, as well as negotiation of a mutually acceptable merger agreement and stockholder voting agreement.

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On July 12, 2001, the American Water Works board of directors held a special meeting to consider RWE's revised proposal at which representatives of Simpson Thacher & Bartlett were present. At this meeting, Mr. Barr advised the American Water Works board of directors of the progress of negotiations and the board determined that it would hold another meeting on July 16, 2001 to further consider the proposal. At the July 16th meeting, representatives of Goldman Sachs reviewed with the American Water Works board of directors various topics relating to American Water Works and the revised RWE proposal. Each of Goldman Sachs and management also discussed with the American Water Works board of directors other strategic options available to American Water Works as an independent company or in other business combinations, including the assessment by Goldman Sachs of the likelihood that (based on knowledge of the industry but without having made specific inquiries) other companies would be interested in making an offer to acquire or merge with American Water Works. After lengthy discussion, the American Water Works board of directors authorized management to hold further discussions with RWE and to allow RWE to proceed with additional financial and legal due diligence to determine if it would be willing to offer a higher price. The board of directors also discussed at length several transaction terms that would be important in evaluating any final proposal, including fiduciary termination rights, regulatory matters, employee and retiree benefits and covenants governing the conduct of business between signing and closing.

On July 17, 2001, Mr. Barr contacted Mr. Alexander and stated that he was not prepared to recommend the \$45.00 offer to the American Water Works board of directors but that American Water Works would be willing to provide additional financial and legal due diligence materials to RWE to allow RWE to determine if it would be willing to offer a higher price for American Water Works' common stock. Mr. Alexander responded that although he believed RWE had already made its best offer, he would instruct RWE representatives to continue due diligence and would discuss internally whether RWE would reconsider its offer. On July 18, 2001, Ms. Wolf had a conference call with Mr. Bunker to discuss detailed arrangements for further due diligence. During the first two weeks of August, members of American Water Works management met with representatives of RWE as part of RWE's additional legal and financial due diligence.

On August 8, 2001, Mr. Barr had breakfast with Mr. Alexander to discuss the progress of negotiations. Mr. Barr reiterated to Mr. Alexander that he was not prepared to recommend the \$45.00 offer to the board and that any offer to acquire American Water Works must address certain contractual areas of importance to American Water Works.

On Friday, August 10, 2001, Ms. Wolf and Daniel Kelleher, Senior Vice President of the American Water Works Service Company, met with Mr. Bunker and Jim McGivern, Managing Director, International Business Development of Thames Water Plc, to discuss the operating covenants of a potential merger agreement. The next day, Cravath, Swaine & Moore, legal advisors to RWE, distributed a draft merger agreement and a draft stockholder voting agreement. On August 13, 2001, Mr. Barr called Mr. Alexander to indicate that substantial issues had

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been raised by the draft merger agreement and that American Water Works would respond with an alternative draft merger agreement that included terms acceptable to American Water Works. American Water Works' legal advisors did this and on August 17, 2001, RWE responded with a revised draft merger agreement, and representatives of the parties commenced negotiations of the merger agreement.

On Sunday, August 19, 2001, Mr. Barr met with Mr. Alexander for breakfast to discuss the progress of negotiations. During that conversation, Mr. Alexander reiterated his strong belief in the transaction and presented RWE's final proposal which included a price of \$46.00 per share of American Water Works common stock. That conversation was followed by a written proposal from Mr. Alexander on behalf of RWE confirming the \$46.00 per share proposal. Mr. Alexander also indicated that RWE was fully prepared to resolve all remaining contract issues. Mr. Alexander

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indicated that he would seek RWE's supervisory board approval on Wednesday, August 22, 2001 and Mr. Barr indicated that he would present RWE's proposal to the American Water Works board of directors that same day.

Between the afternoon of Sunday, August 19, 2001, and the afternoon of Tuesday, August 21, 2001, members of American Water Works' management and representatives of Simpson Thacher & Bartlett met with members of RWE's management and representatives of Cravath, Swaine & Moore to continue negotiating the merger agreement. On the afternoon of Tuesday, August 21, 2001, Mr. Barr called Mr. Alexander to express concern regarding the progress of negotiations. Mr. Alexander assured Mr. Barr that RWE was committed to the transaction on terms acceptable to American Water Works' management. On Tuesday evening, representatives of the management and legal advisors of American Water Works met with representatives of the management and legal advisors of RWE at the offices of Simpson Thacher & Bartlett to continue to negotiate the merger agreement.

Discussions between the advisors of American Water Works and RWE continued throughout the evening of Tuesday, August 21, 2001 and the morning of Wednesday, August 22, 2001 but did not result in a mutually acceptable merger agreement. Representatives of RWE informed representatives of American Water Works that the RWE supervisory board had approved the transaction generally at a meeting held in Germany on the morning of August 22, 2001. During the afternoon of that day, the American Water Works board of directors met to discuss the progress of negotiations. The board of directors was advised of events since the last board meeting on July 12, 2001. Mr. Barr indicated that the parties had not reached a mutually acceptable merger agreement and that he could not recommend that the board of directors approve RWE's proposal at that time. The American Water Works board of directors discussed the matters raised by Mr. Barr, concurred with his recommendations and did not take any further action at this meeting. After the meeting, Mr. Barr called Mr. Alexander to indicate that the American Water Works board of directors had discussed but not approved the transaction.

On Friday, August 24, 2001, Mr. Alexander delivered a letter to Mr. Barr expressing his commitment to the transaction and interest in scheduling a meeting with Mr. Barr.

On Monday, August 27, 2001, Dr. Dietmar Kuhnt, the President and Chief Executive of RWE, delivered a letter to Mr. Barr and Marilyn Ware, Chairman of the American Water Works board of directors, expressing his continued commitment to the transaction. Mr. Barr responded in writing to Dr. Kuhnt expressing his disappointment in the negotiations to date.

Between August 27, 2001 and September 4, 2001, advisors of American Water Works and advisors of RWE continued to discuss the terms of a potential transaction in an effort to overcome any remaining differences between the parties. On September 4, 2001, Mr. Alexander telephoned Mr. Barr to indicate RWE's continuing interest in reaching an agreement with American Water Works. Mr. Barr indicated that he would discuss RWE's interest at a regular American Water Works' board meeting scheduled for September 6, 2001.

On September 6, 2001, the American Water Works board of directors held a regularly scheduled meeting at which it discussed the proposed transaction with RWE and the strategic options available to American Water Works. At this meeting, the American Water Works board of directors discussed the probability of receiving offers to acquire American Water Works from other suitable buyers at a price higher than that offered by RWE and various strategies for continuing to negotiate with RWE.

On September 7, 2001, Mr. Barr indicated to Mr. Alexander that American Water Works would deliver a revised draft merger agreement to RWE, and they decided to arrange a meeting between representatives of each company for September 10, 2001. Later that day American Water Works' management delivered a revised draft merger agreement to RWE.

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On September 10, 2001, Mr. Barr and Ms. Wolf met with Mr. Alexander, Mr. McGivern, Mr. Bunker and Dr. Richard Klein, a member of the executive board of RWE, to discuss the proposed merger agreement. Following that meeting, Mr. Barr and Mr. Alexander directed their respective management and advisor teams to continue to negotiate the merger agreement. Negotiations were interrupted on the morning of September 11, 2001 when the terrorist attacks occurred in New York and Washington, D.C., but continued later that week after management of American Water Works and RWE determined to proceed with the negotiations.

On Sunday, September 16, 2001, the American Water Works board of directors held a special meeting to consider the RWE proposal with representatives of both Simpson Thacher & Bartlett and Goldman Sachs present. The American Water Works board of directors was advised of events relating to the transaction since the board meeting on August 22, 2001. A representative of Simpson Thacher & Bartlett advised the American Water Works board of directors of their legal duties in connection with considering the proposed transaction. A representative of Goldman Sachs then reviewed with the American Water Works board of directors Goldman Sachs' financial analyses with respect to the proposed transaction. Following this presentation, Goldman Sachs orally delivered its opinion to the board of directors of American Water Works, which was subsequently confirmed in writing, to the effect that, as of September 16, 2001, the \$46.00 in cash per share of American Water Works common stock to be received by the holders of American Water Works common stock pursuant to the merger agreement was fair from a financial point of view to those holders. In addition, at this meeting, a representative of Simpson Thacher & Bartlett reviewed with the board of directors the terms of the merger agreement (including changes made since the August 22nd meeting of the board of directors) and the voting agreement. Mr. Barr recommended approval of the transaction to the board of directors based on the terms and conditions of the draft agreements. After extensive discussion and deliberation and based on the factors described below, the American Water Works board of directors unanimously determined that the merger agreement, the merger and the transactions contemplated thereby were fair to and in the best interests of American Water Works and its stockholders, approved and declared advisable the merger agreement and resolved to recommend that the American Water Works stockholders vote to adopt the merger agreement.

Following the special meeting of the American Water Works board of directors, the merger agreement was executed by American Water Works, RWE and other parties thereto, and the voting agreement was executed by Thames Water Holdings and the stockholders party thereto. Prior to the opening of business on Monday, September 17, 2001, American Water Works issued a press release publicly announcing that it had entered into the merger agreement.

