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American Water Works Company, Inc.
Form 10-K
February 27, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

S ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934

For the transition period from to

Commission file: number 001-34028

AMERICAN WATER WORKS COMPANY, INC.

(Exact name of registrant as specified in its charter)

Delaware	51-0063696
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

1025 Laurel Oak Road, Voorhees, NJ	08043
(Address of principal executive offices)	(Zip Code)

(856) 346-8200

(Registrant's telephone number, including area code)

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Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common stock, par value \$0.01 per share	New York Stock Exchange, Inc.

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12(b)-2 of the Exchange Act.:

Large accelerated filer Accelerated filer

Non-accelerated filer Small reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter.

Common Stock, \$0.01 par value—\$7,336,584,365 as of June 30, 2013.

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date.

Common Stock, \$0.01 par value per share—178,722,663 shares, as of February 20, 2014.

DOCUMENTS INCORPORATED BY REFERENCE

(1) Portions of the Company's Proxy Statement for the Company's 2014 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

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FORWARD-LOOKING STATEMENTS

We have made statements under the captions “Business,” “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and in other sections of this Annual Report on Form 10-K (“Form 10-K”), or incorporated certain statements by reference into this Form 10-K, that are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and the Private Securities Litigation Reform Act of 1995. In some cases, these forward-looking statements can be identified by words with prospective meanings such as “intend,” “plan,” “estimate,” “believe,” “anticipate,” “expect,” “predict,” “project,” “forecast,” “outlook,” “future,” “potential,” “continue,” “should” and “could” and similar expressions. Forward-looking statements may relate to, among other things, our future financial performance, including our operations and maintenance (“O&M”) efficiency ratio, our growth and portfolio optimization strategies, our projected capital expenditures and related funding requirements, our ability to repay debt, our ability to finance current operations and growth initiatives, the impact of legal proceedings and potential fines and penalties, business process and technology improvement initiatives, trends in our industry, regulatory or legal developments or rate adjustments, including rate case filings, filings for infrastructure surcharges and filings to address regulatory lag.

Forward-looking statements are predictions based on our current expectations and assumptions regarding future events. They are not guarantees of any outcomes, financial results or levels of performance and you are cautioned not to place undue reliance upon them. These forward-looking statements are subject to a number of risks and uncertainties, and new risks and uncertainties of which we are not currently aware or which we do not currently perceive may arise in the future from time to time. Should any of these risks or uncertainties materialize, or should any of our expectations or assumptions prove incorrect, then our results may vary materially from those discussed in the forward-looking statements herein. Factors that could cause actual results to differ from those discussed in forward-looking statements include, but are not limited to, the factors discussed under the caption “Risk Factors” and the following factors:

- the decisions of governmental and regulatory bodies, including decisions to raise or lower rates;
- the timeliness of regulatory commissions’ actions concerning rates;
- changes in customer demand for, and patterns of use of, water, such as may result from conservation efforts;
- changes in laws, governmental regulations and policies, including environmental, health and water quality and public utility regulations and policies;
- weather conditions, patterns or events, including drought or abnormally high rainfall, strong winds and coastal and intercoastal flooding;
- the outcome of litigation and government action related to recent events in West Virginia;
- our ability to appropriately maintain current infrastructure and manage expansion of our business;
- our ability to obtain permits and other approvals for projects;
- changes in our capital requirements;
- our ability to control operating expenses and to achieve efficiencies in our operations;
- our ability to obtain adequate and cost-effective supplies of chemicals, electricity, fuel, water and other raw materials that are needed for our operations;
- our ability to successfully acquire and integrate water and wastewater systems that are complementary to our operations and the growth of our business, including, among other core growth opportunities, concession arrangements and agreements for the provision of water services in the unregulated shale arena; cost overruns relating to improvements or the expansion of our operations;
- changes in general economic, business and financial market conditions;
- access to sufficient capital on satisfactory terms;
- fluctuations in interest rates;
- restrictive covenants in or changes to the credit ratings on our current or future debt that could increase our financing costs or affect our ability to borrow, make payments on debt or pay dividends;
- fluctuations in the value of benefit plan assets and liabilities that could increase our cost and funding requirements;
- our ability to utilize our U.S. and state net operating loss carryforwards;

· migration of customers into or out of our service territories;

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- difficulty in obtaining insurance at acceptable rates and on acceptable terms and conditions;
- the incurrence of impairment charges;
- labor actions, including work stoppages;
- our ability to affect significant changes to our business processes and corresponding technology;
- ability to retain and attract qualified employees; and
- civil disturbance, or terrorist threats or acts or public apprehension about future disturbances or terrorist threats or acts.

Any forward-looking statements we make, speak only as of the date of this Form 10-K. Except as required by law, we do not have any obligation, and we specifically disclaim any undertaking or intention, to publicly update or revise any forward-looking statements, whether as a result of new information, future events, changed circumstances or otherwise.

PART I

ITEM 1. BUSINESS

Our Company

American Water Works Company, Inc., (the “Company”), a Delaware corporation, is the most geographically diversified, as well as the largest publicly-traded, United States water and wastewater utility company, as measured by both operating revenue and population served. As a holding company, we conduct substantially all of our business operations through our subsidiaries. Our approximately 6,600 employees provide an estimated 14 million people with drinking water, wastewater and other water-related services in over 40 states and two Canadian provinces.

In 2013, our on-going operations generated \$2,901.9 million in total operating revenue and \$369.3 million in income from continuing operations. Included in the 2013 income from continuing operations was an after-tax charge of \$24.8 million related to a loss on extinguishment of debt to effect a tender offer that we announced in September 2013. In 2012, our on-going operations generated \$2,876.9 million in total operating revenue and \$374.3 million in income from continuing operations.

We have two operating segments that are also the Company’s two reportable segments: the Regulated Businesses and the Market-Based Operations. For further details on our segments, see Note 19 of the Consolidated Financial Statements.

For 2013, our Regulated Businesses segment generated \$2,593.9 million in operating revenue, which accounted for 89.4% of our total consolidated operating revenue. For the same period, our Market-Based Operations segment generated \$325.5 million in operating revenue, which accounted for 11.2% of total consolidated operating revenue.

During 2011, we either consummated or announced the sale of assets or stock of certain of our regulated and market-based subsidiaries as outlined in “Our Regulated Businesses” and “Our Market-Based Operations” discussions below. As such, these subsidiaries have been presented as discontinued operations for all periods presented, and are not included in the discussions below unless otherwise noted. See Note 3 to Consolidated Financial Statements for further details on our discontinued operations.

For additional financial information, please see the financial statements and related notes thereto appearing elsewhere in this Form 10-K.

Regulated Businesses Overview

Our primary business involves the ownership of subsidiaries that provide water and wastewater utility services to residential, commercial, industrial and other customers, including sale for resale and public authority customers. We report the results of this business in our Regulated Businesses segment. Our subsidiaries that provide these services are generally subject to economic regulation by certain state commissions or other entities engaged in economic regulation, hereafter referred to as “PUCs,” in the states in which they operate. The federal government and the states also regulate environmental, health and safety, and water quality matters.

As noted above, for 2013, operating revenue for our Regulated Businesses segment was \$2,593.9 million, accounting for 89.4% of total consolidated operating revenue for the same period. Regulated Businesses segment operating revenues were \$2,564.4 million for 2012 and \$2,368.9 million for 2011, accounting for 89.1% and 88.8%, respectively, of total operating revenues for the same periods.

The following charts set forth operating revenue for 2013 and customers as of December 31, 2013, for the states in which our Regulated Businesses provide services:

Market-Based Operations Overview

We also provide services that are not subject to economic regulation by state PUCs through our Market-Based Operations. Our Market-Based Operations include three lines of business:

- Contract Operations Group, which enters into contracts to operate and maintain water and wastewater facilities mainly for the United States military, municipalities, and the food and beverage industry;
- Homeowner Services Group, which provides services to domestic homeowners and smaller commercial establishments to protect against the cost of repairing broken or leaking water pipes and clogged or blocked sewer pipes inside and outside their accommodations; and
- Terratec Environmental Ltd., which we refer to as Terratec, which primarily provides biosolids management, transport and disposal services to municipal and industrial customers.

For 2013, operating revenue for our Market-Based Operations was \$325.5 million, accounting for 11.2% of total operating revenue for the same period. The Market-Based Operations' operating revenue was \$330.3 million for 2012 and \$327.8 million for 2011, accounting for 11.5% and 12.3%, respectively, of total operating revenues for the same periods.

Our Industry

Overview

The United States water and wastewater industry has two main sectors (i) utility ownership, which involves supplying water and wastewater services to consumers; and (ii) general services, which involves providing water and wastewater related services to water and wastewater utilities and other customers on a contract basis.

The utility sector includes investor-owned as well as municipal systems that are owned and operated by local governments or governmental subdivisions. The Environmental Protection Agency ("EPA") estimates that government-owned systems account for approximately 84% of all United States community water systems and approximately 98% of all United States community wastewater systems. Investor-owned water and wastewater systems, including a small number of private companies and developers, account for the remainder of the United States water and wastewater community water systems. Growth of service providers in the investor-owned regulated utility sector is achieved through organic growth within a franchise area, the provision of bulk water service to other community water systems and/or acquisitions, including small water and wastewater systems, typically serving fewer than 10,000 customers that are in close geographic proximity to already established regulated operations, which we herein refer to as "tuck-ins."

The utility sector is characterized by high barriers to entry, given the capital intensive nature of the industry. The aging water and wastewater infrastructure in the United States is in constant need of modernization and replacement. Increased regulations to improve water quality and the management of water and wastewater residuals' discharges, which began with passage of the Clean Water Act in 1972 and the Safe Drinking Water Act in 1974, have been among the primary drivers of the need for modernization. The EPA estimated that the nation's drinking water utilities need \$384.2 billion in infrastructure investments for thousands of miles of pipe as well as thousands of treatment plants storage tanks, and other key assets between 2011 and 2030 to ensure the public health, security and economic well-being of our cities, towns and communities. Also, in 2007 the EPA estimated that approximately \$390 billion of capital spending would be necessary over the next 20 years to replace aging infrastructure and ensure quality wastewater systems across the United States. In addition, the 2011 American Society of Civil Engineers' ("ASCE") report, Failure to Act: The Economic Impact of Current Investment Trends in Water and Wastewater Treatment Infrastructure estimated that as investment needs continue to escalate and current funding trends continue to fall short of the needs, it will likely result in unreliable water service and wastewater treatment. According to the report, this can result in water disruptions, impediments to emergency response, and damage to other types of infrastructure such as roads and bridges, as well as water shortages (from failing infrastructure and drought) that may result in unsanitary conditions and increase the likelihood of public health issues. In its most recent 2013 ASCE Report Card for America's Infrastructure it gave the water and wastewater infrastructure a grade of "D" due to the fact that much of the infrastructure is nearing the end of its useful life. The report concluded that there will be an investment gap between now and 2020 of \$84 billion for drinking water and wastewater infrastructure.

Note: Numbers may not total due to roundingSource: U.S. Environmental Protection Agency's 2011 Drinking Water Infrastructure Needs Survey and AssessmentNote: Numbers may not total due to roundingSource: U.S. Environmental Protection Agency's 2011 Drinking Water Infrastructure Needs Survey and AssessmentThe following chart sets forth estimated capital expenditure needs from 2011 through 2030 for United States water systems:

For 2014 to 2018, we estimate that Company-funded capital investment will amount to approximately \$5.8 billion. Of the \$5.8 billion, \$5.1 billion is anticipated to be utilized to upgrade our infrastructure and systems. In addition to these capital expenditures, we are also estimating additional capital investment over the five-year period for acquisitions and for strategic capital of approximately \$400 million and \$300 million, respectively. Strategic investments could include opportunities in the unregulated shale arena or a major concession. Our total capital plan for 2014 is estimated to be \$1.1 billion with approximately \$900 million allocated to upgrading our infrastructure and systems, including infrastructure renewal programs and construction of facilities to meet environmental requirements and new customer growth. In addition to the \$900 million in infrastructure upgrades, the capital investment plan for 2014 also includes \$100 million for acquisitions and \$100 million for strategic investment purposes. The charts below set forth our estimated percentage of projected capital expenditures over the period of 2014 to 2018 for upgrading our infrastructure and systems by asset type and purpose of investment, respectively:

Investor-owned water and wastewater utilities generally require regulatory approval processes in order to do business, which may involve obtaining relevant operating approvals, including certificates of public convenience and necessity (or similar authorizations) from state PUCs. Investor-owned water and wastewater systems are generally subject to economic regulation by the state PUCs in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters for both investor-owned and government-owned water and wastewater utilities.

The general services sector includes engineering and consulting companies and numerous other fee-for-service businesses. These include building and operating water and wastewater utility systems, system repair services, lab services, sale of water infrastructure and distribution products (such as pipes) and other specialized services. The general services segment is characterized by aggressive competition and market-driven growth and profit margins.

According to the EPA, the utility segment of the United States water and wastewater industry is highly fragmented, with approximately 54,000 community water systems and approximately 15,000 community wastewater facilities. Over half of the community water systems are very small, serving a population of 500 or less.

This large number of relatively small, fragmented water systems as well as fragmented wastewater facilities may result in inefficiencies in the marketplace, since such utilities may not have the operating expertise, financial and technological capability or economies of scale to provide services or raise capital as efficiently as larger utilities. Larger utilities that have greater access to capital are generally more capable of making mandated and other necessary infrastructure upgrades to both water and wastewater systems. In addition, water and wastewater utilities with large customer bases, spread across broad geographic regions, may more easily absorb the impact of significant variations in precipitation and temperatures, such as droughts, excessive rain and cool temperatures in specific areas. Larger utilities generally are able to spread support services over a larger customer base, thereby reducing the costs to serve each customer. Since many administrative and support activities can be efficiently centralized to gain economies of scale, companies that participate in industry consolidation have the potential to improve operating efficiencies, lower costs per unit and improve service at the same time.

Water and Wastewater Rates

Investor-owned water and wastewater utilities generate operating revenue from customers based on rates that are generally established by state PUCs through a rate-setting process that may include public hearings, evidentiary hearings and the submission by the utility of evidence and testimony in support of the requested level of rates. In evaluating a rate case, state PUCs typically focus on six areas: (i) the amount and prudence of investment in facilities considered “used and useful” in providing public service; (ii) the operating and maintenance costs and taxes associated with providing the service (typically by making reference to a representative 12-month period of time, known as a test year); (iii) the appropriate rate of return; (iv) revenue produced by existing rates; (v) the tariff or rate design that allocates operating revenue requirements across the customer base; and (vi) the quality of service the utility provides, including issues raised by customers.

Water and wastewater rates in the United States are among the lowest for developed countries; and for most U.S. consumers, water and wastewater bills make up a relatively small percentage of household expenditures compared to other utility services. The following chart sets forth the relative cost of water and other public services, including trash and garbage collection and sewer maintenance, in the United States as a percentage of total household utility expenditures:

*Source: Bureau of Labor Statistics-Consumer Expenditures Survey, 2012 (assumes four person household)

Our Regulated Businesses

Our Regulated Businesses consist of locally managed utility subsidiaries that generally are subject to economic regulation by the states in which they operate. Our Regulated Businesses provide a high degree of financial stability because (i) high barriers to entry provide certain protections from competitive pressures; (ii) economic regulation promotes predictability in financial planning and long-term performance through the rate-setting process; and (iii) our large customer base.