Reasons for the Merger

In reaching its decision to approve the merger agreement and to recommend that the American Water Works stockholders adopt the merger agreement, the American Water Works board of directors consulted with management and its legal and financial advisors. The American Water Works board of directors considered a number of factors, including, without limitation, the following:

1. the current and historical market prices of American Water Works common stock relative to the merger consideration, and the fact that the \$46.00 per share merger consideration represented a 37.2% premium over the average closing price of American Water Works common stock over the 30 trading days prior to September 10, 2001;
 2. the fact that the merger consideration is all cash, which provides certainty of value to holders of American Water Works common stock compared to a transaction in which stockholders would receive stock;
-
3. the view of management that the trading value for shares of American Water Works common stock was not likely to exceed the merger price in the near term if American Water Works remained independent;
 4. the potential stockholder value that could be expected to be generated from the other strategic options available to American Water Works, including (a) remaining independent and continuing to implement its growth strategy or (b) pursuing other strategic alternatives, as well as the risks and uncertainties associated with those alternatives;
 5. the financial presentation of Goldman Sachs on September 16, 2001 and the opinion of Goldman Sachs delivered on September 16, 2001 to the American Water Works board of directors to the effect that, based upon and subject to the matters set forth in that opinion, as of September 16, 2001, the \$46.00 per share in cash to be received by holders of American Water Works common stock pursuant to the merger agreement was fair from a financial point of view to those holders;
 6. discussions with American Water Works' management and Goldman Sachs regarding the potential transaction with RWE and the business, financial condition, competitive position, business strategy, strategic options and prospects of American Water Works (as well as the risks involved in achieving these prospects), the nature of the water and waste water services industry in which American Water Works competes, and current industry, economic and market conditions, both on an historical and on a prospective basis;

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7. the terms of the merger agreement, as reviewed by the American Water Works board of directors with American Water Works' legal advisors, including:

the agreements by RWE with respect to obtaining regulatory approvals as more fully described under "The Merger Agreement Efforts to Complete The Merger";

sufficient operating flexibility for American Water Works to conduct its business in the ordinary course between signing and closing;

the absence of a financing condition;

a termination fee due to American Water Works if the merger agreement is terminated and RWE is in breach of certain of its covenants or representations and warranties as more fully described under "The Merger Agreement Termination of the Merger Agreement"; and

American Water Works' ability to furnish information to and conduct negotiations with a third party, terminate the merger agreement, and enter into an agreement relating to a superior proposal under certain circumstances, as more fully described under "The Merger Agreement No Solicitation of Other Offers";

8. management's assessment, after its review and discussion with Goldman Sachs of the credit ratings and divestiture plans of RWE, that RWE has the financial capability to consummate the merger;

9. the American Water Works board of directors' determination, based on the fact that no other offers to acquire American Water Works were made after initial press reports on and after August 22, 2001 that RWE was considering an acquisition of American Water Works and after discussing with its advisors the potential risks, costs and benefits of contacting other third parties, that there was insufficient reason to justify the risk of delay in proceeding with the favorable transaction with RWE;

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10. in the view of the American Water Works board of directors, based upon the advice of management after consultation with its legal counsel, that the regulatory approvals necessary to consummate the merger could be obtained. In forming such belief, the American Water Works board of directors and management recognized that regulatory agencies will consider whether RWE, Thames Water Holdings and Thames Water Plc are financially, technologically and managerially suitable to control American Water Works and its applicable subsidiaries and the ability of the American Water Works subsidiaries to continue to provide safe, adequate and reliable service to the public through their plant, equipment and manner of operation. The board's and management's belief was, consequently, based in substantial part upon its perception that the large size, accompanying financial resources and technical expertise of RWE, Thames Water Holdings and Thames Water Plc, as well as their declared commitment to customer service, effective employee relations, strong community service and safe environmental practices, will be found adequate to permit the American Water Works subsidiaries to continue as well-run, customer-oriented water utilities and for the merger to result in benefits to their current and future customers, employees and operations, including mitigation against the frequency and size of future rate increases for American Water Works;

11. that American Water Works will no longer exist as an independent company and its stockholders will no longer participate in the growth of American Water Works or the pursuit of its stand-alone business plan and the other factors set forth in the American Water Works certificate of incorporation;

12. that, under the terms of the merger agreement, American Water Works cannot solicit other acquisition proposals and must pay to RWE a termination fee if American Water Works terminates the merger agreement under certain circumstances, which may deter others from proposing an alternative transaction that may be more advantageous to American Water Works stockholders; and

13. the fact that gains from an all-cash transaction would be taxable to American Water Works stockholders for U.S. federal income tax purposes.

During its consideration of the transaction with RWE, the American Water Works board of directors were also aware that some of the directors and executive officers of American Water Works may have interests in the merger that are different from or in addition to those of

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American Water Works stockholders generally, as described under "The Merger Interests of Directors and Executive Officers in the Merger."

This discussion of the information and factors considered and given weight by the American Water Works board of directors is not intended to be exhaustive, but is believed to address the material information and factors considered by the board of directors. In view of the number and variety of these factors, the American Water Works board of directors did not find it practicable to make specific assessments of, or otherwise assign relative weights to, the specific factors and analyses considered in reaching its determination. The determination to approve the merger agreement was made after consideration of all of the factors and analyses as a whole. In addition, individual members of the American Water Works board of directors may have given different weights to different factors.

Opinion of Financial Advisor

On September 16, 2001, Goldman Sachs delivered its oral opinion, which was subsequently confirmed in writing, to the American Water Works board of directors to the effect that, based upon and subject to the matters set forth in that opinion, as of September 16, 2001, the \$46.00 in cash per share of American Water Works common stock to be received by the holders of American Water

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Works common stock pursuant to the merger agreement was fair from a financial point of view to those holders.

The full text of the written opinion of Goldman Sachs, dated September 16, 2001, which sets forth assumptions made, matters considered, and limitations on the review undertaken in connection with the opinion, is attached as Annex B and is incorporated herein by reference. Goldman Sachs provided its opinion for the information and assistance of the American Water Works board of directors in connection with its consideration of the merger. The Goldman Sachs opinion is not a recommendation as to how any holder of shares of American Water Works common stock or cumulative preferred stock, 5% series should vote with respect to the merger. We urge you to read the opinion in its entirety.

In connection with its opinion, Goldman Sachs reviewed, among other things:

the merger agreement;

the annual reports to stockholders and annual reports on Form 10-K of American Water Works for the three years ended December 31, 2000;

selected interim reports to stockholders and quarterly reports on Form 10-Q of American Water Works;

selected other communications from American Water Works to its stockholders; and

selected internal financial analyses and forecasts for American Water Works prepared by its management.

Goldman Sachs also held discussions with members of the senior management of American Water Works regarding their assessment of the past and current business operations, financial condition and future prospects of their company. In addition, Goldman Sachs:

reviewed the reported price and trading activity for shares of common stock of American Water Works;

compared certain financial and stock market information for American Water Works with similar information for certain other companies the securities of which are publicly traded; and

reviewed the financial terms of certain recent business combinations in the water utility industry specifically and in other industries generally and performed such other studies and analyses as it considered appropriate.

Goldman Sachs relied upon the accuracy and completeness of all of the financial, accounting and other information discussed with or reviewed by it and assumed such accuracy and completeness for purposes of rendering its opinion. In addition, Goldman Sachs did not make an independent evaluation or appraisal of the assets and liabilities of American Water Works or any of its subsidiaries. No evaluation or appraisal of the assets or liabilities of American Water Works or any of its subsidiaries was furnished to Goldman Sachs.

The following is a summary of the material financial analyses used by Goldman Sachs in connection with providing its written opinion to the American Water Works board of directors. This summary does not purport to be a complete description of the analyses performed by Goldman Sachs. In arriving at its opinion, Goldman Sachs considered the results of all of its analyses as a whole and did not attribute any particular weight to any analysis or factor considered by it.

The following summaries of financial analyses include information presented in tabular format. You should read these tables together with the text of each summary.

Historical Stock Trading and Performance Analysis

Using the most recent publicly available information, Goldman Sachs reviewed the historical daily closing prices and trading volumes for shares of American Water Works common stock for the five-year period from September 10, 1996 to September 10, 2001, for the three-year period from September 10, 1998 to September 10, 2001, for the one-year period from September 8, 2000 to September 10, 2001, for the six-month period from March 9, 2001 to September 10, 2001, for the three-month period from June 8, 2001 to September 10, 2001, for the 20-day period from August 22, 2001 to September 10, 2001 and for the one-day period of September 10, 2001. The results of these analyses are set forth below:

Time Period*	Average Price
Five Year	\$ 26.66
Three Year	\$ 27.88
One Year	\$ 28.87
Six Months	\$ 31.49
Three Months	\$ 32.18
Twenty Days	\$ 34.03
One Day	\$ 34.12

*

Based upon periods ending September 10, 2001.