During 2012, we continued to execute our plan for optimizing our Regulated Businesses' portfolio. In January 2012, we completed the sale of all of our stock in our water and wastewater operating companies located in Arizona and New Mexico. On May 1, 2012, we completed the sale of our eight regulated water systems and one wastewater system in Ohio. Ohio American Water served approximately 58,000 customers. Also, on May 1, 2012, we completed the purchase of seven regulated water systems in New York. This acquisition added approximately 50,000 customers to our New York regulated operations.

In May 2011, we completed the acquisition of 11 regulated water systems and 48 wastewater systems in Missouri and in June 2011, we completed the sale of the assets of our Texas regulated subsidiary. The Missouri acquisition added approximately 1,700 water customers and nearly 2,000 wastewater customers. The Texas assets served approximately 4,200 water and 1,100 wastewater customers in the greater Houston metropolitan area.

As noted above, as a result of these sales, these regulated subsidiaries are presented as discontinued operations for all periods presented. Therefore, the amounts, statistics and tables presented in this section refer only to on-going operations, unless otherwise noted.

The following table sets forth our Regulated Businesses operating revenue for 2013 and number of customers from continuing operations as well as an estimate of population served as of December 31, 2013:

	Operating		Estimated			
	Revenues		Population			
			Number of		Served	
	(In millions)	% of Total	Customers	% of Total	(In millions)	% of Total
New Jersey	\$ 638.0	24.6 %	647,168	20.1 %	2.5	21.7 %
Pennsylvania	571.2	22.0 %	666,947	20.7 %	2.1	18.3 %
Missouri	264.8	10.2 %	464,232	14.4 %	1.5	13.1 %

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Illinois (a)	261.7	10.1 %	311,464	9.7 %	1.2	10.4 %
California	209.5	8.1 %	173,986	5.4 %	0.6	5.2 %
Indiana	199.2	7.7 %	293,345	9.1 %	1.2	10.4 %
West Virginia (b)	124.2	4.8 %	173,208	5.4 %	0.6	5.2 %
Subtotal (Top Seven States)	2,268.6	87.5 %	2,730,350	84.8 %	9.7	84.3 %
Other (c)	325.3	12.5 %	489,149	15.2 %	1.8	15.7 %
Total Regulated Businesses	\$ 2,593.9	100.0%	3,219,499	100.0%	11.5	100.0%

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- (a) Includes Illinois-American Water Company, which we refer to as ILAWC and American Lake Water Company, also a regulated subsidiary in Illinois.
- (b) West Virginia-American Water Company, which we refer to as WVAWC, and its subsidiary Bluefield Valley Water Works Company.
- (c) Includes data from our operating subsidiaries in the following states: Georgia, Hawaii, Iowa, Kentucky, Maryland, Michigan, New York, Tennessee, and Virginia.

Approximately 87.5% of operating revenue from our Regulated Businesses in 2013 was generated from approximately 2.7 million customers in our seven largest states, as measured by operating revenues. In fiscal year 2013, no single customer accounted for more than 10% of our annual operating revenue.

Overview of Networks, Facilities and Water Supply

Our Regulated Businesses operate in approximately 1,500 communities in 16 states in the United States. Our primary operating assets include 87 dams along with approximately 80 surface water treatment plants, 500 groundwater treatment plants, 1,000 groundwater wells, 100 wastewater treatment facilities, 1,200 treated water storage facilities, 1,300 pumping stations, and 47,000 miles of mains and collection pipes. Our regulated utilities own substantially all of the assets used by our Regulated Businesses. We generally own the land and physical assets used to store, extract and treat source water. Typically, we do not own the water itself, which is held in public trust and is allocated to us through contracts and allocation rights granted by federal and state agencies or through the ownership of water rights pursuant to local law. Maintaining the reliability of our networks is a key activity of our Regulated Businesses. We have ongoing infrastructure renewal programs in all states in which our Regulated Businesses operate. These programs consist of both rehabilitation of existing mains and replacement of mains that have reached the end of their useful service lives.

Our ability to meet the existing and future water demands of our customers depends on an adequate supply of water. Drought, governmental restrictions, overuse of sources of water, the protection of threatened species or habitats or other factors may limit the availability of ground and surface water. We employ a variety of measures to ensure that we have adequate sources of water supply, both in the short-term and over the long-term. The geographic diversity of our service areas tends to mitigate some of the economic effect of weather extremes we might encounter in any particular service territory. In any given summer, some areas are likely to experience drier than average weather while other areas we serve will experience wetter than average weather.

As noted, our Regulated Businesses are dependent upon a defined source of water supply and obtain their water supply from surface water sources such as reservoirs, lakes, rivers and streams. In addition, we also obtain water from ground water sources, such as wells, and purchase water from other water suppliers. The following chart sets forth the sources of water supply for our Regulated Businesses for 2013 by volume:

In our long-term planning, we evaluate quality, quantity, growth needs and alternate sources of water supply as well as transmission and distribution capacity. Sources of supply are seasonal in nature and weather conditions can have a pronounced effect on supply. In order to ensure that we have adequate sources of water supply, we use planning processes and maintain contingency plans to minimize the potential impact on service through a wide range of weather fluctuations. In connection with supply planning for most surface or groundwater sources, we employ models to determine safe yields under different rainfall and drought conditions.

Surface and groundwater levels are routinely monitored so that supply capacity deficits may, to the extent possible, be predicted and mitigated through demand management and additional supply development.

The percentage of finished water supply by source type for our top seven states by Regulated Businesses revenues for 2013 is as follows:

	Ground water	%	Surface water	%	Purchased Water	%
New Jersey	21	%	73	%	6	%
Pennsylvania	7	%	92	%	1	%
Missouri (a)	17	%	82	%	1	%
Illinois	35	%	54	%	11	%
California (b)	67	%	—		33	%
Indiana	55	%	44	%	1	%
West Virginia	—		99	%	1	%

(a) There are limitations in our Joplin service area where the projected source of water supply capacity is unable to meet projected peak demands under certain drought conditions. To manage this issue on the demand side, the water use of a large industrial customer can be restricted under an interruptible tariff. Additional wells have been and will be developed to address short-term supply deficiencies. Missouri-American Water Company is working with a consortium of agencies to determine a long-term supply solution for the Joplin, Missouri region.

(b) In Monterey, in order to augment our sources of water supply, we have implemented conservation rates and other programs to address demand and are utilizing aquifer storage and recovery facilities to store winter water for summer use. Additionally, in other areas, we are making arrangements to extend or expand our purchase of water from neighboring water providers.

The level of treatment we apply to the water varies significantly depending upon the quality of the water source and customer stipulations. Surface water sources, such as rivers, typically require significant treatment, while some groundwater sources, such as aquifers, require chemical treatment only. In addition, a small amount of treated water is purchased from neighboring water purveyors. Treated water is transported through our transmission and distribution network, which includes underground pipes, above ground storage facilities and numerous pumping facilities with the ultimate distribution of the treated water to the customers' premises.

We also have installed production meters to measure the water that we deliver to our distribution network. We employ a variety of methods of customer meter reading to monitor consumption; ranging from meters with mechanical registers where consumption is manually recorded by meter readers to meters with electronic registers capable of transmitting consumption data to proximity devices (touch read) or via radio frequency to mobile or fixed network data collectors. The majority of new meters are able to support future advances in electronic meter reading.

Wastewater services involve the collection of wastewater from customers' premises through sewer lines. The wastewater is then transported through a sewer network to a treatment facility, where it is treated to meet required effluent standards. The treated wastewater is finally returned to the environment as effluent, and the solid waste by-product of the treatment process is disposed of in accordance with applicable standards and regulations.

Customers

We have a large and geographically diverse customer base in our Regulated Businesses. An active customer is defined as a party with an active agreement to receive a specific service from a connection to our water or wastewater system as of the last business day of each monthly reporting period. Also, as in the case of apartment complexes, businesses

and many homes, multiple individuals may be served by a single contract.

Residential customers make up the majority of our customer base in all of the states in which we operate. In 2013, residential customers accounted for 91.0% of the customers and 59.3% of the operating revenue of our Regulated Businesses. We also serve commercial customers, such as shops and businesses; industrial customers, such as large-scale manufacturing and production operations; and public authorities, such as government buildings and other public sector facilities, including schools. We also supply water to public fire hydrants for firefighting purposes, to private fire customers for use in fire suppression systems in office buildings and other facilities as well as providing bulk water supplies to other water utilities for distribution to their own customers.

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The following table sets forth the number of water and wastewater customers (by customer class) for our Regulated Businesses as of December 31, 2013, 2012, and 2011:

	December 31, 2013		2012		2011	
	Water	Wastewater	Water	Wastewater	Water	Wastewater
Residential	2,813,601	117,584	2,783,354	95,576	2,730,524	95,092
Commercial	219,510	6,287	218,988	5,477	216,415	5,462
Industrial	3,822	16	3,894	12	3,885	13
Public & other	58,420	259	50,702	223	49,705	209
Total	3,095,353	124,146	3,056,938	101,288	3,000,529	100,776

The following table sets forth water services operating revenues by customer class and wastewater services operating revenues, excluding other revenues, for our Regulated Businesses for 2013, 2012, and 2011:

	For the years ended December 31,							
	2013		2012		2011			
	(In millions)							
Water service								
Residential	\$1,473.1	57.8 %	\$1,468.6	58.2 %	\$1,339.4	58.1 %		
Commercial	529.8	20.8 %	518.3	20.6 %	474.2	20.5 %		
Industrial	123.3	4.8 %	139.1	5.5 %	114.5	5.0 %		
Public and other	338.8	13.3 %	317.7	12.6 %	302.3	13.1 %		
Total water services	\$2,465.0	96.7 %	\$2,443.7	96.9 %	\$2,230.4	96.7 %		
Wastewater services	82.8	3.3 %	78.2	3.1 %	76.3	3.3 %		
Total	\$2,547.8	100.0 %	\$2,521.9	100.0 %	\$2,306.7	100.0 %		

The following table sets forth billed sales volumes by customer class for our Regulated Businesses for 2013, 2012 and 2011:

	For the years ended December 31,							
	2013		2012		2011			
	(gallons in millions)							
Billed water sales volumes								
Residential	180,976	51.8 %	188,927	51.5 %	180,916	51.2 %		
Commercial	80,392	23.0 %	84,226	23.0 %	81,455	23.0 %		
Industrial	37,107	10.6 %	39,429	10.7 %	39,295	11.1 %		
Public and other	51,009	14.6 %	54,202	14.8 %	52,069	14.7 %		
Total	349,484	100.0 %	366,784	100.0 %	353,735	100.0 %		

The vast majority of our regulated water customers are metered, which allows us to measure and bill for our customers' water consumption, typically on a monthly basis. Our wastewater customers are billed either on a fixed charge basis or based on their water consumption.

Customer usage of water is affected by weather conditions, particularly during the summer. Our water systems generally experience higher demand in the summer due to the warmer temperatures and increased usage by customers for lawn irrigation and other outdoor uses. Summer weather that is cooler and wetter than average generally serves to suppress customer water demand and can reduce water operating revenues and operating income. Summer weather that is hotter and drier than average generally increases operating revenues and operating income. However, when weather conditions are extremely dry, and even if our water supplies are sufficient to serve our customers, our systems may be affected by drought-related warnings and/or water usage restrictions imposed by governmental agencies, thereby reducing customer usage and operating revenues. These restrictions may be imposed at a regional or state level and may affect our service areas, regardless of our readiness to meet unrestricted customer demands. Other factors affecting our customers' usage of water include conservation initiatives, such as the use of more efficient household fixtures and appliances among residential consumers; declining household sizes in the United States; and changes in the economy and credit markets which could have significant impacts on our industrial and commercial customers' operational and financial performance.

Customer growth in our Regulated Businesses is driven by (i) organic population growth in our authorized service areas; (ii) adding new customers to our regulated customer base by acquiring water and/or wastewater utility systems; and (iii) the sale of water to other community water systems. Generally, we add customers through tuck-ins of small water and/or wastewater systems, typically serving fewer than 10,000 customers, in close geographic proximity to areas where we operate our Regulated Businesses. We will continue to acquire water and wastewater utilities through tuck-ins. The proximity of tuck-in opportunities to our regulated footprint allows us to integrate and manage the acquired systems and operations using our existing management and to achieve efficiencies. Historically, pursuing tuck-ins has been a fundamental part of our growth strategy. We intend to continue to expand our regulated footprint geographically by acquiring water and wastewater systems in our existing markets and, if appropriate, certain markets in the United States where we do not operate our Regulated Businesses. We will also selectively seek larger acquisitions that allow us to acquire multiple water and wastewater utility systems in our existing and new markets. Before entering new regulated markets, we will evaluate the regulatory environment to ensure that we will have the opportunity to achieve an appropriate rate of return on our investment while maintaining our high standards for quality, reliability and compliance with environmental, health and safety and water quality standards.

Supplies

Our water and wastewater operations require an uninterrupted supply of chemicals, energy and fuel, as well as maintenance material and other critical inputs. Many of these inputs are subject to short-term price volatility. Short-term price volatility is partially mitigated through existing procurement contracts, current supplier continuity plans, the regulatory rate setting process and rate mechanisms.

Because of our geographic diversity, we maintain relationships with many chemical, equipment and service suppliers in the marketplace, and we do not rely on any single entity for a significant amount of our supplies. We also employ a strategic sourcing process intended to ensure reliability in supply and long-term cost effectiveness. As a result of this process and our strong relationships with suppliers, we are able to mitigate interruptions in the delivery of the products and services that are critical to our operations.

We typically have a combination of standby power generation or dual electric service feeds at key facilities, multiple water production facilities, emergency interconnections with adjacent water systems and finished water storage that keep our operations running in the event of a temporary loss of our primary energy supplies.

Regulation

Economic Regulation

Our Regulated Businesses are generally subject to extensive economic regulation by their respective PUCs. The term “economic regulation” is intended to indicate that these state PUCs regulate the economic aspects of service to the public but do not generally establish water quality standards, which are typically set by the EPA and/or state environmental authorities. State PUCs have broad authority to regulate many of the economic and service aspects of the utilities. For example, state PUCs often issue certificates of public convenience and necessity (or similar authorizations) that may be required for a company to provide service in specific areas. They also approve the rates and conditions under which service is provided and have extensive authority to establish rules and regulations under which the utilities operate. Specific authority might differ from state to state, but in most states PUCs approve rates, accounting treatments, long-term financing programs, significant capital expenditures and plant additions, transactions and relationships between the regulated subsidiary and affiliated entities, reorganizations, mergers and acquisitions. In many instances, approvals are required prior to the transaction. Regulatory policies not only vary from state to state, but can change over time as well. These policies will affect the timing as well as the extent of recovery of expenses and the realized return on invested capital. Our results of operations are significantly affected by rates authorized by the PUCs in the states in which we operate, and we are subject to risks and uncertainties associated with rate case delays or inadequate rate recovery.