Goldman Sachs also reviewed ratios of daily closing prices for American Water Works common stock to projected current year earnings per share estimates for the five-year period from September 10, 1996 to September 10, 2001 using median earnings per share, or EPS, estimates from Institutional Brokers Estimate System, or IBES, an independent data service that compiles earnings estimates of institutional securities analysts. The analysis indicated a range of price to projected current year earnings ratio multiples of 11.2x to 21.8x over such 5-year period, with an average multiple of 17.1x and a September 10, 2001 price to projected current year earnings ratio multiple of 19.0x.

U.S. Water Utilities Common Stock Comparison

Goldman Sachs reviewed and compared selected financial information and multiples for American Water Works to corresponding financial information and multiples for the following U.S. public water utility companies:

Philadelphia Suburban Corporation;

California Water Service Group;

American States Water Company;

SJW Corp.;

Connecticut Water Service, Inc.;

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Middlesex Water Company; and

Southwest Water Company.

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Goldman Sachs calculated the multiples and other financial information for American Water Works at (1) the transaction price and (2) the closing price for shares of American Water Works common stock on the NYSE on September 10, 2001. The multiples and other financial information for the selected companies calculated by Goldman Sachs were based on the closing prices on September 10, 2001 for shares of the selected companies' common stock. The multiples and other financial information for American Water Works and the selected companies calculated by Goldman Sachs were based on the most recent publicly available information for American Water Works and the selected companies. The price to earnings figures and the five-year EPS growth figures for American Water Works and the selected companies were based upon the latest available median IBES estimates. All latest twelve months, or LTM, figures are as of June 30, 2001. Goldman Sachs' analysis of the selected companies compared the following to the results for American Water Works:

share price as a percentage of the 52-week high share price;

the equity market capitalization, based on diluted shares outstanding;

the enterprise value;

the enterprise value as a multiple of LTM sales, earnings before interest, taxes, depreciation and amortization, or EBITDA, and earnings before interest and taxes, or EBIT;

the ratio of price to estimated earnings for 2001 and 2002;

the ratio of total market capitalization to book value as of June 30, 2001;

the five-year EPS annual growth rate for the fiscal years 1996 through 2000;

the estimated five-year EPS annual growth rate for the fiscal years 2001 through 2006;

the annual dividend yield based upon the latest four quarters' figures;

the LTM EBITDA and EBIT margins; and

the enterprise value and LTM EBITDA per customer.

The results of these analyses with respect to American Water Works are summarized as follows:

	Transaction Price	Closing Price On September 10, 2001
Share price as a percentage of 52-week high share price	130%	96%
Equity market capitalization (in millions)	\$ 4,611	\$ 3,415
Enterprise value (in millions)	\$ 7,575	\$ 6,379
Enterprise value as a multiple of LTM Sales	5.5x	4.7x
Enterprise value as a multiple of LTM EBITDA	11.9x	10.0x
Enterprise value as a multiple of LTM EBIT	16.4x	13.8x
Price to estimated earnings ratio for 2001	25.6x	19.0x
Price to estimated earnings ratio for 2002	24.2x	18.0x
Total market capitalization to book value as of June 30, 2001	2.7x	2.0x
Annual EPS growth for 1996-2000	6.3%	6.3%
Five year estimated annual EPS growth rate for 2001-2006	6.0%	6.0%
Annual dividend yield	2.8%	2.8%
LTM EBITDA margins	NM	46.8%
LTM EBIT margins	34.0%	34.0%

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	Transaction Price	Closing Price On September 10, 2001
Enterprise value per customer	\$ 2,935	\$ 2,472
LTM EBITDA per customer	\$ 247	\$ 247

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The results of the analysis with respect to the selected U.S. water utility companies is as follows:

	High	Median	Mean	Low
Share price as a percentage of 52-week high share price	97%	87%	87%	70%
Equity market capitalization (in millions)	NA	NA	NA	NA
Enterprise value (in millions)	NA	NA	NA	NA
Enterprise value as a multiple of LTM Sales	7.6x	2.9x	4.1x	1.2x
Enterprise value as a multiple of LTM EBITDA	14.3x	10.1x	11.0x	8.4x
Enterprise value as a multiple of LTM EBIT	20.2x	15.1x	15.1x	11.2x
Price to estimated earnings ratio for 2001	25.6x	20.2x	20.6x	15.1x
Price to estimated earnings ratio for 2002	25.0x	18.2x	19.2x	14.3x
Total market capitalization to book value as of June 30, 2001	3.6x	2.4x	2.4x	1.7x
Annual EPS growth for 1996-2000	9.7%	3.1%	2.8%	(4.5)%
Five year estimated annual EPS growth rate	8.0%	4.0%	4.4%	3.0%
Annual dividend yield	4.7%	3.7%	3.5%	1.7%
LTM EBITDA margins	59.2%	32.7%	36.0%	12.0%
LTM EBIT margins	47.7%	23.3%	26.9%	8.0%
Enterprise value per customer	\$ 4,591	\$ 1,555	\$ 2,150	\$ 770
LTM EBITDA per customer	\$ 357	\$ 185	\$ 194	\$ 54

Selected U.S. Water Utility Transactions

Goldman Sachs analyzed information relating to the following twelve announced transactions in the water utility industry since 1998:

Acquirer	Target
Kelda Group	American Water Works New England Assets
City of Indianapolis	IWC Resources
Nuon NV	Utilities, Inc.
Truckee Meadows Water	Sierra Pacific Water Assets
Thames Water Plc	E'Town Corp.
American Water Works	SJW Corp.
American Water Works	Citizens Water Resources
Suez Lyonnaise des Eaux	United Water Resources
Kelda Group	Aqurion Co.
California Water Service Group	Dominguez Services
American Water Works	National Enterprises
Philadelphia Suburban Corporation	Consumers Water Company

Goldman Sachs compared the following information relating to each of the selected transactions to the contemplated transaction:

the premium of the transaction price to (1) the target's stock price on the day prior to the announcement of the particular transaction, (2) the target's stock price average for the 30 days prior to the announcement of the transaction and (3) the target's all-time high stock price prior to the announcement of the particular transaction;

the transaction price as a multiple of the target's LTM sales, EBITDA, EBIT and net income;

the transaction price as a multiple of the target's price to earnings, or P/E, ratio (based on the transaction price and the target's current year median IBES EPS estimates and forward year median IBES EPS estimates);

ratio of the target's market capitalization (based upon the transaction price) to the target's book value; and the target's enterprise value per target customer.

The results of this analysis were as follows:

Selected U.S. Water Utility Transactions

	High	Mean	Median	Low	Proposed Transaction
Premium of transaction price to target's stock price on day prior to announcement	32.5%	23.7%	23.4%	12.7%	34.8%
Premium of transaction price to 30 day average target's stock price prior to announcement	52.7%	45.8%	45.7%	38.8%	37.2%
Premium of transaction price to target's stock price all time high prior to announcement	20.5%	9.6%	8.2%	5.5%	29.5%
Transaction price as a multiple of target's LTM sales	6.2x	5.0x	5.0x	2.5x	5.5x
Transaction price as a multiple of target's LTM EBITDA	15.9x	12.7x	12.3x	10.2x	11.9x
Transaction price as a multiple of target's LTM EBIT	24.8x	17.7x	17.2x	13.6x	16.4x
Transaction price as a multiple of target's LTM net income	34.1x	26.7x	25.7x	20.3x	28.4x
Transaction price as a multiple of P/E for current year EPS	27.7x	25.3x	25.5x	21.8x	25.6x
Transaction price as a multiple of P/E for forward year EPS	26.3x	24.1x	24.5x	20.6x	24.2x
Market capitalization to book value	3.3x	2.8x	2.9x	2.4x	2.7x
Enterprise value per customer	\$ 4,861	\$ 3,027	\$ 2,738	\$ 1,681	\$ 2,935

Discounted Cash Flow Analysis

Goldman Sachs performed a discounted cash flow analysis of American Water Works using American Water Works management projections and information regarding after-tax investments provided by American Water Works. Goldman Sachs calculated a range of implied net present values per share of American Water Works common stock based on (1) the discounted present value of the five year (2001-2006) stream of projected free cash flows of American Water Works, plus (2) the discounted present value of the terminal value of American Water Works in 2006, assuming an EBITDA exit multiple range between 9.0x to 11.0x, minus (3) American Water Works' net debt as of June 30, 2001, plus (4) the after-tax value of American Water Works' investments. The stream of projected free cash flows was discounted back to July 1, 2001 using a range of discount rates representing an estimated range of the weighted average cost of capital for American Water Works. The range of discount rates utilized by Goldman Sachs in its analysis was 6.0% to 8.0%. The result of this calculation was divided by the number of fully diluted shares of American Water Works common stock outstanding as of September 10, 2001. The results of this analysis yielded implied net present values per share of American Water Works common stock ranging from \$36.73 to \$55.43.