Economic regulation of utilities involves many competing, and occasionally conflicting, public interests and policy goals. The primary responsibility of PUCs is to promote the overall public interest by balancing the interests of customers and the utility. Although the specific approach to economic regulation varies, certain general principles are consistent across the states in which our regulated subsidiaries operate. For example, based on certain legal and regulatory principles, utilities are entitled to recover, through rates charged to customers, prudent and reasonable operating costs as well as an opportunity to earn an appropriate return on and recovery of prudent, used and useful capital investment necessary to provide service to customers. PUCs will also generally accord a utility the right to serve specific areas and will also provide investor-owned utilities with limited protection from competition because the requirement of an investor-owned utility to operate pursuant to a certificate of public convenience and necessity (or similar authorizations) typically prevents other investor-owned utilities from competing with it in the authorized area. In return, the utility undertakes the obligation to provide reliable service without unreasonable discrimination to all customers within the authorized area.

Our operating revenue is typically determined by reference to a volumetric charge based on consumption and a base fee component set by a tariff approved by the PUC. The process to obtain approval for a change in rates generally involves filing a petition or “rate case” by the utility with the PUC on a periodic basis as determined by the need to recover capital expenditures, a reduction in operating revenues due to reduced consumption, increased operating costs or the utility determines that its current authorized return is not sufficient, given current market conditions, to provide a reasonable return on investment. A PUC may also initiate a rate proceeding or investigation if it believes a utility may be earning in excess of its authorized rate of return or other issues exist, which justify a review. PUCs may also impose other conditions on the content and timing of filings designed to affect rates. Rate cases often involve a lengthy administrative process that can be costly. The utility, the state PUC staff, consumer advocates, and other customers and interveners, who may participate in the process, generally submit testimony and supporting financial data from a twelve month period of time, known as the “test year.” State statutes and PUC rules and precedent usually determine whether the test year should be based on a historical period, a historical period adjusted for certain “known and measurable” changes or forecasted data. The majority of our states use a forecasted test year. The evidence is presented in public hearings held in connection with the rate case, which are economic and service quality fact-finding in nature, and are typically conducted in a trial-like setting before the PUC or an administrative law judge. During the process, the utility is required to provide PUC staff and interveners with all relevant information they may request concerning the utility’s operations, costs and investments. The decision of the PUC should be based on the evidence presented at the hearing.

State PUCs differ with regard to the types of expenses and investments that may be recovered in rates as well as with regard to the transparency of their rate-making processes and how they reach their final rate determinations. However, in evaluating a rate case, state PUCs typically focus on a number of areas, including, the amount and prudence of investment in facilities; operating and maintenance expenses and taxes; the appropriate cost of capital and equity return; revenues or consumption at current and expected levels; allocation of the revenue requirements among customer classes; service quality and issues raised by customers.

Failure of the PUCs to recognize reasonable and prudent operating and capital costs can result in the inability of the utility to earn the allowed return and can have a significant impact on the operations and earnings of our Regulated Businesses. Rate cases and other rate-related proceedings can take several months to over a year to complete. Therefore, there is frequently a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating cost increase and when those costs are reflected in rates. For instance, an unexpected increase in chemical costs or new capital investment that is not reflected in the most recently completed rate case will generally not begin to be recovered by the regulated subsidiary until the effective date of the subsequent rate case. Our rate case management program is guided by the goals of obtaining efficient recovery of costs of capital, recognition of declining consumption and appropriate recovery of utility operating and maintenance costs, including costs incurred for compliance with environmental regulations. The management team at each of our regulated subsidiaries anticipates the time required for the regulatory process and files rate cases with the goal of obtaining rates that reflect as closely as possible the cost of providing service at the time the rates become effective. Even if rates are sufficient, we face the risk that we will not achieve the rates of return on and of invested capital that are permitted by the PUC.

Our regulated subsidiaries work with legislatures and PUCs to mitigate the adverse impact of regulatory lag through the adoption of positive regulatory policies. These policies include, for example, infrastructure replacement surcharges that allow rates to change outside the context of a general rate proceeding to reflect, on a more timely basis, investments to replace infrastructure necessary to sustain high quality, reliable service. Currently, Pennsylvania, Illinois, Missouri, Indiana, New York, New Jersey and Tennessee allow the use of infrastructure surcharges.

Forward-looking test year mechanisms allow us to earn, on a more current basis, our current or projected usage and costs and a rate of return on our current or projected invested capital. Some states have permitted use of a fully forecasted test year instead of historical data to set rates. Examples of these states include: Illinois, Kentucky, New York, Tennessee, California, Pennsylvania and Indiana. In all states in which we operate on a regulated basis, PUCs

have allowed utilities to update historical data for certain “known and measurable” changes that occur for some limited period of time subsequent to the historical test year. This allows utilities to take into account more current costs or capital investments in the rate-setting process. The extent to which historical data can be updated will generally vary from state to state.

Surcharge mechanisms are also available in a number of states to reflect, outside of a general rate proceeding, changes in major operating expenses which may be beyond the utility’s control. For example, New Jersey, California, Virginia and Illinois have allowed surcharges for purchased water costs. California has allowed surcharges for power and certain other costs, and New York has allowed annual reconciliations for revenues and expenses such as power, fuel, chemicals and property taxes.

Certain states have approved consolidated rates or single-tariff pricing policies. Consolidated rates or single-tariff pricing is the use of a unified rate structure for multiple water systems that are owned and operated by a single utility, but may or may not be contiguous or physically interconnected. The single-tariff pricing structure may be used fully or partially in a state, based on costs that are determined on a state-wide or intra-state regional basis, thereby moderating the impact of periodic fluctuations in local costs while lowering administrative costs for us and our customers. For states that do not employ single-tariffs, we may have multiple general rate cases filed at any given point in time. Examples of states that have adopted a full or partial single-tariff pricing policy include:

Pennsylvania, New Jersey, Missouri, West Virginia, Kentucky, Indiana, Illinois and Iowa. Therefore, of our seven largest states, six have some form of single-tariff pricing. Pennsylvania also permits a blending of water and wastewater rate structures, which results in single tariff pricing among water and wastewater systems.

Another mechanism to address issues of regulatory lag is the potential ability, in certain circumstances, to recover in rates a return on utility plant before it is in service, instead of capitalizing an allowance for funds used during construction. Examples of states that have allowed such recovery include Pennsylvania, Kentucky, Virginia, Illinois and California. In addition, some states, such as Indiana, allow the utility to seek pre-approval of certain capital projects and associated costs. In this pre-approval process, the PUC assesses the prudence of such projects.

In some states, the PUC has implemented mechanisms to enhance utility revenue stability in light of conservation initiatives, decreasing per capita consumption or other factors. Sometimes referred to as “decoupling,” these mechanisms, to some extent, separate recoverable revenues from volumes of water sold. For example, the state of California has decoupled revenues from water sold to help achieve the state initiative to reduce water usage by 20% by 2020. This progressive regulation enables utilities to encourage water efficiency, as revenues are not tied to sales. Similarly, New York has implemented a surcharge or credit based on the difference between actual net revenues and the revenues allowed in the most recent rate order.

The Company pursues these positive regulatory policies as part of our rate and revenue management program to enhance our ability to provide high quality, sustainable, cost effective service to customers, to facilitate efficient recovery of our costs and investments, and to ensure positive short-term liquidity and long-term profitability. The ability of the Company to seek regulatory treatment as described above does not guarantee that the state PUCs will accept the Company’s proposal in the context of a particular rate case, and these policies will reduce, but not eliminate, regulatory lag associated with traditional rate making processes. However, the Company strives to use these and other regulatory policies to address issues of regulatory lag wherever appropriate. It is also our strategy to expand their use in areas where they may not currently apply.

Environmental, Health and Safety and Water Quality Regulation

Our water and wastewater operations are subject to extensive United States federal, state and local laws and regulations, and in the case of our Canadian operations, Canadian laws and regulations governing the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights and the manner in which we collect, treat, discharge and dispose of wastewater. We are also subject to certain regulations regarding fire protection services in the areas we serve. These regulations include the Safe Drinking Water Act, the Clean Water Act and other federal, state, local and Canadian laws and regulations governing the provision of water and wastewater services, particularly with respect to the quality of water we distribute. We also are subject to various federal, state, local and Canadian laws and regulations governing the storage of hazardous materials, the management and disposal of hazardous and solid wastes, discharges to air and water, the cleanup of contaminated sites, dam safety and other matters relating to the protection of the environment and health and safety. State PUCs also set conditions and standards for the water and wastewater services we deliver.

Environmental, health and safety and water quality regulations are complex and change frequently. The overall trend has been that they have become more stringent over time. As newer or stricter standards are introduced, our capital and operating costs could increase. We incur substantial costs associated with compliance with environmental, health and safety and water quality regulation to which our Regulated Businesses are subject. In the past, we have generally been able to recover costs associated with compliance related to environmental, health and safety standards, but this recovery is affected by regulatory lag and the corresponding uncertainties surrounding rate recovery.

We maintain an appropriate environmental policy including responsible business practices, compliance with environmental laws and regulations, effective use of natural resources, and stewardship of biodiversity. We believe that our operations are materially in compliance with, and in many cases surpass, minimum standards required by

applicable environmental laws and regulations. Water samples from across our water systems are analyzed on a regular basis for material compliance with regulatory requirements. Across the Company, we conduct over one million water quality tests each year at our laboratory facilities and plant operations, including continuous on-line instrumentations such as monitoring turbidity levels, disinfectant residuals and adjustments to chemical treatment based on changes in incoming water. For 2013, we achieved a score of greater than 99% for drinking water compliance and according to the EPA statistics, American Water's performance has been far better than the industry average over the last several years. In fact, in 2013, American Water was 20 times better than the industry average for compliance with drinking water quality standards (Maximum Contaminant Levels) and 150 times better for compliance with drinking water monitoring and reporting requirements.

We participate in the Partnership for Safe Water, the United States EPA's voluntary program to meet more stringent goals for reducing microbial contaminants. With 68 of our 82 surface water plants receiving the program's "Director" award, we account for approximately one-third of the plants receiving such awards nationwide. In addition, 63 American Water plants have received the "Five-Year Phase III" award, while 60 have been awarded the "Ten-Year Phase III" award. Additionally, three plants received the inaugural "Fifteen-Year Phase III" award in 2013.

Safe Drinking Water Act

The Federal Safe Drinking Water Act and regulations promulgated thereunder establish national quality standards for drinking water. The EPA has issued rules governing the levels of numerous naturally occurring and man-made chemical and microbial contaminants and radionuclides allowable in drinking water and continues to propose new rules. These rules also prescribe testing requirements for detecting regulated contaminants, the treatment systems which may be used for removing those contaminants and other requirements. Federal and state water quality requirements have become increasingly stringent, including increased water testing requirements, to reflect public health concerns. To date, the EPA has set standards for approximately 90 contaminants and indicators for drinking water. Further, certain of our water systems are in the process of monitoring for 28 additional contaminants that are not currently regulated to help the EPA determine if any of them occur at high enough levels to warrant being regulated. There are thousands of other chemical compounds that are not regulated, many of which are lacking a testing methodology, occurrence data, health effects information and/or treatment technology.

To effect the removal or inactivation of microbial organisms, the EPA has promulgated various rules to improve the disinfection and filtration of drinking water and to reduce consumers' exposure to disinfectants and byproducts of the disinfection process. In January 2006, the EPA promulgated the Long-term 2 Enhanced Surface Water Treatment Rule and the Stage 2 Disinfectants and Disinfection Byproduct Rule. In October 2006, the EPA finalized the Ground Water Rule, applicable to water systems providing water from underground sources. The EPA also revised the monitoring and reporting requirements of the existing Lead and Copper Rule in 2007 and Congress enacted the Reduction of Lead in Drinking Water Act on January 4, 2011 regarding the use and introduction into commerce of lead pipes, plumbing fittings or fixtures, solder and flux. In 2012, the EPA finalized revisions to the Total Coliform Rule that were part of the mandate of a Federal Advisory Committee appointed to negotiate the changes. Most of the anticipated changes to the rule will not be effective until 2016. The EPA is actively considering regulations for a number of contaminants, including hexavalent chromium, fluoride, nitrosamines, perchlorate, some pharmaceuticals and certain volatile organic compounds, but we do not anticipate that any of these regulations will require implementation in 2014.

Although it is difficult to project the ultimate costs of complying with the above or other pending or future requirements, we do not expect current requirements under the Safe Drinking Water Act to have a material impact on our operations or financial condition. In addition, capital expenditures and operating costs to comply with environmental mandates traditionally have been recognized by PUCs as appropriate for inclusion in establishing rates. As a result, we expect to fully recover the operating and capital costs resulting from these pending or future requirements.

Clean Water Act

The Federal Clean Water Act regulates discharges from drinking water and wastewater treatment facilities into lakes, rivers, streams and groundwater. In addition to requirements applicable to our wastewater collection systems, our operations require discharge permits under the National Pollutant Discharge Elimination System ("NPDES") permit program established under the Clean Water Act. Pursuant to the NPDES program, the EPA or implementing states set maximum discharge limits for wastewater effluents and overflows from wastewater collection systems. We believe that we maintain the necessary permits and approvals for the discharges from our water and wastewater facilities. From time to time, discharge violations occur at our facilities, some of which result in fines. We do not expect any such violations or fines to have a material impact on our results of operations or financial condition.

Other Environmental, Health and Safety and Water Quality Matters

Our operations also involve the use, storage and disposal of hazardous substances and wastes. For example, our water and wastewater treatment facilities store and use chlorine and other chemicals which generate wastes that require proper handling and disposal under applicable environmental requirements. We also could incur remedial costs in connection with any contamination relating to our operations or facilities or our off-site disposal of wastes. Although

we are not aware of any material cleanup or decontamination obligations, the discovery of contamination or the imposition of such obligations in the future could result in additional costs. Our facilities and operations also are subject to requirements under the United States Occupational Safety and Health Act and are subject to inspections thereunder. For further information, see “Business—Research and Development.”

Certain of our subsidiaries are involved in pending legal proceedings relating to environmental matters. These proceedings are described further in the section entitled “Item 3—Legal Proceedings.”

Competition

In our Regulated Businesses, we generally do not face direct competition in providing services in our existing markets because (i) we operate within those markets pursuant to certificates of public convenience and necessity (or similar authorizations) issued by state PUCs; and (ii) the high cost of constructing a new water and wastewater system in an existing market creates a barrier to market

entry. Our Regulated Businesses do face competition from governmental agencies, other investor-owned utilities, large industrial customers with the ability to provide their own water supply/treatment process and strategic buyers that are entering new markets and/or making strategic acquisitions. Our largest investor-owned competitors, when pursuing acquisitions, based on a comparison of operating revenues and population served, are Aqua America Inc., United Water (owned by Suez Environnement), American States Water Co. and California Water Services Group.

Condemnation

The potential exists that all or portions of our subsidiaries' utility assets could be acquired by municipalities or other local government entities through one or more of the following methods:

- eminent domain (also known as condemnation);
- the right of purchase given or reserved by a municipality or political subdivision when the original certificate of public convenience and necessity was granted; and
- the right of purchase given or reserved under the law of the state in which the utility subsidiary was incorporated or from which it received its certificate.

The acquisition consideration related to such a transaction initiated by a local government may be determined consistent with applicable eminent domain law, or may be negotiated or fixed by appraisers as prescribed by the law of the state or in the particular franchise or charter. We believe our operating subsidiaries would be entitled to fair market value for any assets required to be sold, and we are of the opinion that fair market value would be in excess of the book value for such assets.

We are periodically subject to condemnation proceedings in the ordinary course of business. For example, condemnation threats have been made over the last several years with respect to the following systems:

- Chicago, Illinois area. The municipalities of Homer Glen (approximately 7,400 customer connections) and Bolingbrook (approximately 21,500 customer connections) have commissioned studies to determine the cost and feasibility of condemning Illinois-American's retail distribution systems serving those communities and have formally requested certain financial and other information from Illinois-American. In addition, five municipalities formed a water agency to pursue eminent domain of the water pipeline that serves those five communities. Before filing its eminent domain lawsuit in January 2013, the water agency made an offer of \$37.6 million for the pipeline.
- Mooresville, Indiana: The Town of Mooresville (approximately 3,700 customer connections) filed a lawsuit to condemn Indiana American's Mooresville operations in August 2012. A jury trial is scheduled for April 15 - 18, 2014. The Town has offered \$6.5 million for the utility, the company's appraisal valued it at \$24.1 million, and the court appointed appraisers established a value of \$14.5 million.
- Monterey, California: A citizens group in Monterey, California (approximately 40,000 customer connections submitted enough signatures to have a measure added to the June 2014 election ballot asking voters to decide whether the local water management district should conduct a nine-month feasibility study concerning the potential purchase of California American Water's Monterey service district.

We actively monitor condemnation activities that may affect us as soon as we become aware of them. We do not believe that condemnation poses a material threat to our ability to operate our Regulated Businesses.

Our Market-Based Operations

In addition to our Regulated Businesses, we operate the following lines of business in our Market-Based Operations. Of the lines of business outlined below; no single group within our Market-Based Operations generates in excess of 10% of our aggregate consolidated revenue.

Contract Operations Group

Our Contract Operations Group enters into public/private partnerships, including O&M and Design, Build and Operate (“DBO”) contracts for the provision of services to water and wastewater facilities for the United States military, municipalities, the food and beverage industry and other customers. We typically make no long-term capital investment under these contracts with municipalities and other customers; instead we perform our services for a fee. During the contract term, we may make limited short term capital investments under our contracts with the United States military and certain industrial customers. Our Contract Operations Group generated revenue of \$212.6 million in 2013, representing 65.3% of revenue for our Market-Based Operations.

We are party to more than 70 contracts, varying in size and scope, across the United States and Canada, with contracts ranging in terms from one to 50 years. Included in these contracts are ten 50-year contracts, including the Hill Air Force Base contract that was awarded to us in January 2014, with the Department of Defense for the operation and maintenance of the water and wastewater systems on certain military bases. All of our contracts with the U.S. government may be terminated, in whole or in part, prior to the end of the 50-year term for convenience of the U.S. government or as a result of default or non-performance by the subsidiary performing the contract. In either event, pursuant to the standard terms of the U.S. government contract termination provisions, we would be entitled to recover allowable costs that we may have incurred under the contract, plus the contract profit margin on incurred costs. The contract price for each of these contracts is subject to redetermination two years after commencement of operations and every three years thereafter. Price redetermination is a contract mechanism to periodically adjust the service fee in the next period to reflect changes in contract obligations and anticipated market conditions.

On December 31, 2011, we completed the sale of our Applied Water Management, Inc. group (“AWM”). As noted above, this subsidiary is included in discontinued operations for all periods presented. Therefore, all amounts and statistics disclosed for the Contract Operations Group refer only to on-going operations of the Contract Operations Group.

Homeowner Services Group

Our Homeowner Services Group, through our Service Line Protection Program, provides services to domestic homeowners and smaller commercial establishments to protect against the cost of repairing broken or leaking water pipes and clogged or blocked sewer pipes inside and outside their accommodations. These repairs are not typically covered by homeowners’ insurance or by their water or sewer service provider.

Our LineSaver™ program involves partnering with municipalities to offer our protection programs to homeowners serviced by the municipalities. During 2012, we entered into a contract with the New York City Water Board (the “Board”), a corporate municipal instrumentality of the State of New York, to offer our LineSaver™ program to the Board’s approximately 650,000 homeowners throughout the city’s five boroughs. As of December 31, 2013, our Homeowner Services Group has approximately 1.3 million customer contracts in 37 states, including the New York City customer contracts.

Terratec Environmental Ltd

Our Market-Based Operations also includes our biosolids management group, Terratec, which is located in Canada and provides environmentally sustainable management and disposal of biosolids and wastewater by-products.

Competition

We face competition in our Market-Based Operations from a number of service providers, including Veolia Environnement, American States Water, OMI and Southwest Water, particularly in the area of O&M contracting. Securing new O&M contracts is highly competitive, as these contracts are awarded based on a combination of customer relationships, service levels, competitive pricing, references and technical expertise. We also face competition in maintaining existing O&M contracts to which we are a party, as the municipal and industrial fixed term contracts frequently come up for renegotiation and are subject to an open bidding process.

Our Homeowner Services Group faces competition outside our existing footprint primarily from HomeServe USA and Utility Service Partners, Inc.

Research and Development

We established a formal research and development program in 1981 with the goal of improving water quality and operational effectiveness in all areas of our business. Our research and development personnel are located in New Jersey. In addition, our quality control and testing laboratory in Belleville, Illinois supports research through sophisticated testing and analysis. Since its inception, our research and development program has evolved to become a leading water-related research program, achieving advancements in the science of drinking water, including sophisticated water testing procedures and desalination technologies.

Since the formation of the EPA in 1970, we have collaborated with the agency to achieve effective environmental, health and safety and water quality regulation. This relationship has developed to include sharing of our research and national water quality monitoring data in addition to our treatment and distribution system optimization research. Our engagement with the EPA has helped us to achieve a leadership position for our company within the water and wastewater industry and has provided us with early insight into emerging regulatory issues and initiatives, thereby allowing us to anticipate and to accommodate our future compliance requirements.

In 2013, we spent \$2.9 million on research and development compared to \$2.8 million and \$2.6 million spent in 2012 and 2011, respectively. Approximately one-quarter of our research budget is comprised of competitively awarded outside research grants. Such grants reduce the cost of research and allow collaboration with leading national and international researchers.

We believe that continued research and development activities are critical in providing quality and reliable service at reasonable rates, in maintaining our leadership position in the industry and will provide us with a competitive advantage as we seek additional business with new and existing customers.

Support Services

Our American Water Works Service Company subsidiary provides shared services and corporate governance that achieve economies of scale through central administration. These services are provided predominantly to our Regulated Businesses under the terms of contracts with these companies that have been approved by state PUCs, where necessary. These services, which are provided at cost, may include accounting, administration, business development, communications, corporate secretarial, education and training, engineering, financial, health and safety, human resources, information systems, internal audit, legal, operations, procurement, rates, security, risk management, water quality and research and development. These arrangements afford our operating companies professional and technical talent on an economical and timely basis. We also operate two national customer service centers, which are located in Alton, Illinois and Pensacola, Florida.

Our security department provides oversight and governance of physical and information security throughout our operations and is responsible for designing, implementing, monitoring and supporting active and effective physical and information security controls. We have complied with EPA regulations concerning vulnerability assessments and have made filings to the EPA as required. Vulnerability assessments are conducted regularly to evaluate the effectiveness of existing security controls and serve as the basis for further capital investment in security for the facility. Information security controls are deployed or integrated to prevent unauthorized access to company information systems, assure the continuity of business processes dependent upon automation, ensure the integrity of our data and support regulatory and legislative compliance requirements. While we do not make public comments on the details of our security programs, we are in contact with federal, state and local law enforcement agencies to coordinate and improve the security of our water delivery systems and to safeguard our water supply.

Employee Matters

Approximately 50% of our workforce is represented by unions. We have 76 collective bargaining agreements in place with 18 different unions representing our unionized employees. We have three union contracts beyond expiration that affect approximately 200 employees, all of which are actively working under the old agreements. During 2014, 22 of our local union contracts will expire.

September 2010, we declared “impasse” in negotiations of our national benefits agreement with most of the labor unions representing employees in our Regulated Businesses. The prior agreement expired on July 31, 2010; however negotiations did not produce a new agreement. We implemented our last, best and final offer on January 1, 2011 in order to provide health care coverage for our employees in accordance with terms of the offer. The unions have challenged our right to implement our last, best, and final offer. In this regard, following the filing by the Utility Workers Union of America of an unfair labor practice charge, the National Labor Relations Board (“NLRB”) issued a complaint against us in January 2012, claiming that we implemented the last, best and final offer without providing sufficient notice of the existence of a dispute with the Federal Mediation and Conciliation Service, a state mediation agency, and several state departments of labor. We asserted that we did, in fact, provide sufficient notice.

On October 16, 2012, the NLRB Administrative Law Judge hearing the matter ruled that, although we did provide sufficient notification to the Federal Mediation and Conciliation Service, we did not provide notice to state agencies,

in violation of the National Labor Relations Act. The Administrative Law Judge ordered, among other things, that we cease and desist from implementing the terms of our last, best and final offer and make whole all affected employees for losses suffered as a result of our implementation of our last, best and final offer. The “make whole” order, if upheld on appeal, would require us to provide backpay plus interest, from January 1, 2011 through the date of the final determination. Based on current estimates and assumptions, we estimate the cash impact could be in the range of \$3.0 to \$3.5 million per year, with the total impact dependent on the length of time the issue remains unresolved. In November 2012, we filed an exception to the decision of the Administrative Law Judge in order to obtain a review by the full NLRB. We expect to hear from the NLRB in 2014.

Available Information

We are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended. We file or furnish annual, quarterly and current reports, proxy statements and other information with the United States Securities and Exchange Commission (“SEC”). You may obtain a copy of any of these reports, free of charge, from the Investor Relations section of our website, <http://www.amwater.com>, shortly after we file or furnish the information to the SEC. Information contained on our website shall not be deemed incorporated into, or to be a part of, this report.

You may also obtain a copy of any of these reports directly from the SEC. You may read and copy any material we file or furnish with the SEC at their Public Reference Room, located at 100 F Street N.E., Washington, D.C. 20549. The phone number for information about the operation of the Public Reference Room is 1-800-732-0330 (if you are calling from within the United States), or 202-551-8090. Because we electronically file our reports, you may also obtain this information from the SEC internet website at <http://www.sec.gov>. You can obtain additional contact information for the SEC on their website.

The American Water corporate governance guidelines and the charters for each of the standing committees of the board of directors, together with the American Water Code of Ethics and additional information regarding our corporate governance, are available on our website, <http://www.amwater.com>, and will be made available, without charge, in print to any shareholder who requests such documents from Investor Relations Department, American Water Works Company, Inc., 1025 Laurel Oak Road, Voorhees, NJ, 08043.

ITEM 1A. RISK FACTORS

We operate in a market and regulatory environment that involves significant risks, many of which are beyond our control. In addition to the other information included or incorporated by reference in this Form 10-K, the following factors should be considered in evaluating our business and future prospects. Any of the following risks, either alone or taken together, could materially and adversely affect our business, financial position, results of operations or cash flows and liquidity.

Risks Related to Our Industry and Business

Our utility operations are subject to extensive economic regulation. Decisions by state PUCs and other regulatory agencies can significantly affect our business and results of operations.

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

Our ability to successfully implement our business plan and strategy depends upon the rates authorized by the various state PUCs. We periodically file rate increase applications with state PUCs. The ensuing administrative process may be lengthy and costly. We can provide no assurances that our rate increase requests will be approved, or that any approval will be given in a timely manner. Moreover, a PUC may not approve a rate request to an extent that is sufficient to cover our expenses, including purchased water and costs of chemicals, fuel and other commodities used in our operations; enable us to recover our investment; and provide us an opportunity to earn an appropriate rate of return on our investment, in which case our business, financial condition, results of operations, cash flow and liquidity may be adversely affected. Even if rates are sufficient, we face the risk that we will not achieve the rates of return on our invested capital and a return of our invested capital to the extent permitted by state PUCs. This could occur if water usage is less than anticipated in establishing rates, as billings to customers are, to a considerable extent, based on usage in addition to a base rate, or if our investments or expenses prove to be higher than was estimated in establishing rates.

Our operations and the quality of water we supply are subject to extensive environmental, water quality and health and safety laws and regulations. Compliance with increasingly stringent laws and regulations could impact our operating costs; and violations of such laws and regulations could subject the Company to substantial liabilities and costs.

Our water and wastewater operations are subject to extensive United States federal, state and local laws and regulations and, in the case of our Canadian operations, Canadian laws and regulations that govern the protection of the environment, health and safety, the quality of the water we deliver to our customers, water allocation rights, and the manner in which we collect, treat, discharge and dispose of wastewater. These requirements include the United States Clean Water Act of 1972, which we refer to as the Clean Water Act, and the United States Safe Drinking Water Act of 1974, which we refer to as the Safe Drinking Water Act, and similar state and Canadian laws and regulations. We are also required to obtain various environmental permits from regulatory agencies for our operations. For example, recently the Monterey County Health Department, Environmental Health Bureau (“MCHD”) notified our subsidiary, California American Water (“CAWC”) that the MCHD had received a complaint filed with the Department of Toxic Substance Control regarding arsenic levels and disposal locations of sludge generated from the company’s Ambler Park and Toro water treatment plants prior to May 2013. MCHD requested that CAWC provide MCHD with sludge disposal records, analytical results and supporting documentation related to this matter. Through two separate letters, CAWC submitted the requested documentation and information to MCHD and advised MCHD that, based on the analysis performed, it appears that some of the residual wastes from the two plants, as well as CAWC’s Ryan Ranch water treatment plant, may have exceeded California hazardous waste soluble threshold limit concentration requirements and, therefore, should not have not been disposed of at the non-hazardous disposal facilities to which they were transported. CAWC further advised MCHD that, in light of the findings, CAWC modified its

procedures to insure that wastes sent for disposal are properly characterized and managed. CAWC similarly reported to the Sacramento County Department of Environmental Management that it may have improperly disposed of arsenic residuals from its Isleton treatment plant before July 2013. By letter dated November 6, 2013, the Monterey County District Attorney advised CAWC that it had received a report from the MCHD that CAWC had transported and disposed such hazardous wastes in violation of applicable provisions of the California Health and Safety Code and the California Business and Professions Code which subject violators to civil penalties of up to \$25,000 per violation and up to \$2,500 per violation, respectively. The District Attorney invited CAWC to arrange a meeting to discuss the matter prior to taking any enforcement action, and a meeting was held on November 20, 2013. The District Attorney has not indicated whether enforcement action will be taken. Similarly, CAWC continues to discuss the matter relating to the Isleton Treatment Plant with the Sacramento County Department of Environmental Management, which has not indicated whether enforcement action will be taken. The Company is unable to predict the outcome of this matter.