Future Stock Price and Dividends Analysis

Goldman Sachs calculated the present value of implied future stock prices and dividends received for shares of American Water Works common stock based upon American Water Works management estimates of future earnings and dividends. Goldman Sachs initially calculated the implied value of

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future stock prices for shares of American Water Works common stock using price to earnings multiples ranging from 14x to 22x for the years 2002 to 2005. Goldman Sachs then calculated the discounted present value of these implied future stock prices and dividends received based on an assumed discount rate of 8%. The results of this analysis yielded present values of future stock prices and dividends received ranging from \$25 to \$40 in the case of future stock prices and dividends for 2002, \$27 to \$41 for 2003, \$28 to \$43 for 2004 and \$29 to \$44 for 2005, in each case discounted back to July 1, 2001 and rounded to the nearest dollar. The 8% discount rate utilized by Goldman Sachs is consistent with the cost of equity assumption used to generate the lower end of the range of weighted average cost of capital used in the discounted cash flow analysis described above. A higher assumed discount rate than the 8% assumed by Goldman Sachs would have yielded lower present values of future stock prices and dividends received for shares of American Water Works common stock.

The preparation of a fairness opinion is a complex process and is not necessarily susceptible to partial analysis or summary description. Selecting portions of the analyses or of the summary set forth above, without considering the analyses as a whole, could create an incomplete view of the processes underlying Goldman Sachs' opinion. In arriving at its fairness determination, Goldman Sachs considered the results of all the analyses. No company or transaction used in the above analyses as a comparison is directly comparable to American Water Works, RWE or the proposed merger.

The analyses were prepared solely for purposes of Goldman Sachs' providing its opinion to the American Water Works board of directors as to the fairness from a financial point of view of the \$46.00 in cash per share of American Water Works common stock to be received by the holders of American Water Works common stock pursuant to the merger agreement. These analyses do not purport to be appraisals or to reflect the prices at which businesses or securities actually may be sold. Analyses based upon forecasts of future results are not necessarily indicative of actual future results, which may be significantly more or less favorable than suggested by such analyses. Because such analyses are inherently subject to uncertainty, being based upon numerous factors or events beyond the control of the parties or their respective advisors, none of American Water Works, Goldman Sachs or any other person assumes responsibility if future results are materially different from those forecast.

As described above, Goldman Sachs' opinion to the American Water Works board of directors was one of many factors taken into consideration by the board of directors in making its determination to approve the merger agreement. The foregoing summary does not purport to be a complete description of the analyses performed by Goldman Sachs.

Goldman Sachs, as part of its investment banking business, is continually engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements, and valuations for estate, corporate and other purposes. Goldman Sachs is familiar with American Water Works, having provided certain investment banking services to American Water Works from time to time, including having acted as its financial advisor in connection with its recently completed acquisition of Azurix North America Corp. and Azurix Industrials Corp., and having acted as its financial advisor in connection with, and having participated in certain of the negotiations leading to, the merger agreement.

Goldman Sachs has also provided certain investment banking services to RWE from time to time, including having acted as:

financial advisor to Hochtief AG, a company in which RWE owns an approximately 62% equity interest, in connection with its acquisition of Turner Corporation in September 1999;

financial advisor to RWE in connection with its acquisition of a minority interest in Lahmeyer AG in February 2000;

financial advisor to RWE in connection with its acquisition of VEW AG in November 2000; and

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agent to Thames Water Plc, a wholly owned subsidiary of RWE, in connection with its public offering of JPY 2,000,000,000 aggregate principal amount of Floating Rate Notes due January 28, 2002 in July 2000.

Goldman Sachs may also provide investment banking services to RWE, Thames Water Holdings and Thames Water Plc in the future. American Water Works selected Goldman Sachs as its financial advisor because it is an internationally recognized investment banking firm that has substantial experience in transactions similar to the merger.

Goldman Sachs provides a full range of financial advisory and securities services and, in the course of its normal trading activities, may from time to time effect transactions and hold securities, including derivative securities, of American Water Works and RWE for its own account and for the accounts of customers.

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Pursuant to a letter agreement, dated June 14, 2001, American Water engaged Goldman Sachs to act as its financial advisor in connection with the proposed merger. Pursuant to the terms of this engagement letter, American Water Works has agreed to pay Goldman Sachs a customary fee, a portion of which was paid upon announcement of the transaction and a portion of which will be paid upon consummation of the transaction.

American Water Works has agreed to reimburse Goldman Sachs for its reasonable out-of-pocket expenses, including reasonable attorneys' fees, and to indemnify Goldman Sachs against certain liabilities, including certain liabilities under the federal securities laws.

Regulatory Approvals

Utilities Regulation

American Water Works and its subsidiaries have a business presence in 28 states and Canada and are regulated by state agencies in 21 of those states. Under applicable state laws, the merger may not be consummated until it is approved by certain of those state regulatory agencies in accordance with their respective state laws. We currently anticipate regulatory review in Arizona, California, Connecticut, Illinois, Kentucky, Maryland, New Hampshire, New Jersey, New Mexico, New York, Pennsylvania, Virginia and West Virginia. Approval in Connecticut and New Hampshire will not be required if the sale of our properties in those states to Kelda Group Plc is completed prior to the completion of the merger. We believe that we will only be required to file advisory letters in Hawaii, Iowa, Missouri, Tennessee and Texas. We estimate that this regulatory review will take at least a year to complete. The merger agreement may be terminated by either American Water Works or RWE if the required regulatory approvals are not obtained by September 16, 2003, subject to a 60 day extension for any regulatory waiting period that has not yet expired by September 16, 2003, if all other conditions are satisfied.

We believe that regulatory agencies with jurisdiction over the transaction will consider whether it is in the public interest, whether RWE, Thames Water Holdings and Thames Water Plc are financially, technologically and managerially suitable to control the American Water Works subsidiaries that are regulated by the particular agency and the ability of those subsidiaries to continue to provide safe, adequate and reliable service to the public through their plant, equipment and manner of operation. We believe that the large size, accompanying financial resources and technical expertise of RWE, Thames Water Holdings and Thames Water Plc, as well as their commitment to customer service, effective employee relations, strong community service and safe environmental practices, will be found adequate to permit the American Water Works subsidiaries to continue as well-run customer-oriented water utilities and for the merger to result in benefits to their current and future customers, employees and operations. We therefore expect that all state regulatory approvals necessary to consummate the transaction will be obtained. It is a condition to the closing of the merger that all such required state regulatory approvals be obtained, and that these regulatory approvals not impose terms or conditions which would reasonably be expected to have a material adverse effect on us or on us and Thames Water Holdings' U.S. subsidiaries, taken as a whole. While we do not anticipate any such terms or conditions, we cannot assure you that this condition will be met.

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Antitrust Regulation

Under the HSR Act and the rules promulgated thereunder by the FTC, the merger may not be completed until we and RWE file a notification and report form under the HSR Act and the applicable waiting period has expired or been terminated. We expect to file notification and report forms under the HSR Act with the FTC and the Antitrust Division of the Department of Justice during the spring of 2002. It is a condition to the closing of the merger that the waiting period under the HSR Act with respect to the merger expire, or the FTC and the Antitrust Division grant early termination of the waiting period under the HSR Act. At any time before or after completion of the merger, notwithstanding whether early termination of the waiting period under the HSR Act has been granted, the Antitrust Division or the FTC could take such action under the antitrust laws as it deems necessary or desirable in the public interest, including seeking to enjoin the completion of the merger or seeking divestiture of substantial assets of American Water Works or RWE. At any time before or after the completion of the merger, and notwithstanding whether early termination of the waiting period under the HSR Act has been granted, any state could take such action under the antitrust laws as it deems necessary or desirable in the public interest. Such action could include seeking to enjoin the completion of the merger or seeking divestiture of substantial assets of American Water Works or RWE. Private parties may also seek to take legal action under the antitrust laws under certain circumstances.

While there can be no assurance that the merger will not be challenged by a governmental authority or private party on antitrust grounds, we and RWE believe that the merger can be effected in compliance with federal and state antitrust laws.

Financing of the Merger

RWE has informed American Water Works that it estimates that approximately \$4.75 billion will be required to complete the purchase of shares of our common stock, restricted stock and options pursuant to the merger and to pay its related fees and expenses. RWE expects this

amount to be funded through an issuance of debt securities and internally available funds. The merger is not conditioned on any financing arrangements.

Material U.S. Federal Income Tax Consequences of the Merger to our Stockholders

The following is a summary of United States federal income tax consequences of the merger to stockholders whose shares of our common stock are converted into the right to receive cash under the merger. The discussion is for general information only and does not purport to consider all aspects of United States federal income taxation that might be relevant to our stockholders. The discussion is based on current law which is subject to change possibly with retroactive effect. The discussion applies only to stockholders who hold shares of our common stock as capital assets, and may not apply to shares of our common stock received in connection with the exercise of employee stock options or otherwise as compensation, or to certain types of stockholders (such as insurance companies, tax-exempt organizations, financial institutions and broker-dealers) who may be subject to special rules. This discussion does not discuss the tax consequences to any stockholder who, for United States federal income tax purposes, is a non-resident alien individual, foreign corporation, foreign partnership or foreign estate or trust, and does not address any aspect of state, local or foreign tax laws.

The receipt of cash for shares of our common stock in the merger will be a taxable transaction for United States federal income tax purposes. In general, a stockholder who surrenders shares of our common stock for cash in the merger will recognize capital gain or loss for United States federal income tax purposes equal to the difference, if any, between the amount of cash received and the stockholder's adjusted tax basis in the shares of our common stock surrendered. Gain or loss will be determined separately for each block of shares (*i.e.*, shares acquired at the same cost in a single transaction) surrendered for cash pursuant to the merger. Such gain or loss will be long-term capital gain or loss provided that a stockholder's holding period for such shares is more than 12 months at the time of the consummation of the merger. Capital gains of individuals derived in respect of capital

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assets held for more than one year are eligible for reduced rates of taxation. There are limitations on the deductibility of capital losses.

Backup withholding will apply to all cash payments to which a holder of shares or other payee is entitled pursuant to the merger agreement, unless the stockholder or other payee provides a taxpayer identification number (social security number, in the case of individuals, or employer identification number, in the case of other stockholders), certifies that such number is correct, and otherwise complies with such backup withholding tax rules. Each of our stockholders and, if applicable, each other payee, should complete and sign the Substitute Form W-9 included as part of the letter of transmittal to be returned to the paying agent, in order to provide the information and certification necessary to avoid backup withholding tax, unless an exemption applies and is established in a manner satisfactory to the paying agent.

Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your United States federal income tax liability provided the required information is furnished to the IRS.

The United States federal income tax consequences set forth above are for general information purposes only and are not intended to constitute a complete description of all tax consequences relating to the merger. Because individual circumstances may differ, each stockholder should consult the stockholder's tax advisor regarding the applicability of the rules discussed above to the stockholder and the particular tax effects to the stockholder of the merger, including the application of state, local and foreign tax laws.

Interests of Directors and Executive Officers in the Merger

Members of our board of directors and our executive officers have various interests in the merger described in this section that may be in addition to, or different from, the interests of our stockholders generally. The members of American Water Works' board of directors were aware of these interests and considered them at the time they approved the merger agreement. You should keep this in mind when considering the recommendation of our board of directors for the proposal to adopt the merger agreement.

Stock Options

The merger agreement provides that as of the effective time of the merger, all outstanding unvested employee stock options for American Water Works common stock will become exercisable. The merger agreement provides that, for each share covered by outstanding stock options at the time of the merger, the holders of the options will have the right to receive a cash payment. The amount of this payment will equal the excess, if any, of the merger consideration of \$46.00 in cash per share of American Water Works common stock over the per share exercise price of the options, reduced by applicable withholding taxes.

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Our executive officers currently hold a total of approximately 395,000 options, approximately 101,000 of which are currently vested and 294,000 of which are currently unvested. The aggregate spread that the executive officers would be entitled to receive for all of their options as of the date of this proxy statement is approximately \$8.9 million. One of our executive officers is a director. None of our other directors hold options.

Supplemental Executive Retirement Plan and Supplemental Retirement Plan

Six of our executive officers participate in either our supplemental executive retirement plan, or SERP, or our Supplemental Retirement Plan, or SRP. SERP and SRP benefits are paid in addition to benefits payable under other retirement programs.

Benefits under the SERP are provided to certain executives and are intended to (1) provide the additional retirement benefits that would be payable under our qualified defined benefit pension plan if

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federal tax law did not restrict such benefits and (2) compute the benefits payable on the basis of the highest average remuneration during 36 consecutive months rather than 60 consecutive months of employment.

The SRP is also designed to provide benefits to certain key associates designated by our board of directors, equal to those that would be provided under our qualified defined benefit pension plan's benefit formula if it were unaffected by the federal tax law restrictions on benefits, and provides additional years of service to those covered associates hired in mid-career.

The SERP and the SRP both contain change in control provisions that provide that upon termination of a participant's employment with us, the participant will receive a lump sum payment equal to the present value (based on the assumptions used to calculate benefits under our qualified defined benefit pension plan) of each of their respective accrued benefits under the SERP or the SRP, as applicable.

If we were to complete the merger and immediately thereafter terminate our executive officers involuntarily, their annual SERP or SRP benefits that would be payable after giving effect to the SERP's or SRP's change in control provisions, as applicable, would equal, in the aggregate, approximately \$10 million.

Change in Control Agreements

On January 1, 2000, each of our executive officers entered into a change in control agreement with us. The agreements provide that, if within three years after the merger, an executive's employment terminates without cause (as defined in the agreements) or for good reason (as defined in the agreements), the executive will receive certain severance benefits. The benefits include a lump sum cash payment equal to a multiple (3, 2 or 1.5 times depending on the level of senior management) of the sum of salary and target bonus; pro rata target bonus for the year of termination; accelerated vesting of supplemental retirement benefits, stock options and restricted or deferred stock awards; continued welfare benefits for 36, 24 or 18 months (depending on the level of senior management); and 36, 24 or 18 months (depending on the level of senior management) of additional age and service credit for purposes of calculating supplemental retirement benefits and retiree medical benefits. Mr. Barr is entitled to three times salary and bonus and 36 months welfare benefits and service credit. Messrs. Kelleher and Pohl and Ms. Wolf are entitled to two times salary and bonus and 24 months welfare benefits and service credits. Messrs. Sievers and Harnett are entitled to 1.5 times salary and bonus and 18 months welfare benefits and service credits. The agreements also provide a tax gross-up feature so that such officers will be made whole for any excise taxes imposed on such payments.

Executive and Director Deferred Compensation Plans

We maintain a deferred compensation plan for our non-employee directors and a deferred compensation plan for our executive officers and key employees. The deferred compensation plans are unfunded. The directors deferred compensation plan accounts are payable in a lump sum or in up to ten annual installments at the director's prior election. The executive deferred compensation plan accounts are payable in a lump sum or in such number of installments as the executive may previously elect. Both deferred compensation plans contain a change in control provision that the participants may elect to receive payment of his or her account within one year after the merger, subject to a 5% early withdrawal penalty.

Retention Bonus Program

Our board of directors recently approved a retention bonus program, under which, after the merger, our executive officers and other key employees will be eligible to receive retention bonuses equal to a multiple of their current base salary (2, 1.50, 1.25 or .75, depending upon the level of the employee). Messrs. Barr, Kelleher and Pohl and Ms. Wolf will receive two times their respective base

salaries, and Messrs. Sievers and Hartnett will receive 1.5 times their respective base salaries. The bonus amounts will be payable as follows: (1) 75% of the bonus amount will be paid on the date of the merger, so long as the employee continues to be employed on such date and (2) the remaining 25% will be paid upon the earlier to occur of a specified date (without regard to whether or not the merger actually occurs) and six months after the date of the merger, so long as the employee continues to be employed on such date. The 25% of the bonus amount is also subject to accelerated payment upon a termination of employment by us without cause or by the employee for good reason after the merger. The aggregate amount of all retention bonus payments, including those made to non-executive officers, is not expected to exceed \$10 million.

In addition, we have established a discretionary bonus pool equal to \$5 million, which may be allocated and paid to employees as determined by the compensation committee of our board of directors, based on our chief executive officer's recommendations.

Indemnification and Insurance

The merger agreement provides that, for six years after the merger, the surviving corporation's certificate of incorporation will contain certain agreed provisions with respect to indemnification, expense advancement and exculpation of our current and former directors and officers, and the surviving corporation's by-laws will contain the provisions with respect to such matters as set forth in our current by-laws. The merger agreement also requires the surviving corporation to maintain in effect the current directors' and officers' liability insurance or substantially similar insurance. This insurance must cover those persons who were covered on the date of the merger agreement by our directors' and officers' liability insurance policy, for a period of at least six years. However, if the annual premium for the policy exceeds 200% of the annual premium paid by us for the year from July 21, 2001 through July 21, 2002, then the surviving corporation in the merger is required only to get the best coverage available for an annual premium equal to 200% of the annual premium paid by us for the year from July 21, 2001 through July 21, 2002. The merger agreement also requires RWE and Thames Water Holdings to indemnify and hold harmless any of our former or current officers or directors against any losses in connection with any threatened or actual action, suit, or proceeding, based in whole or in part on, or arising in whole or in part out of, the fact that the person is or was our officer or director.

Positions with Surviving Corporation

Upon completion of the merger, J. James Barr, our President and Chief Executive Officer and a member of our board of directors, will become President and Chief Executive Officer of RWE's combined water operations in North and South America and be elected a director of Thames Water Plc. In addition, upon completion of the merger, Marilyn Ware, chairman of our board of directors, will be elected a member of the Thames International Advisory Council.

THE MERGER AGREEMENT

This section of the proxy statement describes the material provisions of the merger agreement but does not purport to describe all of the terms of the merger agreement. The following summary is qualified in its entirety by reference to the complete text of the merger agreement, which is attached as Annex A to this proxy statement and incorporated into this proxy statement by reference. We urge you to read the full text of the merger agreement because it is the legal document that governs the merger.

The Merger

The merger agreement provides for the merger of Apollo with and into American Water Works upon the terms, and subject to the conditions, of the merger agreement. As the surviving corporation, we will survive the merger and continue to exist as a wholly owned indirect subsidiary of RWE. The merger will be effective at the time we file a certificate of merger with the Secretary of State of the State of Delaware (or at a later time, if agreed upon by the parties and specified in the certificate of merger). We expect to complete the merger as promptly as practicable after we receive stockholder approval and required regulatory approvals of the merger.