In addition, state PUCs also set conditions and standards for the water and wastewater services we deliver. If we deliver water or wastewater services to our customers that do not comply with regulatory standards, or otherwise violate environmental laws, regulations or permits, or other health and safety and water quality regulations, we could incur substantial fines, penalties or other sanctions or costs, as well as damage to our reputation. In the most serious cases, regulators could force us to discontinue operations and sell our operating assets to another utility or to a municipality. Given the nature of our business which, in part, involves supplying water for human consumption, any potential non-compliance with, or violation of, environmental, water quality and health and safety laws or regulations would likely pose a more significant risk to us than to a company not similarly involved in the water and wastewater industry.

We incur substantial operating and capital costs on an ongoing basis to comply with environmental, water quality and health and safety laws and regulations. These laws and regulations, and their enforcement, generally have become more stringent over time, and new or stricter requirements could increase our costs. Although we may seek to recover ongoing compliance costs in our rates, there can be no guarantee that the various state PUCs or similar regulatory bodies that govern our Regulated Businesses would approve rate increases to recover such costs or that such costs will not materially and adversely affect our financial condition, results of operations, cash flows and liquidity.

We may also incur liabilities if, under environmental laws and regulations, we are required to investigate and clean up environmental contamination at our properties, including potential spills of hazardous chemicals, such as chlorine, which we use to treat water, or at off-site locations where we have disposed of waste or caused an adverse environmental impact. The discovery of previously unknown conditions, or the imposition of cleanup obligations in the future, could result in significant costs and could adversely affect our financial condition, results of operations, cash flows and liquidity. Such remediation costs may not be covered by insurance and may make it difficult for us to secure insurance at acceptable rates in the future.

Limitations on availability of water supplies or restrictions on our use of water supplies as a result of government regulation or action may adversely affect our access to sources of water, our ability to supply water to customers or the demand for our water services.

Our ability to meet the existing and future demand of our customers depends on the availability of an adequate supply of water. As a general rule, sources of public water supply, including rivers, lakes, streams and groundwater aquifers, are held in the public trust and are not owned by private interests. As a result, we typically do not own the water that we use in our operations, and the availability of our water supply is established through allocation rights (determined by legislation or court decisions) and passing-flow requirements set by governmental entities. Passing-flow requirements set minimum volumes of water that must pass through specified water sources, such as rivers and streams, in order to maintain environmental habitats and meet water allocation rights of downstream users. Allocation rights are imposed to ensure sustainability of major water sources and passing-flow requirements are most often imposed on source waters from smaller rivers, lakes and streams. These requirements, which can change from time to time, may adversely impact our water supply. Supply issues, such as drought, overuse of sources of water, the

protection of threatened species or habitats, or other factors may limit the availability of ground and surface water. For example, in our Monterey County, California operations, we are seeking to augment our sources of water supply, principally to comply with an October 20, 2009 order of the California State Water Resources Control Board (the "2009 Order") that our subsidiary, CAWC, significantly decrease its diversion from the Carmel River in accordance with a reduction schedule running through December 31, 2016 (the "2016 Deadline"). We are also required to augment our Monterey County sources of water supply to comply with the requirements of the Endangered Species Act. We have implemented conservation rates and other programs to address demand and are utilizing aquifer storage and recovery facilities to store winter water for summer use. We were hopeful that we could address the water supply issues in a meaningful way through a Regional Desalination Project (the "Project") that was to be implemented through a Water Purchase Agreement and ancillary agreements (the "Agreements") among the Marina Coast Water District ("MCWD"), the Monterey County Water Resources Agency ("MCWRA") and CAWC. However, the Project was subject to considerable delay and disputes among the parties. On July 7, 2011, MCWRA advised MCWD and CAWC that the Agreements were void, and on January 17, 2012, CAWC publicly announced that it had withdrawn support of the Project. Finally, on July 12, 2012, the California Public Utility Commission ("CPUC") closed the proceedings relating to the Project. Nevertheless, disputes among the parties with respect to the Project continued thereafter, and, while CAWC and MCWRA have entered into a settlement agreement to resolve their disputes, the terms of

the settlement agreement are largely contingent on approval by the CPUC of the settlement agreement, as well as CAWC's recovery through rates of its provision to MCWRA of \$1.9 million in loan forgiveness and up to approximately \$1.5 million in additional payments. Moreover CAWC's disputes with MCWD remain unresolved and subject to ongoing litigation, although CAWC and MCWD currently are subject to an agreement with respect to certain claims by CAWC against MCWD that tolls the applicable statute of limitations and a deadline for commencement by CAWC of litigation relating to certain of its claims against MCWD. Following its withdrawal of support for the Project, CAWC filed an application with the CPUC on April 23, 2012 for approval of the Monterey Peninsula Water Supply Project (the "New Project"). The New Project involves construction of a desalination plant and related facilities, all to be owned by CAWC. In addition, the New Project may encompass CAWC's purchase of water from the proposed Monterey Peninsula Groundwater Replenishment Project, a joint project between the Monterey Regional Water Pollution Control Agency and the Monterey Peninsula Water Management District ("MPWMD"). The application also seeks CPUC approval of ratemaking mechanisms designed to enable CAWC to recover its costs related to construction and operation of the New Project, including funding for principal and interest on a State Revolving Fund Loan that CAWC believes it is eligible to receive. Under a July 2012 settlement agreement among CAWC and 15 other parties that have intervened in the CPUC proceedings with respect to the New Project, including several Monterey County government entities the parties have agreed to, among other things, cost caps for the desalination plant and certain pipeline facilities to be constructed by CAWC aggregating \$295.7 million to \$338.4 million, depending on the size of the desalination plant ultimately approved by the CPUC. In a separate settlement agreement among most of the same parties, the participating parties agreed on sizing of the desalination plant at 9.6 million gallons per day, if the GWR Project does not supply water to CAWC, and, if the GWR Project supplies water to CAWC, either 6.4 million gallons per day or 6.9 million gallons per day depending on discrete capacities of GWR Project water. The settlement agreements are subject to the approval of the CPUC and will not take effect unless the CPUC determines they are reasonable within the law and the public interest, and until the CPUC certifies an environmental impact report for the proposed New Project, currently scheduled for the first quarter of 2015. CAWC's ability to move forward on the New Project will be subject to extensive administrative review, including public hearings before the CPUC and testimony from intervening parties. In addition, a large number of federal, state and local approvals must also be obtained. moreover, due to delays related to, among other things, determination of the need for government approval to proceed with certain testing required to enable the preparation of the environmental impact report, CAWC currently estimates that the earliest date by which the New Project could be completed is mid to late 2018. Because the projected completion date is beyond the 2016 Deadline, CAWC has commenced discussions with the State Water Resources Control Board and other government representatives to extend the 2016 Deadline. While CAWC believes the discussions have been constructive, we cannot assure that that the 2016 Deadline will be extended. We cannot predict the ultimate effect of the events described above on CAWC's efforts to secure alternative sources of water, or on CAWC's exposure to liabilities as a result of its ongoing disputes relating to the Project or its inability to meet the 2016 Deadline under the 2006 Order. If CAWC is unable to secure an alternative source of water, or if other adverse consequences result from the events described above, our business, financial condition, results of operations and cash flows could be adversely affected.

Government restrictions on water use may also result in decreased use of water services, even if our water supplies are sufficient to serve our customers, which may adversely affect our financial condition and results of operations. Seasonal drought conditions that would impact our water services are possible across all of our service areas. If a regional drought were to occur, governmental restrictions may be imposed on all systems within a region independent of the supply adequacy of any individual system. For example, as a result of the reduced rain fall and overall dry conditions throughout the state of California, CAWC has been closely monitoring its owned and purchased water supplies. On January 17, 2014, the California Governor issued a drought declaration asking Californians to reduce their water use by 20%. At this time, CAWC is awaiting determination by CPUC staff on an advice letter CAWC submitted that would clarify the water conservation and rationing plan for certain districts in CAWC's tariffs, including a conservation and rationing mechanism for the Sacramento district. The CPUC suspended the effective date of the advice letter until after CAWC holds a public meeting for the Sacramento district. During a February 2014 meeting between the CPUC staff and representatives from several water utilities, including CAWC, participants noted that the drought may result in utilities opening the Catastrophic Event Memorandum Accounts in all districts, which

affords the opportunity to seek recovery of extraordinary expenditures related to the drought. Following drought conditions, water demand may not return to pre-drought levels even after restrictions are lifted. Decreased use of water services resulting from any of these events may adversely affect our business, financial condition, results of operations and cash flows.

Service disruptions caused by severe weather conditions may disrupt our operations and economic conditions may reduce the demand for water services, either of which could adversely affect our financial condition and results of operations.

Service interruptions due to severe weather events are possible across all our service areas. These include winter storms and freezing conditions, high wind conditions, tornados, earthquakes, coastal and intercoastal floods or high water conditions, including those in or near designated flood plains, hurricanes and severe electrical storms. These weather events may affect the condition or operability of our facilities, limiting or preventing us from delivering water or wastewater services to our customers, or requiring us to make substantial capital expenditures to repair any damage. In the third quarter of 2011, our New Jersey and Pennsylvania subsidiaries experienced service interruptions in certain of our operating areas and, in some cases, a loss in customers as a result of the extreme weather, including Hurricane Irene and other severe storms in the Northeast. In October 2012, our east coast subsidiaries were affected by Hurricane Sandy. The most significant impact to our business was caused by the widespread power outages caused by the storm's heavy winds, rain and snow.

In addition, adverse economic conditions can cause our customers, particularly industrial customers, to curtail operations. A curtailment of operations by an industrial customer would typically result in reduced water usage. In more severe circumstances, the decline in usage could be permanent. Any decrease in demand resulting from difficult economic conditions could adversely affect our financial condition and results of operations.

Regulatory and environmental risks associated with the collection, treatment and disposal of wastewater may impose significant costs.

The wastewater collection, treatment and disposal operations of our subsidiaries are subject to substantial regulation and involve significant environmental risks. If collection or treatment systems fail, overflow, or do not operate properly, untreated wastewater or other contaminants could spill onto nearby properties or into nearby streams and rivers, causing damage to persons or property, injury to aquatic life and economic damages, which may not be recoverable in rates. This risk is most acute during periods of substantial rainfall or flooding, which are the main causes of sewer overflow and system failure. Liabilities resulting from such damage could adversely and materially affect our business, results of operations and financial condition. Moreover, if we are deemed liable for any damage caused by overflow, our losses might not be covered by insurance, and such losses may make it difficult for us to secure insurance at acceptable rates in the future.

The current regulatory rate setting structure may result in a significant delay, or “regulatory lag,” from the time that we invest in infrastructure improvements, incur increased operating expenses or experience declining water usage, to the time at which we can address these events through the rate case application process; our inability to minimize regulatory lag could adversely affect our business.

There is typically a delay, or regulatory lag, between the time one of our regulated subsidiaries makes a capital investment or incurs an operating expense increase and the time when those costs are reflected in rates. In addition, billings permitted by state PUCs typically are, to a considerable extent, based on the volume of water usage in addition to a minimum base rate. Thus, we may experience a regulatory lag between the time our revenues are affected by declining usage and the time we are able to adjust the rate per gallon of usage to address declining usage. Our inability to reduce this regulatory lag could have an adverse effect on our financial condition, results of operations, cash flow and liquidity.

The Company endeavors to reduce regulatory lag by pursuing positive regulatory policies. For example, seven state PUCs permit rates to be adjusted outside of the rate case application process through surcharges that address certain capital investments, such as replacement of aging infrastructure. These surcharges are adjusted periodically based on factors such as project completion or future budgeted expenditures, and specific surcharges are eliminated once the related capital investment is incorporated in new PUC approved rates. Other examples of such programs include states that allow us to increase rates for certain cost increases that are beyond the utility’s control, such as purchased water costs or property or other taxes, or power, conservation, chemical or other expenditures. These surcharge mechanisms enable us to adjust rates closer to the time costs have been incurred than would be the case under the rate case application process. While these programs have been a positive development and we continue to work for expansion of programs to mitigate regulatory lag, some state PUCs have not approved such programs and there is no assurance that any PUC will adopt any of them in the future or that existing programs will continue in their current form, or at all, in the future. Furthermore, no state has adopted surcharge programs that include all elements of cost that may change between general rate proceedings. Although we intend to continue our efforts to expand state PUC approval of surcharges to address issues of regulatory lag, our efforts may not be successful, in which case our business, financial condition, results of operations, cash flow and liquidity may be adversely affected.

Our Regulated Businesses require significant capital expenditures and may suffer if we fail to secure appropriate funding to make investments, or if we experience delays in completing major capital expenditure projects.

The water and wastewater utility business is very capital intensive. We invest significant amounts of capital to add, replace and maintain property, plant and equipment. In 2013, we invested \$950 million in net Company-funded capital improvements. The level of capital expenditures necessary to maintain the integrity of our systems could increase in the future. We fund capital improvement projects using cash generated from operations, borrowings under our revolving credit facility and commercial paper programs and issuances of long-term debt and equity securities. We can provide no assurance that we will be able to access the debt and equity capital markets on favorable terms or at all.

In addition, we could be limited in our ability to both pursue growth and pay dividends in line with our dividend policy. In particular, the use of cash to pay dividends could affect our ability to make large acquisitions or pursue other growth opportunities that require cash investments in amounts greater than our available cash and external financing resources. In order to fund construction expenditures, acquisitions (including tuck-in acquisitions), principal and interest payments on our indebtedness, and dividends at the level currently anticipated under our dividend policy, we expect that we will need additional financing. However, we intend to retain sufficient cash from operating activities after the distribution of dividends to fund a portion of our capital expenditures.

If we do not obtain sufficient capital, we may be unable to maintain our existing property, plant and equipment, realize our capital investment strategies, meet our growth targets and successfully expand the rate base upon which we are able to earn future returns on our investment and a return of our investment. Even if we have adequate resources to make required capital expenditures, we face the additional risk that we will not complete our major capital expenditures on time, as a result of construction delays or other obstacles. Each of these outcomes could adversely affect our financial condition and results of operations.

Weather conditions could adversely affect demand for our water service and our revenues.

Demand for our water during the warmer months is generally greater than during cooler months due primarily to additional requirements for water in connection with irrigation systems, swimming pools, cooling systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand tends to vary with temperature, rainfall levels and rainfall frequency. In the event that temperatures during the typically warmer months are cooler than normal, or if there is more rainfall than normal, the demand for our water may decrease and adversely affect our revenues.

Market conditions may unfavorably impact the value of benefit plan assets and liabilities, as well as assumptions related to the benefit plans, which may require us to provide significant additional funding.

The performance of the capital markets affects the values of the assets that are held in trust to satisfy significant future obligations under our pension and postretirement benefit plans. These assets are subject to market fluctuations, which may cause investment returns to fall below our projected return rates. A decline in the market value of the pension and postretirement benefit plan assets can increase the funding requirements under our pension and postretirement benefit plans if future returns on these assets are insufficient to offset the decline in value. Additionally, the Company's pension and postretirement benefit plan liabilities are sensitive to changes in interest rates. If interest rates decrease, our liabilities would increase, potentially increasing benefit expense and funding requirements. Further, changes in demographics, such as increases in life expectancy assumptions may also increase the funding requirements of our obligations related to the pension and other postretirement benefit plans. Future increases in pension and other postretirement costs as a result of reduced plan assets may not be fully recoverable in rates, and our results of operations and financial position could be negatively affected.