We or Thames Water Holdings may terminate the merger agreement prior to the completion of the merger in some circumstances, whether before or after the adoption of the merger agreement by stockholders. Additional details on termination of the merger agreement are described in "Termination of the Merger Agreement."

Merger Consideration

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Each share of our common stock issued and outstanding immediately before the merger (other than treasury shares, dissenting shares and shares held by Thames Water Holdings or Apollo) will automatically be canceled and will cease to exist and will be converted into the right to receive \$46.00 in cash, without interest. When this merger consideration is distributed, holders of our common stock will also receive any declared but unpaid dividends, including a "stub period" dividend for the period between the immediately prior dividend record date and the date on which the merger is consummated. After the merger is effective, each holder of a certificate representing any of these shares of our common stock will no longer have any rights with respect to the shares, except for the right to receive the merger consideration or, if a holder exercises appraisal rights, the right to receive payment of the judicially determined fair value of its shares upon compliance with the requirements of Delaware law. Each share of our common stock held by us as treasury shares or held by Thames Water Holdings or Apollo at the time of the merger will be canceled without any payment.

Directors and Officers

Upon completion of the merger, J. James Barr will be elected as a director of Thames Water Plc and Marilyn Ware will be elected as a member of the Thames International Advisory Council. The officers of American Water Works at the time the merger is completed will remain the officers of the surviving corporation after the merger. All American Water Works officers will hold their positions until their successors are duly elected and qualified or until the earlier of their resignation or removal.

Treatment of Stock Options and Other Stock-Based Rights

The merger agreement provides that, upon completion of the merger (1) each option to purchase shares of our common stock outstanding immediately prior to the completion of the merger, whether vested or unvested, will be converted into the right to receive \$46.00 minus the exercise price per share of the stock option multiplied by the number of shares of common stock subject to the stock option (2) all other rights to receive our common stock, whether vested or unvested, will be converted into the

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right to receive an amount of cash equal to the number of shares of common stock subject to the stock right outstanding immediately prior to the completion of the merger multiplied by \$46.00; and (3) our board of directors will make any other changes to the company stock plans as we and Thames Water Holdings agree are appropriate to give effect to the merger. All amounts payable are subject to applicable withholding taxes.

Payment for the Shares

Before the merger, Thames Water Holdings will designate a paying agent reasonably acceptable to us to make payment of the merger consideration as contemplated by the merger agreement. Immediately following the completion of the merger, Thames Water Holdings will, or will cause Apollo to, deposit in trust with the paying agent cash in an aggregate amount equal to the merger consideration for all stockholders plus any declared but unpaid dividends, including a "stub period" dividend for the period between the immediately prior dividend record date and the date on which the merger is completed.

At the close of business on the day of the completion of the merger, we will close our stock ledger. After that time, the surviving corporation will not transfer common stock on its stock transfer books.

As soon as reasonably practicable after the completion of the merger, the paying agent will send you a letter of transmittal and instructions advising you how to surrender your certificates in exchange for the merger consideration. The paying agent will promptly pay you your merger consideration, together with any dividends to which you are entitled, after you have (1) surrendered your certificates to the paying agent and (2) provided to the paying agent any other items specified by the letter of transmittal. Interest will not be paid or accrue in respect of cash payments. The surviving corporation will reduce the amount of any merger consideration paid to you by any applicable withholding taxes. **You should not forward your stock certificates to the paying agent without a letter of transmittal, and you should not return your stock certificates with the enclosed proxy.**

If the paying agent is to pay some or all of your merger consideration to a person other than you, you must have your certificates properly endorsed or otherwise in proper form for transfer, and you must pay any transfer or other taxes payable by reason of the transfer or establish to the surviving corporation's satisfaction that the taxes have been paid or are not required to be paid.

The transmittal instructions will tell you what to do if you have lost your certificate, or if it has been stolen or destroyed. You will have to provide an affidavit to that fact and, if required by the paying agent, RWE or the surviving corporation, post a bond in an amount that the paying agent, RWE or the surviving corporation, as the case may be, reasonably directs as indemnity against any claim that may be made against those parties in respect of the certificate.

Redemption of our Preferred and Preference Stock

The merger agreement provides that, on or prior to the completion of the merger, we will redeem each issued and outstanding share of our cumulative preferred stock, 5% series and 5% cumulative preference stock in accordance with the terms and conditions provided in our certificate of incorporation.

Representations and Warranties

In the merger agreement, American Water Works, RWE, Thames Water Holdings and Apollo each made representations and warranties relating to, among other things:

corporate organization and existence;

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corporate power and authority to enter into and perform its obligations under, and enforceability of, the merger agreement;

required consents and approvals of governmental entities;

the absence of conflicts with or defaults under organizational documents, debt instruments, other contracts and applicable laws and judgments;

regulation as a public utility holding company or public utility;

broker's fees; and

information supplied for inclusion in this proxy statement.

In the merger agreement, RWE, Thames Water Holdings and Apollo also made representations and warranties relating to the availability of the funds necessary to complete its obligations under the merger agreement, the interim operations of Apollo and their ownership of our common stock.

We also made representations and warranties relating to, among other things:

subsidiaries;

capital structure;

documents filed with the Securities and Exchange Commission;

absence of specified changes or events since December 31, 2000;

legal proceedings and regulatory actions;

compliance with applicable laws;

environmental matters;

compliance with the Employee Retirement Income Securities Act and other employee benefit matters;

tax matters;

inapplicability of state takeover statutes;

stockholder voting requirements;

title to properties;

receipt of Goldman Sachs' fairness opinion to our board of directors; and

material contracts.

Covenants; Conduct of Business Pending the Merger

With limited exceptions we agreed in the merger agreement that, until the completion of the merger, we and each of our subsidiaries will:

carry on our respective businesses in the ordinary course consistent with past practice;

use commercially reasonable efforts to preserve our material assets and technology, preserve our business and regulatory relationships and maintain our material franchises, rights and permits necessary to conduct our business; and

use commercially reasonable efforts to comply with all applicable laws.

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We have also agreed that, until completion of the merger, except as expressly contemplated or permitted by the merger agreement or consented to in writing by Thames Water Holdings, which consent will not be unreasonably withheld, we will not, and will not permit any of our subsidiaries to:

declare, set aside or pay dividends, or make other distributions, except (i) dividends by any of our wholly owned subsidiaries, (ii) regular quarterly cash dividends with respect to our common stock, not to exceed an annual rate of \$0.94 per share in 2001, \$0.98 per share in 2002 and \$1.02 per share in 2003, in accordance with our past dividend policy, (iii) a pro rata "stub period" dividend based on the number of days elapsed between the most recent dividend record date and the effective date of the merger, (iv) regular cash dividends with respect to the cumulative preferred stock, 5% series and 5% cumulative preference stock in accordance with our past dividend policy or (v) cash dividends with respect to the preferred stock of any of our subsidiaries or cash dividends with respect to the non-preferred capital stock of any non-wholly owned subsidiaries in the ordinary course of business consistent with such subsidiary's past practice;

purchase, redeem or otherwise acquire any shares of our respective capital stock or any other equity interests, except for (i) the redemption of the outstanding cumulative preferred stock, 5% series and 5% cumulative preference stock, (ii) purchases, redemptions or other acquisitions required or permitted by the terms of any of our preferred stock or that of our subsidiaries, (iii) the purpose of funding or providing benefits under employee benefit plans, stock option and other

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incentive compensation plans, directors' plans and the dividend reinvestment provisions of our dividend reinvestment and stock purchase plan, (iv) purchases, redemptions or other acquisitions in the ordinary course of business consistent with past practice of any voting stock of any of our subsidiaries or (v) purchases of shares of capital stock of any of our wholly owned subsidiaries;

split, combine or reclassify any capital stock or other equity interests or issue any other securities in respect of, in lieu of or in substitution for such shares or interests;

issue, deliver, sell, pledge or otherwise encumber any shares of our capital stock or other equity interests or grant any options, warrants, calls or rights to acquire any such shares or interests, other than (i) upon the exercise of stock options or other rights to purchase common stock in effect as of the date of the merger agreement, (ii) the delivery or sale of shares held as treasury stock as of the date of the merger agreement, or thereafter purchased on the open market to fund benefits under employee benefit plans, (iii) issuances by any of our subsidiaries of shares of capital stock to us or any of our wholly owned subsidiaries, (iv) issuances of our common stock pursuant to our rights agreement, (v) issuances of our common stock pursuant to our dividend reinvestment and stock purchase plan or (vi) issuances of our common stock which are necessary in our reasonable judgment, after consultation with Thames Water Holdings, in order to maintain our credit ratings and that of our subsidiaries;

amend our respective certificates of incorporation or by-laws, except as required by applicable law or by the rules of the New York Stock Exchange;

acquire or agree to acquire any corporation, any assets constituting a business, any other business entity or other assets that are material, other than (i) any business which is regulated by a state regulatory body or owned or operated by a municipality or local governmental entity, provided that all such acquisitions shall not involve aggregate payments (including debt assumption) of more than \$300,000,000, (ii) any business in or related to the water services or wastewater services industry or 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 state regulatory body or owned or operated by a municipality

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or local governmental entity, provided that all such acquisitions shall not involve aggregate payments (including debt assumption) of more than \$100,000,000, or (iii) assets constituting a business the acquisition of which does not require consent or approval under the merger agreement;

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 material interests in properties or assets, other than (i) sales in which the fair market value of all such properties and assets does not exceed \$100,000,000, (ii) sales to a governmental entity required by threat of condemnation or similar proceedings, conducted in a manner consistent with past practice, (iii) sales of securities at arm's-length which are held as passive minority investments or (iv) grants of easements, rights of way and liens in the ordinary course of business or in connection with our secured indebtedness or that of any of our subsidiaries, in each case consistent with past practice;

incur or guarantee any indebtedness or issue or sell any debt securities or options, warrants, calls or other rights to acquire any of our debt securities or the debt securities of any of our 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 above, except for (i) short-term indebtedness in the ordinary course of business consistent with past practice, (ii) 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 the merger agreement (with certain exclusions), 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 our business plan for the five-year period ending on December 31, 2005, (iii) arrangements to finance acquisitions permitted by the merger agreement or to fund capital expenditures permitted by the merger agreement, (iv) any guarantees, bid bonds, performance bonds,

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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 us and our subsidiaries or in support of our indebtedness or other obligations, of our subsidiaries or among our subsidiaries; or (v) indebtedness in an amount equal to (1) the cost of our common stock purchased to fund or provide benefits under employee benefit plans, plus (2) the amount of cash proceeds that we would otherwise expect to receive from the sale of common stock under the dividend reinvestment and stock purchase plan for so long as such plan is indefinitely suspended pursuant to the merger agreement;

make any material loans, advances or capital contributions to, or investments in, any other person, other than any of our subsidiaries, other than (i) investments made in joint ventures permitted by the merger agreement, (ii) loans, advances, capital contributions and investments made in connection with actions permitted by the merger agreement or (iii) in the ordinary course of business;

incur or commit to incur any capital expenditures in excess of 120% of the amount budgeted in our five-year capital plan, other than (i) capital expenditures required by changes in or newly promulgated applicable laws or judgments or applicable standards or policies of any governmental entity, (ii) capital expenditures funded by customer advances or contributions in aid of construction, (iii) capital expenditures incremental to our 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, (iv) capital expenditures related to the operation of any business acquired through an acquisition permitted by the merger agreement, (v) capital expenditures to the extent covered by insurance or as reasonably required

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in our judgment following a catastrophic event or (vi) capital expenditures in connection with performance by us or one of our subsidiaries under any contract to the extent our or our subsidiary's obligations in connection with any such capital expenditure are non-recourse to us or our subsidiary and funded by the United States government;

except as required by applicable law or any judgment (i) 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 September 16, 2001, or on the date of acquisition of the person subject thereto or (C) incurred since September 16, 2001, in the ordinary course of business consistent with past practice, (ii) waive, release, grant or transfer any right of material value, other than in the ordinary course of business consistent with past practice or (iii) 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 consent is required under, any material confidentiality, standstill or similar agreement to which we or any of our subsidiaries is a party;

take any action to fund or in any other way secure the payment of compensation or benefits under any benefit plan or other contract, accelerate the vesting or payment of any compensation or benefit under any benefit plan or other contract, grant any compensation, benefits, severance or termination pay or increases under any benefit plan or establish, adopt, enter into, amend or terminate any benefit plan, except as required to implement grants or increases permitted by the merger agreement, except (i) as required to comply with applicable law or any judgment, any collective bargaining agreement or any provision of our benefit plans or other contract, (ii) in the ordinary course of conducting our or any of our subsidiaries' respective businesses consistent with past practice, (iii) as would, in our discretion, be commercially reasonable in order to retain our employees and employees of our subsidiaries 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 us and/or our subsidiaries or (v) as would not, individually or in the aggregate, materially increase our and our subsidiaries' annual expense for compensation and benefits provided or to be provided to our respective employees;

enter into any material contract other than (i) any contract related to our business regulated by public utility commissions as entered into in the ordinary course of business consistent with past practice, (ii) any contract related to the water services or wastewater services industry; provided that the average aggregate annual revenues to be received by us and our subsidiaries over the first three years of such contract, together with the total average aggregate annual revenues to be received by us and our subsidiaries over the first three years of all such other contracts entered into during the twelve-month period beginning the date of the merger agreement or during any subsequent twelve-month period shall not exceed \$60 million per year;

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provided, further that (A) the average annual amounts of any payments to be made to us during the first three years of such contract in respect of any capital expenditures permitted by the merger 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 which we reasonably determine 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 (iii) any contract providing for any transaction otherwise permitted by the merger agreement;

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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 us in carrying on our business in the ordinary course;

modify, amend, waive or terminate any material contract other than in the ordinary course of business or the contracts filed with the SEC, in either case without consulting with Thames Water Holdings in good faith in advance; or

authorize, or commit, resolve or agree to take any action described above.

In addition to the foregoing, if we request the consent of Thames Water Holdings to enter into a contract or to make an acquisition not otherwise permitted by the merger agreement, Thames Water Holdings will promptly inform us whether RWE or any of its subsidiaries is participating or intends to participate in the bidding for such acquisition or contract and, if they inform us that RWE or any of its subsidiaries is participating or intends to participate in the bidding for the acquisition or contract or if they do in fact participate, then we will not be subject to the restrictions of the merger agreement with respect to that acquisition or contract. For the purposes of this procedure, unless Thames Water Holdings has given us written notice to the contrary, we may presume that RWE or one of its subsidiaries is participating in any competitive bidding process for an acquisition or contract which has been marketed broadly to major participants in the water services or wastewater services industries and we will not be required to request the consent of Thames Water Holdings or otherwise be restricted by the merger agreement with respect to that acquisition or contract.

We have agreed to consult with Thames Water Holdings and provide reasonable documentation prior to taking certain of the actions permitted by the merger agreement during the period prior to completion of the merger.

Efforts to Complete the Merger

Subject to the terms and conditions set forth in the merger agreement, each of the parties to the merger agreement has agreed to use its reasonable best efforts to take, or cause to be taken, as promptly as reasonably practicable, all actions that are necessary, proper and advisable to achieve the completion of the merger, including (i) the taking of all acts necessary to satisfy the conditions necessary for the completion of the merger, (ii) 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 that approval or waiver from, or, to the extent any approval or waiver cannot be obtained, to avoid the need to obtain the approval or waiver from, or to avoid an action or proceeding by, any governmental entity and (iii) the obtaining of all necessary consents, approvals or waivers from third parties. To that effect, RWE and Thames Water Holdings, on the one hand, and we, on the other hand, have agreed to cooperate to develop a mutually acceptable plan to obtain the required regulatory approvals as expeditiously as reasonably practicable and to provide each other with assistance, information and cooperation as reasonably requested in that regard.

We, RWE and Thames Water Holdings have each agreed not to take any action that would reasonably be expected to materially impede or delay obtaining the required regulatory approvals or otherwise materially impede or delay the completion of the merger.

In addition, subject to certain exceptions, RWE and Thames Water Holdings have agreed that, prior to the completion of the merger and except as we may consent to (which consent will not be unreasonably withheld or delayed), they will not and will cause their subsidiaries not to (i) acquire any U.S. water services or wastewater services business that is regulated by a public utility commission or similar regulatory body (other than any acquisition which does not involve aggregate payments (including debt assumption) by RWE, Thames Water Holdings or their subsidiaries in excess of

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\$20 million), (ii) acquire any business that would cause RWE, Thames Water Holdings or any of their subsidiaries to be required to register as a holding company under the Public Utility Holding Company Act of 1935, which we refer to in this proxy statement as the Holding Company Act, (iii) acquire any business that would subject RWE, Thames Water Holdings, Apollo or any of their 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, (iv) acquire any business that would, upon the consummation of that acquisition, subject RWE, Thames Water Holdings or any of their subsidiaries to regulation under the Holding Company Act in a manner other than that described in clauses (ii) and (iii) above or (v) acquire any business that is a U.S. gas or electric utility, if in the case of clause (iv) or this clause (v), that business is subject to regulation as a gas or electric utility by any public utility commission in any material state. RWE and Thames Water Holdings have also agreed not to acquire shares of our common stock before the approval by our stockholders of the merger agreement and not to acquire more than 4.9% of our common stock at any time prior to the completion of the merger.