In addition, market factors can affect assumptions we use in determining funding requirements with respect to our pension and postretirement plans. For example, a relatively modest change in our assumptions regarding discount rates can materially affect our calculation of funding requirements. To the extent that market data compels us to reduce the discount rate used in our assumptions, our benefit obligations could be materially increased, which could adversely affect our financial position and results of operations.

Our indebtedness could affect our business adversely and limit our ability to plan for or respond to changes in our business, and we may be unable to generate sufficient cash flows to satisfy our liquidity needs.

As of December 31, 2013, our indebtedness (including preferred stock with mandatory redemption requirements) was \$5,874.5 million, and our working capital (defined as current assets less current liabilities) was in a deficit position. Our indebtedness could have important consequences, including:

- limiting our ability to obtain additional financing to fund future working capital requirements or capital expenditures;
- exposing us to interest rate risk with respect to the portion of our indebtedness that bears interest at a variable rate;
- limiting our ability to pay dividends on our common stock or make payments in connection with our other obligations;
- impairing our access to the capital markets for debt and equity
- likely requiring that an increasing portion of our cash flows from operations be dedicated to the payment of the principal and interest on our debt, thereby reducing funds available for future operations, acquisitions, dividends on our common stock or capital expenditures;
- limiting our ability to take advantage of significant business opportunities, such as acquisition opportunities, and to react to changes in market or industry conditions; and
- placing us at a competitive disadvantage compared to those of our competitors that have less debt.

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In order to meet our capital expenditure needs, we may be required to make additional borrowings under our revolving credit facility or issue new debt securities in the capital markets. Moreover, additional borrowings may be required to refinance outstanding indebtedness. Debt maturities and sinking fund payments in 2014 and 2015 are \$14.2 million and \$60.7 million, respectively. We can provide no assurances that we will be able to access the debt capital markets on favorable terms, if at all. If new debt is added to our current debt levels, the related risks we now face could intensify, limiting our ability to refinance existing debt on favorable terms.

We will depend primarily on operations to fund our expenses and to pay the principal and interest on our outstanding debt. Therefore, our ability to pay our expenses and satisfy our debt service obligations depends on our future performance, which will be affected by financial, business, economic, competitive, legislative, regulatory and other factors beyond our control. If we do not have sufficient cash flows to pay the principal and interest on our outstanding debt, we may be required to refinance all or part of our existing debt, sell assets, borrow additional funds or sell additional equity. In addition, if our business does not generate sufficient cash flows from operations, or if we are unable to incur indebtedness sufficient to enable us to fund our liquidity needs, we may be unable to plan for or respond to changes in our business, which could cause our operating results and prospects to be affected adversely.

Contamination of our sources of water could result in service interruptions and human exposure to hazardous substances and subject our subsidiaries to civil or criminal enforcement actions, private litigation and cleanup obligations.

Our water supplies into our treatment plants or the supplies then delivered into our distribution system are subject to contamination, including contamination from naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources, such as perchlorate and methyl tertiary butyl ether, and possible terrorist attacks. If one of our water supplies is contaminated, depending on the nature of the contamination, we may have to either 1) interrupt the use of that water supply and locate an adequate supply of water from another water source, including, in some cases, through the purchase of water from a third-party supplier, or 2) continue the water supply under a “Do Not Use” protective order that allows for continuation of basic sanitation and essential fire protection. If service is disrupted and we are unable to access a substitute water supply in a cost-effective manner, our financial condition, results of operations, cash flows, liquidity and reputation may be adversely affected. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities, or development of new treatment methods. We might not be able to recover costs associated with treating or decontaminating water supplies through rates, or recovery of these costs may not occur in a timely manner. Moreover, we could be held liable for environmental damage as well as damages arising from toxic tort or other lawsuits, criminal enforcement actions, contractual obligations or other consequences arising out of human exposure to hazardous substances in our drinking water supplies.

In this regard, on January 9, 2014, a chemical storage tank owned by Freedom Industries, Inc. leaked two substances used for processing coal (4-methylcyclohexane methanol, or MCHM, and PPH, a mix of polyglycol ethers), into the Elk River near the West Virginia-American Water Company (“WVAWC”) treatment plant intake in Charleston, West Virginia. After having been alerted to the leak of MCHM by the West Virginia Department of Environmental Protection (“DEP”) (Freedom Industries first notified DEP on January 21, 2014 that PPH was also leaked), WVAWC took immediate steps to gather more information about MCHM, augment its treatment process as a precaution, and begin consultations with federal, state, and local public health officials. As soon as possible after it was determined that the augmented treatment process would not fully remove the MCHM, a joint decision was reached in consultation with the West Virginia Bureau for Public Health to issue a “Do Not Use” order to approximately 300,000 people in parts of nine West Virginia counties. The order addressed the use of water for drinking, cooking, washing, and bathing, but did not affect continued use of water for sanitation and fire protection. Over the next several days, WVAWC and an interagency team of state and federal officials engaged in extensive sampling and testing to determine if levels of MCHM were below one part per million (1 ppm), a level that the U.S. Centers for Disease

Control and Prevention (“CDC”) and U.S. Environmental Protection Agency indicated would be protective of public health. Beginning on January 13, 2014, based on the results of the continued testing, the Do Not Use order was lifted in stages to help ensure the water system was not overwhelmed by excessive demand, which could have caused additional water quality and service issues. By January 18, 2014, none of WVAWC’s customers were subject to the Do Not Use order, although CDC guidance suggesting that pregnant women avoid consuming the water until the chemicals are at a non-detectable level remained in place. In addition, based on re-analysis of previously saved samples, PPH was no longer detected at any sampling locations as of January 18, 2014. On February 21, 2014, WVAWC announced that all points of testing throughout its water distribution system indicated that levels of MCHM are below 10 parts per billion (10 ppb). The interagency team established 10 ppb as the “non-detect” level of MCHM in the water distribution system based on the measurement capabilities of the multiple laboratories used. WVAWC is continuing sampling and testing in an effort to pinpoint its flushing activities and address odor issues.

WVAWC has and may continue to incur significant costs in responding to this incident and may not be able to recover such costs through rates or from insurers. Even if recovery is possible, it may not occur in a timely manner. Moreover, government investigations relating to the Freedom Industries spill have been initiated, state and federal legislatures have begun considering changes to existing laws, and more than 50 lawsuits have been filed to date against WVAWC and, in a few cases, the Company or other Company affiliates. Freedom Industries (which is now in bankruptcy) is also named in many of the complaints. In addition, a purported stockholder has made a demand that the Company's board of directors take action to remedy alleged breaches of fiduciary duties by all of the members of the board and another Company officer in connection with this matter, which is being referred to the board of directors for its consideration. While the Company and WVAWC believe that WVAWC has responded appropriately to, and

has no responsibility for, the Freedom Industries spill, and the Company and WVAWC believe they and other Company affiliates have valid, meritorious defenses to the lawsuits, WVAWC will incur substantial defense costs. Moreover, an adverse outcome in one or more of the lawsuits could have a material adverse effect on the Company's financial condition, results of operations, cash flows, liquidity and reputation. WVAWC and the Company are unable to predict the outcome of the ongoing government investigations or any legislative initiatives that might impact water utility operations.

Work stoppages and other labor relations matters could adversely affect our results of operations.

Approximately 50% of our workforce is represented by unions. We have 76 collective bargaining agreements in place with 18 different unions representing our unionized employees. We might not be able to renegotiate labor contracts on terms that are fair to us. Any negotiations or dispute resolution processes undertaken in connection with our labor contracts could be delayed or affected by labor actions or work stoppages. Labor actions, work stoppages or the threat of work stoppages, and our failure to obtain favorable labor contract terms during renegotiations may adversely affect our financial condition, results of operations, cash flows and liquidity. In September 2010, we declared "impasse" in negotiations of our national benefits agreement with most of the labor unions representing employees in our Regulated Businesses. The prior agreement expired on July 31, 2010; however, negotiations did not produce a new agreement. We implemented our "last, best and final" offer on January 1, 2011 in order to provide health care coverage for our employees in accordance with the terms of the offer. The unions have challenged our right to implement our last, best, and final offer. In this regard, following the filing by the Utility Workers Union of America of an unfair labor practice charge, the National Labor Relations Board ("NLRB") issued a complaint against us in January 2012, claiming that we implemented the last, best and final offer without providing sufficient notice of the existence of a dispute with the Federal Mediation and Conciliation Service, a state mediation agency, and several state departments of labor. We have asserted that we did, in fact, provide sufficient notice. On October 16, 2012, the NLRB Administrative Law Judge hearing the matter ruled that, although we did provide sufficient notification to the Federal Mediation and Conciliation Service, we did not provide notice to state agencies, in violation of the National Labor Relations Act. The Administrative Law Judge ordered, among other things, that we cease and desist from implementing the terms of our last, best and final offer and make whole all affected employees for losses suffered as a result of our implementation of our last, best and final offer. The "make whole" order, if upheld on appeal, would require us to provide backpay plus interest, from January 1, 2011 through the date of the final determination by the NLRB. Based on current estimates and assumptions, we estimate the cash impact could be in the range of \$3.5 to \$4.5 million per year, with the total impact dependent on the length of time the issue remains unresolved. In November 2012, we filed an exception to the decision of the Administrative Law Judge in order to obtain a review by the full NLRB. Although no work stoppages have occurred with respect to the expired contracts described above, we cannot provide assurance that a work stoppage or strike will not occur. While we have developed contingency plans to be implemented as necessary if a work stoppage or strike does occur, we cannot assure that a strike or work stoppage would not have a material adverse impact on our results of operations, financial position or cash flows.

The failure of, or the requirement to repair, upgrade or dismantle, any of our dams may adversely affect our financial condition and results of operations.

We own 87 dams. A failure of any of those dams could result in personal injury and downstream property damage for which we may be liable. The failure of a dam would also adversely affect our ability to supply water in sufficient quantities to our customers and could adversely affect our financial condition and results of operations. Any losses or liabilities incurred due to a failure of one of our dams might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance at acceptable rates in the future.

We also are required from time to time to decommission, repair or upgrade the dams that we own. The cost of such repairs can be and has been material. We might not be able to recover such costs through rates. The inability to recover these higher costs or delayed recovery of the costs as a result of regulatory lag can affect our financial condition, results of operations, cash flows and liquidity. The federal and state agencies that regulate our operations

may adopt rules and regulations requiring us to dismantle our dams.

Any failure of our network of water and wastewater pipes and water reservoirs could result in losses and damages that may affect our financial condition and reputation.

Our operating subsidiaries distribute water and collect wastewater through an extensive network of pipes and storage systems located across the United States. A failure of major pipes or reservoirs could result in injuries and property damage for which we may be liable. The failure of major pipes and reservoirs may also result in the need to shut down some facilities or parts of our network in order to conduct repairs. Such failures and shutdowns may limit our ability to supply water in sufficient quantities to our customers and to meet the water and wastewater delivery requirements prescribed by government regulators, including state PUCs with jurisdiction over our operations, and adversely affect our financial condition, results of operations, cash flows, liquidity and reputation. Any business interruption or other losses might not be covered by insurance policies or be recoverable in rates, and such losses may make it difficult for us to secure insurance at acceptable rates in the future. Moreover, to the extent such business interruptions or other losses are not covered by insurance, they may not be recovered through rate adjustments.

Our inability to access the capital or financial markets could affect our ability to meet our liquidity needs at reasonable cost and our ability to meet long-term commitments, which could adversely affect our financial condition and results of operations.

In addition to cash from operations, we rely on our revolving credit facility, commercial paper programs, and the capital markets to satisfy our liquidity needs. In this regard, our principal external source of liquidity is our revolving credit facility. We regularly use our commercial paper program as a principal source of short-term borrowing due to the generally more attractive rates we obtain in the commercial paper market. However, disruptions in the capital markets could limit our ability to access capital. While our credit facility lending banks have met all of their obligations, disruptions in the credit markets, changes in our credit ratings, or deterioration of the banking industry's financial condition could discourage or prevent lenders from meeting their existing lending commitments, extending the terms of such commitments, or agreeing to new commitments. In order to meet our short-term liquidity needs, particularly if borrowings through the commercial paper market are unavailable, we maintain a \$1.25 billion revolving credit facility. Under the terms of our revolving credit facility, commitments, which total \$1.18 billion, mature in October 2018. Our inability to maintain, renew or replace these commitments could materially increase our cost of capital and adversely affect our financial condition, results of operations and liquidity.

American Water Capital Corp. ("AWCC"), our financing subsidiary, had no outstanding borrowings under the revolving credit facility and \$41.6 million of outstanding letters of credit under the credit facility as of February 21, 2014. AWCC had \$629.9 million of outstanding commercial paper as of February 21, 2014. We cannot assure that our lenders will meet their existing commitments or that we will be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all.

Longer term disruptions in the capital and credit markets as a result of uncertainty, reduced financing alternatives, or failures of significant financial institutions could adversely affect our access to the liquidity needed for our business. Any significant disruption in the capital and credit markets, or financial institution failures could require us to take measures to conserve cash until the market stabilizes or until alternative financing can be arranged. Such measures could include deferring capital expenditures, reducing or suspending dividend payments, and reducing other discretionary expenditures.

Any impediments to our access to the capital markets, failure of our lenders to meet their commitments, increased interest expense, or cash conservation measures resulting from financial market disruptions or otherwise could adversely affect our business, financial condition, results of operations, cash flow, and liquidity.

Changes in laws and regulations over which we have no control and changes in certain agreements can significantly affect our business and results of operations.

New legislation, regulations, government policies or court decisions can materially affect our operations. The individuals who serve as regulators are elected or are political appointees. Therefore, elections which result in a change of political administration or new appointments may also result in changes in the individuals who serve as regulators and the policies of the regulatory agencies that they serve. New laws or regulations, new interpretations of existing laws or regulations, changes in agency policy, including those made in response to shifts in public opinion, or conditions imposed during the regulatory hearing process may affect our business in a number of ways that could have an adverse effect on our business, financial condition, results of operations, cash flows and liquidity, including the following:

- making it more difficult for us to raise our rates and, as a consequence, to recover our costs or earn our expected rates of return;
- changing the determination of the costs, or the amount of costs, that would be considered recoverable in rate cases;
- changing water quality or delivery service standards, including storage capacity, or wastewater collection, treatment, discharge and disposal standards with which we must comply;

- restricting our ability to terminate our services to customers who owe us money for services previously provided or limiting our bill collection efforts;
- requiring us to provide water services at reduced rates to certain customers;
- restricting our ability to buy or sell assets or issue securities;
- changing regulations that affect the benefits we expected to receive when we began offering services in a particular area;
- changing or placing additional limitations on change in control requirements relating to any concentration of ownership of our common stock;
 - making it easier for governmental entities to convert our assets to public ownership via eminent domain;
- placing limitations, prohibitions or other requirements on the sharing of information and transactions by or between a regulated utility and its affiliates, including us, our service company and any of our other subsidiaries;

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- restricting or prohibiting our extraction of water from rivers, streams, reservoirs or aquifers; and
- revoking or altering the terms of the certificates of public convenience and necessity (or similar authorizations) issued to us by state PUCs.