Conditions to the Merger

Conditions to Each Party's Obligations

Each party's obligation to complete the merger is subject to the satisfaction or waiver of the following conditions:

we must obtain the adoption of the merger agreement by the affirmative vote of the holders of a majority of the votes represented by all the outstanding shares of our common stock and our cumulative preferred stock, 5% series, voting together as a single class, with each share of our common stock entitled to one vote and each share of cumulative preferred stock, 5% series entitled to 1/10th of a vote;

the waiting period applicable to the completion of the merger under the Hart-Scott-Rodino Antitrust Improvements Act shall have expired or been terminated;

any other required approval or waiting period under any other similar competition, merger control, antitrust or similar law or regulation the failure of which to obtain or comply with would reasonably be expected to have a material adverse effect on us, shall have been obtained or shall have terminated or expired;

there must not be in effect any temporary restraining order, preliminary or permanent injunction or other order or decree issued by a court of competent jurisdiction or other legal restraint or prohibition that has the effect of preventing the completion of the merger;

all required regulatory approvals under the laws and judgments of any state public utility commission, state public service commission or similar state regulatory body must have been obtained and must not have been reversed, enjoined or suspended and any waiting periods or conditions thereto must be expired or satisfied;

all material required regulatory approvals under the laws and judgments of any public health departments, environmental protection agencies or of any federal or state regulatory body having jurisdiction over similar matters shall have been obtained and must not have been reversed, enjoined or suspended and any waiting periods or conditions thereto must be expired or satisfied; and

the redemption of our outstanding cumulative preferred stock, 5% series and 5% cumulative preference stock must be completed.

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The obligation of RWE, Thames Water Holdings and Apollo to complete the merger is subject to the satisfaction or waiver of the following additional conditions:

our representations and warranties must be true and correct as of the date of the merger agreement and as of the closing date, except representations and warranties that speak as of an earlier date, which must be true and correct as of that earlier date, other than any failure to be true and correct that would not reasonably be expected to have a material adverse effect on us;

we must have performed in all material respects all obligations that we are required to perform under the merger agreement prior to the closing date;

no material adverse effect on us shall have occurred and there must be no state of facts, change, development, effect, condition or occurrence that would reasonably be expected to have a material adverse effect on us; and

the required regulatory approvals for the merger and other regulatory approvals obtained between the date of the merger agreement and the closing date in connection with acquisitions by us must not impose any terms or conditions that would reasonably be expected to have a material adverse effect either on us or on Thames Water Holdings' U.S. subsidiaries and us, taken as a whole.

Conditions to American Water Works' Obligations

Our obligation to complete the merger is subject to the satisfaction or waiver of the following additional conditions:

RWE's, Thames Water Holdings' and Apollo's representations and warranties must be true and correct as of the date of the merger agreement and as of the closing date, except representations and warranties that speak as of an earlier date, which must be true and correct as of that earlier date, other than any failure to be true and correct that would not reasonably be expected to impair in any material respect the ability of RWE, Thames Water Holdings or Apollo to perform its obligations under the merger agreement or prevent or materially delay the completion of the merger; and

RWE, Thames Water Holdings and Apollo must have performed in all material respects all obligations that each of them are required to perform under the merger agreement prior to the closing date.

No Solicitation of Other Offers

The merger agreement provides that neither we nor our representatives will:

solicit, initiate or encourage, or take any action knowingly to facilitate the submission of, any takeover proposal, as described below; or

except as provided below, provide any nonpublic information relating to us to any person relating to a takeover proposal, or engage in any discussions or negotiations concerning a takeover proposal.

We may, however, at any time prior to the adoption of the merger agreement by our stockholders, in response to a takeover proposal that our board of directors determines in good faith could reasonably be expected to lead to a superior proposal, as described below:

provide information regarding us to the person making that takeover proposal pursuant to a customary confidentiality agreement that does not contain any prohibition on making an unsolicited takeover proposal (so long as such information is concurrently provided to Thames Water Holdings); and

participate in discussions or negotiations with the person making that takeover proposal regarding that takeover proposal.

In addition, we have agreed that neither our board of directors nor any of its committees will:

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withdraw, or modify in a manner adverse to Thames Water Holdings or Apollo, recommendation with respect to, the merger agreement or publicly propose to do so, or recommend, or propose publicly to recommend, the approval of any takeover proposal, unless our board of directors determines in good faith, after consulting with legal counsel, that such action is necessary for our board of directors to comply with its fiduciary duties to our stockholders under applicable law and our certificate of incorporation;

adopt or approve, or publicly propose to adopt or approve, any takeover proposal, or withdraw its approval of the merger;

cause or permit us 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 constituting or related to a takeover proposal; or

agree or resolve to take any of the foregoing actions.

Our board of directors may, however, at any time prior to the special meeting, terminate the merger agreement in response to a superior proposal and concurrently or promptly thereafter enter into an agreement with respect to that superior proposal if:

it delivers written notice to Thames Water Holdings five days prior to terminating the merger agreement, advising Thames Water Holdings that it has received a superior proposal, specifying the terms and conditions of, and the identity of the person making, the superior proposal, and that it intends to accept the superior proposal and exercise its right to terminate the merger agreement; and

prior to or concurrently with the termination, we pay to Thames Water Holdings the \$138 million termination fee.

We have agreed to cease any discussion or negotiations with any third parties conducted on or before the date of the merger agreement with a view toward a takeover proposal, and to notify Thames Water Holdings of any takeover proposal and keep Thames Water Holdings informed of the status of such takeover proposal.

Nothing described above limits our ability to take actions to comply with certain rules under the Securities Exchange Act of 1934, or make any disclosure to our stockholders if, in the good faith judgment of our board of directors, after consultation with outside counsel, such failure to disclose would be inconsistent with applicable law.

For purposes of the merger agreement, the term "takeover proposal" means any inquiry, proposal or offer from any person relating to, or that is reasonably likely to lead to:

a merger, consolidation or any similar transaction involving us or any of our significant subsidiaries;

a purchase, other acquisition or assumption of assets or businesses that constitute or represent 20% or more of the total revenue, operating income, EBITDA or assets of us and our subsidiaries, taken as a whole;

a purchase or other acquisition of our voting securities that, if completed, would result in any person beneficially owning securities representing 20% or more of our total equity or voting interests, or that of our subsidiaries, if such subsidiaries held the assets or businesses referred to in the previous bullet point; or

any substantially similar transaction.

The merger agreement defines the term "superior proposal" to mean:

any bona fide written offer by a third party that if consummated would result in the third party acquiring, directly or indirectly, 50% or more of the voting power of our common stock or 50% of our and our subsidiaries' combined assets or a direct merger between such third party and us; and

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the consideration offered for which consists of cash and/or securities which our board of directors determines in its good faith judgment (after consultation with a recognized financial advisor) to be more favorable from a financial point of view to our stockholders, taking into account any counterproposals that Thames Water Holdings may make in response to a superior proposal or otherwise.

Termination of the Merger Agreement

The merger agreement may be terminated at any time prior to the completion of the merger, whether before or after stockholder approval has been obtained:

1. by mutual written consent of American Water Works, Thames Water Holdings and Apollo;
2. by either American Water Works or Thames Water Holdings, if:
 - the merger is not completed on or before March 16, 2003, except that
 - (i) this right to terminate will not be available to any party whose failure to comply with the merger agreement has been the primary reason the merger has not been completed by that date;
 - (ii) if all conditions are satisfied or are capable of being satisfied other than obtaining the required regulatory approvals, the termination date will be extended to September 16, 2003, and the date will be further extended up to an additional 60 days for any waiting period in respect of a regulatory approval that has not yet expired if all other conditions are satisfied or are capable of being satisfied; and
 - (iii) the date will be extended to September 16, 2003, if all other conditions are satisfied other than the consummation of the stock redemption and American Water Works has mailed the notice of redemption;
- any order, injunction or other legal restraint or prohibition that prevents the completion of the merger is in effect and has become final and nonappealable; or
- our stockholders do not approve the merger agreement at the special meeting;
3. by Thames Water Holdings if:
 - our board of directors withdraws or modifies in a manner adverse to RWE its recommendation of the merger agreement or recommends to our stockholders any takeover proposal by a third party; or
 - we have breached any of our representations or warranties, other than any failures of our representations and warranties to be true and correct that individually or in the aggregate would not reasonably be expected to have a material adverse effect, or materially breached any covenants in the merger agreement and the breach is not cured within 20 business days after written notice of the breach is delivered; or
4. by us if:
 - Thames Water Holdings has breached any of its representations or warranties, other than any failures of its representations and warranties to be true and correct that individually or in the aggregate would not reasonably be expected to have a material adverse effect, or

materially breached any covenants in the merger agreement and the breach is not cured within 20 business days after written notice of the breach is delivered; or

prior to obtaining stockholder approval, our board of directors authorizes us to enter into an agreement with respect to a takeover proposal from a third party concurrently with such termination, provided that we have complied with the provisions of the merger agreement described above under " No Solicitation of Other Offers,"

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including the payment to Thames Water Holdings of the \$138 million termination fee described below.

Termination Fees

We must pay to Thames Water Holdings a termination fee of \$138 million if the merger agreement is terminated under any of the following circumstances:

either party terminates pursuant to the first or third bullet points under paragraph (2) above under " Termination of the Merger Agreement", a takeover proposal shall have been made to us or any person has publicly announced an intention to make a takeover proposal prior to such termination and, within 12 months after such termination, we enter into a definitive agreement to consummate or do consummate a takeover proposal which results in a change in control;

we terminate pursuant to the second bullet point under paragraph (4) above under " Terminati