An important part of our growth strategy is the acquisition of water and wastewater systems. Any future acquisitions we undertake may involve risks. Further, competition for acquisition opportunities from other regulated utilities, governmental entities, and strategic and financial buyers may hinder our ability to grow our business.

An important element of our growth strategy is the acquisition and integration of water and wastewater systems in order to broaden our current, and move into new, service areas. We will not be able to acquire other businesses if we cannot identify suitable acquisition opportunities or reach mutually agreeable terms with acquisition candidates. It is our intent, when practical, to integrate any businesses we acquire with our existing operations. The negotiation of potential acquisitions as well as the integration of acquired businesses could require us to incur significant costs and cause diversion of our management's time and resources. Future acquisitions by us could result in:

- dilutive issuances of our equity securities;
- incurrence of debt, contingent liabilities, and environmental liabilities;
- unknown capital expenditures;
- failure to maintain effective internal control over financial reporting;
- recording goodwill and other intangible assets for which we may never realize their full value and may result in an asset impairment that may negatively affect our results of operations;
- fluctuations in quarterly results;
- other acquisition-related expenses; and
- exposure to unknown or unexpected risks and liabilities.

Some or all of these items could have a material adverse effect on our business and our ability to finance our business, pay dividends and to comply with regulatory requirements. The businesses we acquire in the future may not achieve sales and profitability that would justify our investment, and any difficulties we encounter in the integration process, including in the integration of processes necessary for internal control and financial reporting, could interfere with our operations, reduce our operating margins and adversely affect our internal controls. We compete with governmental entities, other regulated utilities, and strategic and financial buyers, for acquisition opportunities. If consolidation becomes more prevalent in the water and wastewater industries and competition for acquisitions increases, the prices for suitable acquisition candidates may increase to unacceptable levels and limit our ability to grow through

acquisitions. In addition, our competitors may impede our growth by purchasing water utilities near our existing operations, thereby preventing us from acquiring them. Competing governmental entities, utilities, environmental or social activist groups, and strategic and financial buyers have challenged, and may in the future challenge, our efforts to acquire new companies and/or service territories. Our growth could be hindered if we are not able to compete effectively for new companies and/or service territories with other companies or strategic and financial buyers that have lower costs of operations. Any of these risks may adversely affect our business, financial condition, and results of operations.

We have recorded a significant amount of goodwill, and we may never realize the full value of our intangible assets, causing us to record impairments that may negatively affect our results of operations.

Our total assets include substantial goodwill. At December 31, 2013, our goodwill totaled \$1,207.8 million. The goodwill is primarily associated with the acquisition of American Water by an affiliate of our previous owner in 2003 and the acquisition of E'Town Corporation by a predecessor to our previous owner in 2001. Goodwill represents the excess of the purchase price the purchaser paid over the fair value of the net tangible and intangible assets acquired. Goodwill is recorded at fair value on the date of an acquisition and is reviewed annually or more frequently if changes in circumstances indicate the carrying value may not be recoverable. As required by the applicable accounting rules, we have taken significant non-cash charges to operating results for goodwill impairments in the past. In the aggregate, goodwill impairment charges including those recognized in our discontinued operations taken in each year from 2006 through 2009 totaled approximately \$1.93 billion and reduced net income by approximately \$1.91 billion.

We may be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to our performance. These market events could include a decline over a period of time of our stock price, a decline over a period of time in

valuation multiples of comparable water utilities, the lack of an increase in our market price consistent with our peer companies, or decreases in control premiums. A decline in the forecasted results in our business plan, such as changes in rate case results or capital investment budgets or changes in our interest rates, could also result in an impairment charge. Recognition of impairments of a significant portion of goodwill would negatively affect our reported results of operations and total capitalization, the effect of which could be material and could make it more difficult to maintain our credit ratings, secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

The assets of our Regulated Businesses are subject to condemnation through eminent domain.

Municipalities and other government subdivisions have historically been involved in the provision of water and wastewater services in the United States, and organized efforts may arise from time to time in one or more of the service areas in which our Regulated Businesses operate to convert our assets to public ownership and operation through exercise of the governmental power of eminent domain. Should a municipality or other government subdivision seek to acquire our assets through eminent domain, we may resist the acquisition. For example, condemnation threats have been made over the last several years with respect to the following systems:

- Chicago, Illinois area. The municipalities of Homer Glen (approximately 7,400 customer connections) and Bolingbrook (approximately 21,500 customer connections) have commissioned studies to determine the cost and feasibility of condemning Illinois-American's retail distribution systems serving those communities and have formally requested certain financial and other information from Illinois-American. In addition, five municipalities formed a water agency to pursue eminent domain of the water pipeline that serves those five communities. Before filing its eminent domain lawsuit in January 2013, the water agency made an offer of \$37.6 million for the pipeline.
- Mooresville, Indiana: The Town of Mooresville (approximately 3,700 customer connections) filed a lawsuit to condemn Indiana American's Mooresville operations in August 2012. A jury trial for valuation is set for April 15-18, 2014. The Town originally appraised the system at \$6.5 million, the company's appraisal valued it at \$24.1 million, and the court appointed appraisers established a value of \$14.5 million.
- Monterey, California: A citizens group in Monterey, California (approximately 40,000 customer connections) submitted enough signatures to have a measure added to the June 2014 election ballot asking voters to decide whether the local water management district should conduct a nine-month feasibility study concerning the potential purchase of California American Water's Monterey service district.

Contesting an exercise of condemnation through eminent domain may result in costly legal proceedings and may divert the attention of the affected Regulated Business's management from the operation of its business. Moreover, our efforts to resist the acquisition may not be successful.

If a municipality or other government subdivision succeeds in acquiring the assets of one or more of our Regulated Businesses through eminent domain, there is a risk that we will not receive adequate compensation for the business, that we will not be able to keep the compensation, or that we will not be able to divest the business without incurring significant one-time charges.

We rely on our information technology ("IT") systems to assist with the management of our business and customer and supplier relationships, and a disruption of these systems could adversely affect our business.

Our IT systems are an integral part of our business, and a serious disruption of our IT systems could significantly limit our ability to manage and operate our business efficiently, which, in turn, could cause our business and competitive position to suffer and adversely affect our results of operations. We depend on our IT systems to bill customers, process orders, provide customer service, manage construction projects, manage our financial records, track assets,

remotely monitor certain of our plants and facilities and manage human resources, inventory and accounts receivable collections. Our IT systems also enable us to purchase products from our suppliers and bill customers on a timely basis, maintain cost-effective operations and provide service to our customers. While we recently completed the business transformation implementation for our ERP, EAM and CIS systems, a number of our mission and business critical IT systems are older, such as our SCADA (Supervisory Control And Data Acquisition) system. Although we do not believe that our IT systems are at a materially greater risk of cyber security incidents than other similar organizations, our IT systems remain vulnerable to damage or interruption from:

- power loss, computer systems failures, and internet, telecommunications or data network failures;
- operator negligence or improper operation by, or supervision of, employees;
- physical and electronic loss of customer data due to security breaches, cyber attacks, misappropriation and similar events;

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- computer viruses;
- intentional security breaches, hacking, denial of services actions, misappropriation of data and similar events; and
- hurricanes, fires, floods, earthquakes and other natural disasters.

These events may result in physical and/or electronic loss of customer or financial data, security breaches, misappropriation and other adverse consequences. In addition, the lack of redundancy for certain of our IT systems, including billing systems, could exacerbate the impact of any of these events on us.

In addition, we may not be successful in developing or acquiring technology that is competitive and responsive to the needs of our business, and we might lack sufficient resources to make the necessary upgrades or replacements of our outdated existing technology to allow us to continue to operate at our current level of efficiency.

We may not be able to fully utilize our U.S. and state net operating loss carryforwards.

As of December 31, 2013, we had U.S. federal and state net operating loss (“NOL”) carryforwards of approximately \$1,182.1 million and \$628.0 million, respectively. Our federal NOL carryforwards begin to expire in 2028, and our state NOL carryforwards will expire between 2014 and 2033. Our ability to utilize our NOL carryforwards is primarily dependent upon our ability to generate sufficient taxable income. Moreover, because our previous owner’s divestiture of its stock was considered an “ownership change” under Section 382 of the Internal Revenue Code, the amount of NOL carryforwards that may be utilized in any year is limited. Our management believes the federal NOL carryforwards are more likely than not to be recovered and therefore currently require no valuation allowance. At December 31, 2013, \$130.6 million of the state NOL carryforwards have been offset by a valuation allowance because the Company does not believe these NOLs will more likely than not be realized in the future, and we have, in the past, been unable to utilize certain of our NOLs. The establishment or increase of a valuation allowance in the future would reduce our deferred income tax assets and our net income.

Our actual results may differ from those estimated by management in making its assessment as to our ability to use the NOL carryforwards. Moreover, changes in income tax laws, the economy and general business environment could affect the future utilization of the NOL carryforwards. If we are unable to fully utilize our NOL carryforwards to offset taxable income generated in the future, our financial position, results of operations and cash flows could be materially adversely affected.

Our Market-Based Operations, through American Water (excluding our regulated subsidiaries) provide performance guarantees, including financial guarantees or deposits, to our public-sector and public clients, who may seek to enforce the guarantees if our Market-Based Operations do not satisfy certain obligations.

Under the terms of some of our agreements for the provision of services to water and wastewater facilities with municipalities, other governmental entities and other customers, American Water (excluding our regulated subsidiaries) provides guarantees of specified performance obligations of our Market-Based Operations, including financial guarantees or deposits. In the event our Market-Based Operations fail to perform these obligations, the entity holding the guarantees may seek to enforce the performance commitments against us or proceed against the deposit. In that event, our financial condition, results of operations, cash flows, and liquidity could be adversely affected.

At December 31, 2013, we had remaining performance commitments as measured by remaining contract revenue totaling approximately \$2916.0 million and this amount is likely to increase if our Market-Based Operations grow. The presence of these commitments may adversely affect our financial condition and make it more difficult for us to secure financing on attractive terms.

Our Market-Based Operations’ long-term contracts with the Department of Defense may be terminated for the convenience of the U.S. Government and are subject to periodic contract price redetermination.

All of our contracts with the Department of Defense for the operation and maintenance of water and wastewater systems may be terminated, in whole or in part, prior to the end of the 50-year term for convenience of the U.S. Government or as a result of default or non-performance by the subsidiary performing the contract. In addition, the contract price for each of these military contracts is typically subject to redetermination two years after commencement of operations and every three years thereafter. Price redetermination is a contract mechanism to periodically adjust the service fee in the next period to reflect changes in contract obligations and anticipated market conditions. Any early contract termination or unfavorable price redetermination could adversely affect our results of operations.

We operate a number of water and wastewater systems under O&M contracts and face the risk that the owners of those systems may fail to maintain those systems, which may negatively affect us as the operators of the systems.

We operate a number of water and wastewater systems under O&M contracts. Pursuant to these contracts, we operate the system according to the standards set forth in the applicable contract, and it is generally the responsibility of the owner to undertake capital improvements. In some cases, we may not be able to convince the owner to make needed improvements in order to maintain compliance with applicable regulations. Although violations and fines incurred by water and wastewater systems may be the responsibility of the owner of the system under these contracts, those non-compliance events may reflect poorly on us as the operator of the system and damage our reputation, and in some cases, may result in liability to the same extent as if we were the owner.

Our Market-Based Operations are party to long-term contracts to operate and maintain water and wastewater systems under which we may incur costs in excess of payments received.

Some of our Market-Based Operations enter into long-term contracts pursuant to which they agree to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities, which includes responsibility for certain major maintenance for some of those facilities, in exchange for an annual fee. Our Market-Based Operations are generally subject to the risk that costs associated with operating and maintaining the facilities, including production costs such as purchased water, electricity, fuel and chemicals used in water treatment, may exceed the fees received from the municipality or other contracting party. In addition, directly or through our market-based subsidiaries, we often guarantee our Market-Based Operations' obligations under those contracts. Losses under these contracts or guarantees may adversely affect our financial condition, results of operations, cash flows and liquidity.

Our inability to efficiently optimize and stabilize our recently implemented business transformation project, could result in higher than expected costs or otherwise adversely impact our internal controls environment, operations and profitability.

Over the past several years, we have implemented a "business transformation" project, which is intended to improve our business processes and upgrade our legacy core information technology systems. This multi-year, enterprise-wide initiative supports our broader strategic initiatives. The project is intended to optimize workflow throughout our field operations, improve our back-office operations and enhance our customer service capabilities. The scale and costs associated with the business transformation project were significant. Any technical or other difficulties in optimizing and stabilizing this initiative may increase the costs of the project and have an adverse effect on our operations and reporting processes, including our internal control over financial reporting. In August 2012, our new business systems associated with Phase I of our business transformation project became operational. Phase I consisted of the roll-out of the Enterprise Resource Planning systems ("ERP"), which encompass applications that handle human resources, finance, and supply chain/procurement management activities. In the second quarter of 2013, we implemented Phase II of our business transformation project in a number of our regulated subsidiaries. In the fourth quarter of 2013, Phase II of our business transformation project was implemented in our remaining regulated subsidiaries. Phase II consisted of the roll-out of a new Enterprise Asset Management system, which manages an asset's lifecycle, and a Customer Information system, which contains all billing and collections data pertaining to American Water's customers for our Regulated segment. Although efforts have been made to minimize any adverse impact on our controls, we cannot assure that all such impacts have been mitigated.

As we make adjustments to our operations, we may incur incremental expenses prior to realizing the benefits of a more efficient workforce and operating structure. Further, we may not realize anticipated cost improvements and greater efficiencies from the project.

We operate numerous information technology systems that have varying degrees of integration, sometimes leading to inefficiencies. Therefore, delays in stabilization and optimization of the business transformation project will also delay

cost savings and efficiencies expected to result from the project. We may also experience difficulties consolidating our current systems, moving to a common set of operational processes and implementing a successful change management process. These difficulties may impact our ability to meet customer needs efficiently. Any such delays or difficulties may have a material and adverse impact on our business, client relationships and financial results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our properties consist of transmission, distribution and collection pipe, water and wastewater treatment plants, pumping wells, tanks, meters, supply lines, dams, reservoirs, buildings, vehicles, land, easements, software rights and other facilities and equipment used for the operation of our systems, including the collection, treatment, storage and distribution of water, and the collection and treatment of wastewater. Substantially all of our properties are owned by our subsidiaries, and a substantial portion of our property is subject to liens of our mortgage bonds. We lease our corporate offices, equipment and furniture, located in Voorhees, New Jersey from certain of our wholly-owned subsidiaries. These properties are utilized by our directors, officers and staff in the conduct of the business.

Our regulated subsidiaries own, in the states in which they operate, transmission, distribution and collection pipes, pump stations, treatment plants, storage tanks, reservoirs and related facilities. A substantial acreage of land is owned by our Regulated Businesses, the greater part of which is located in watershed areas, with the balance being principally sites of pumping and treatment plants, storage reservoirs, tanks and standpipes. Additionally, property and facilities including such items as well fields, tanks, offices and operation centers, are also leased by our regulated subsidiaries. Our Market-Based Operations' properties consist mainly of spreading and waste transportation equipment, office furniture and IT equipment and are primarily located in New Jersey and Canada. Approximately 50% of our properties are located in New Jersey and Pennsylvania.

We maintain property insurance against loss or damage to our properties by fire or other perils, subject to certain exceptions. For insured losses, we are self-insured to the extent that any losses are within the policy deductible or exceed the amount of insurance maintained. Any such losses could have a material adverse effect on our consolidated results of operations, financial position or cash flows.

We believe that our properties are generally maintained in good operating condition and in accordance with current standards of good water and wastewater works industry practice, and units of property are replaced as and when necessary.

ITEM 3. LEGAL PROCEEDINGS

Alternative Water Supply in Lieu of Carmel River Diversions

In 1995, the California Water Resources Control Board (the "Water Resources Control Board") issued an administrative order (the "1995 Order") to California-American Water Company ("CAWC") requiring CAWC to implement an alternative water supply in lieu of diversions from the Carmel River. The Water Resources Control Board held administrative hearings in the summer of 2008 to address claims that CAWC has exceeded its water diversion rights in the Carmel River and has not diligently pursued establishing an alternative water supply as required by the 1995 Order. The Water Resources Control Board adopted a Cease and Desist Order applicable to CAWC on October 20, 2009 (the "2009 Order"). The 2009 Order finds that CAWC has not sufficiently implemented actions to terminate its unpermitted diversions from the Carmel River as required by the 1995 Order. The 2009 Order requires, among other things, that CAWC significantly decrease its yearly diversions from the Carmel River according to a set reduction schedule running from the date the 2009 Order was adopted until December 31, 2016, at which point all unpermitted diversions must end. Failure to effect the decrease in diversions mandated by the 2009 Order could result in substantial penalties. We can provide no assurances that CAWC will be able to comply with the diversion reduction requirements and other remaining requirements under the 2009 Order or that any such compliance will not result in material additional costs or obligations to us. As noted below, CAWC does not expect to have sufficient alternative sources of water available by the December 31, 2016 deadline, and has begun discussions with the Water Resources Control Board to extend the deadline.

On December 2, 2010, the California Public Utilities Commission (“CPUC”) approved the Regional Desalination Project (the “Project”), involving the construction of a desalination facility on the California central coast, north of Monterey. The Project was to be implemented through a Water Purchase Agreement and ancillary agreements (collectively, the “Agreements”) among the Marina Coast Water District (“MCWD”), the Monterey County Water Resources Agency (“MCWRA”) and CAWC. The desalination facility was to be constructed and owned by MCWD, and MCWRA was to construct the wells that were to supply water to the desalination facility. The Project was intended, among other things, to fulfill CAWC’s obligations under the 1995 Order, in addition to other obligations.

The Project was subject to delay due to, among other things, funding delays and investigations and inquiries initiated by public authorities relating to an alleged conflict of interest concerning a former member of the MCWRA Board of Directors (the “Former Director”). The Former Director was paid for consulting work by a contractor to MCWD while serving on the MCWRA Board of Directors. The contractor subsequently was retained as project manager for the Project. (On November 15, 2011, the Monterey County District Attorney charged the Former Director with two felony counts of conflict of interest relating to the Project, as well as additional felony and misdemeanor counts for other activities.)

On July 7, 2011, MCWRA advised MCWD and CAWC that the Agreements were void as a result of the conduct of the Former Director. Subsequently, on August 12, 2011, CAWC advised MCWD and MCWRA that they have defaulted in performance of certain financing obligations under the Water Purchase Agreement. By letter delivered to MCWD and MCWRA on September 28, 2011, CAWC terminated the Agreements, based on MCWRA's repudiation of the Agreements. In other communications among the parties, each of MCWD and MCWRA have stated that it complied with the financing obligations, and MCWD further responded that, among other things, CAWC did not comply on a timely basis with an obligation under the Water Purchase Agreement that CAWC provide a letter of credit. MCWD also asserted that the Agreements remain in effect. On January 17, 2012, following unsuccessful mediation efforts among the parties, CAWC publicly announced that it had withdrawn support of the Project.

Disputes among the parties with respect to the Project continued thereafter. In public filings before the CPUC, MCWD asserted, among other things, that the CPUC should require CAWC to reimburse MCWD for all costs expended by MCWD in connection with the Project. MCWRA asserted that it was entitled to reimbursement of all costs or expenses relating to the Project, including enumerated expenses under the WPA. Each of MCWD and MCWRA also claimed entitlement to forgiveness of the indebtedness to CAWC that it incurred in connection with the Project. In response, CAWC challenged MCWD's claim that it is entitled to reimbursement for certain purported litigation expenses, and has stated generally that, in light of the failure of MCWD and MCWRA to fulfill their contractual obligations under the Water Purchase Agreement, their entitlement to reimbursement is unclear. On July 12, 2012, the CPUC closed the proceedings relating to the Project and stated that it would examine the recoverability of costs related to the Project in other proceedings. CAWC plans to file a new application seeking recovery of legal costs relating to the Project after any pending legal disputes are resolved.

On September 17, 2012, CAWC and MCWRA entered into a Tolling and Standstill Agreement whereby each party agreed to toll the statute of limitations on any claims either party may have against the other with respect to the Project and agreed not to commence litigation against the other while the agreement is in effect. In December 2012, CAWC, MCWRA, and the County of Monterey entered into a settlement agreement under which CAWC will forgive approximately \$1.9 million previously loaned by CAWC to MCWRA in connection with the Project, and CAWC will make additional payments of up to approximately \$1.5 million to MCWRA (approximately half of which will be paid directly to MCWRA; the remaining amount will be placed in an escrow account to pay claims of consultants and contractors against MCWRA relating to the Project). The settlement agreement, the debt forgiveness and the additional payments are conditioned on CPUC approval, including approval of CAWC rate recovery of the debt forgiveness and the additional payments. The settlement agreement does not affect a civil proceeding filed by CAWC for declaratory relief relating to the validity of the Agreements, which is described below. On May 24, 2013, CAWC filed an application with the CPUC for approval of the settlement agreement and rate recovery on CAWC's debt forgiveness and additional payments to MCWRA under the settlement agreement. The application is pending.

CAWC sought to enter into an agreement with MCWD whereby each party would agree to toll the statute of limitations on any claims either party may have against the other with respect to the Project and agree not to commence litigation against the other, but MCWD initially refused to do so. Therefore, on September 18, 2012, CAWC filed a formal claim with the MCWD Board seeking monetary damages against MCWD. In its claim, CAWC alleges that the Project was terminated due to, among other things, MCWD's breach of one of the Agreements by failing to use its best efforts to obtain project financing, that MCWD has failed to repay approximately \$6 million loaned by CAWC to MCWD in connection with the Project, and that CAWC made substantial expenditures in connection with the Project, which it is entitled to recover from MCWD. CAWC has claimed damages potentially in excess of \$20 million. On November 2, 2012, MCWD provided notice that the Board of MCWD rejected CAWC's claims for damages. CAWC had six months from such date to file a court action on this claim, but prior to the expiration of the six month period, CAWC and MCWD entered into a tolling agreement, which, as extended by subsequent agreement, toll applicable statutes of limitations and the deadline for commencement of litigation regarding CAWC's claims until March 1, 2014.

On October 4, 2012, CAWC filed a Complaint for Declaratory Relief in the Monterey County Superior Court against MCWRA and MCWD, seeking a determination by the Court as to whether the Agreements are void as a result of the Former Director's alleged conflict of interest, or remained valid. On November 21, 2012, MCWD filed an Answer to CAWC's Complaint, a Motion to Change Venue, and a Cross-Complaint for Declaratory Relief. MCWD's cross-complaint seeks a judicial declaration that any challenge to the validity of the Agreements are time-barred or barred by the California Public Utilities Code. MCWRA filed its Answer to CAWC's cross-complaint on December 7, 2012, alleging, among other things, that this action must be stayed pending conclusion of the criminal proceeding relating to the alleged conflict of interest by the Former Director. After CAWC indicated that it did not object to a change of venue, the Monterey County Superior Court approved MCWD's motion to transfer the case to San Francisco County Superior Court, and the transfer was accepted by the San Francisco County Superior Court on January 30, 2013. On October 9, 2013, MCWD filed a Motion for Summary Judgment and Summary Adjudication, seeking a determination that the Agreements are valid. In its motion, MCWD asserts that the Court does not have jurisdiction to determine the validity of the agreements on the basis that the agreements were approved by final decisions of the CPUC, and under the California Public Utilities Code, superior courts are prohibited from exercising jurisdiction to decide matters that would interfere with the CPUC's policies or performance of its duties. MCWD also argued that the action was barred by 60-day statutes of limitations applicable to certain contracts entered into by the MCWD and to certain contracts entered into by the MCWRA. CAWC filed responsive pleadings challenging the motion. On

February 21, 2014, the Court conducted a hearing on the motion, and ordered the parties to submit additional briefs by February 21, 2014. Subject to the Court's decision on the motion, a trial has been scheduled to commence on March 24, 2014.

On April 23, 2012, CAWC filed an application with the CPUC for approval of the Monterey Peninsula Water Supply Project (the "New Project"). The New Project involves construction of a desalination plant and related facilities, all to be owned by CAWC. In addition, the New Project may encompass CAWC's purchase of water from the proposed Monterey Peninsula Groundwater Replenishment Project (the "GWR Project"), a joint project between the Monterey Regional Water Pollution Control Agency and the Monterey Peninsula Water Management District ("MPWMD"). The New Project also would involve aquifer storage and recovery through an already established aquifer storage and recovery program between CAWC and the MPWMD. CAWC stated in the application that it anticipates, based on discussions with the Water Resources Control Board, that it is eligible for a State Revolving Fund Loan for the New Project. The application also seeks CPUC approval of ratemaking mechanisms designed to enable CAWC to recover its costs related to construction and operation of the New Project, including funding for principal and interest on the State Revolving Fund Loan.

On July 31, 2013, CAWC entered into a settlement agreement with 15 other parties that have intervened in the CPUC proceedings with respect to the New Project, including several Monterey County government entities, the Division of Ratepayer Advocates of the CPUC and several interest groups. Under the settlement agreement, the parties have agreed on several matters relating to the New Project, including, among other things, the following: cost caps for the desalination plant and certain pipeline facilities to be constructed by CAWC aggregating \$295.7 million to \$338.4 million, depending on the size of the desalination plant ultimately approved by the CPUC; the process for recovery of project costs, including cost recovery for capital (CAWC agreed to maintain a fixed equity investment in the New Project equal to approximately 27% of total costs related to the desalination plant and certain other facilities to be constructed by CAWC), and operation and maintenance costs; procedures by which CAWC may seek recovery for reasonable and prudent costs above the caps; recommended criteria the CPUC should use to determine whether CAWC should build a smaller desalination plant to accommodate CAWC's purchase of water from the GWR Project; the development of a hydrogeologic study work plan to determine the extent, if any, to which the proposed New Project may adversely affect the Salinas River Groundwater Basin and the water supply; contingency measures if the initially proposed intake wells, brine discharge mechanisms and plant location are infeasible; and financing mechanisms for the New Project. In a separate settlement agreement among most of the same parties, the participating parties agreed on sizing of the desalination plant at 9.6 million gallons per day, if the GWR Project does not supply water to CAWC, and, if the GWR Project supplies water to CAWC, either 6.4 million gallons per day or 6.9 million gallons per day depending on discrete capacities of GWR Project water.

The settlement agreements are subject to the approval of the CPUC and will not take effect unless the CPUC determines they are reasonable within the law and the public interest, and until the CPUC certifies an environmental impact report for the proposed New Project, which currently is expected to be issued in the first quarter of 2015.

Moreover, CAWC's ability to move forward on the New Project is subject to extensive administrative review by the CPUC, review by other government agencies of necessary permit applications, and intervention from other parties, including some that are not participants in the settlement agreements. In addition, there have been delays in the initial timetable for preparation of the environmental impact report due to, among other things, uncertainties regarding timing of government approval of various required permits. As a result, CAWC estimates that the earliest date by which the New Project could be completed is mid- to late 2018. We cannot assure that CAWC's application for the New Project will be approved or that the New Project will be completed on a timely basis, if ever.

Because the projected completion date of the New Project is beyond the December 31, 2016 deadline for CAWC to terminate unpermitted diversions from the Carmel River, CAWC has commenced discussions with the Water Resources Control Board and other government representatives to extend the December 2016 deadline. While CAWC believes the discussions have been constructive, we cannot assume that the deadline will be extended.

Water Treatment Residuals Disposal Matters

CAWC operates six water treatment plants in California that remove excess arsenic from raw water in order to achieve compliance with applicable drinking water standards. The water treatment plants are located in Monterey (Ambler, Ryan Ranch, Toro), Sacramento (Isleton, Walnut Grove) and Sonoma (Larkfield) Counties. The removal process generates a waste stream (“residuals”) that contains, among other things, low levels of the arsenic removed from the raw water. If arsenic levels in solid waste exceed certain specified concentrations, the waste should be characterized as “hazardous.” Under the California Hazardous Waste Control Act (“HWCA”), hazardous waste is subject to different transportation and disposal requirements than non-hazardous waste. For purposes of classifying a waste as hazardous, California uses a threshold for arsenic that is significantly lower than the threshold specified by the United States Environmental Protection Agency. In April 2013, the Monterey County Health Department, Environmental Health Department (“MCHD”) notified CAWC that the MCHD received a complaint filed with the California Department of Toxic Substance Control regarding arsenic levels and disposal locations of sludge generated from CAWC’s Ambler Park and Toro water treatment plants prior to May 2013. MCHD requested that CAWC provide MCHD with sludge disposal records, analytical results and supporting documentation related to this matter. CAWC submitted the requested information to MCHD and advised MCHD that, based on the analysis performed, it appears that some of the residual wastes from the Ambler Park and Toro plants, as well as a third plant (Ryan Ranch), may have exceeded California hazardous waste soluble threshold limit concentration requirements and should

therefore have not been disposed of at the non-hazardous waste disposal facilities to which they were transported. CAWC further advised MCHD that, in light of the findings, CAWC modified its procedures to insure that wastes transported for disposal are properly characterized and managed. CAWC similarly determined and self-reported to the Sacramento County Environmental Management Department ("SCEMD") that it may have improperly disposed of arsenic residuals from its Isleton treatment plant before July 2013.

By letter dated November 6, 2013, the Monterey County District Attorney advised CAWC that it had received a report from the MCHD that CAWC had transported and disposed such hazardous wastes in violation of applicable provisions of the California Health and Safety Code and the California Business and Professions Code. Violators of the Health and Safety Code and the Business and Professions Code are subject to liabilities of \$25,000 per violation and \$2,500 per violation, respectively. On November 20, 2013, CAWC met with the District Attorney to discuss the matter. The District Attorney has not indicated whether enforcement action will be taken. Similarly, CAWC continues to discuss the matter related to the Isleton treatment plant with the SCEMD, which also has not indicated whether enforcement action will be taken. The Company is unable to predict the outcome of this matter.

West Virginia Elk River Chemical Spill

On January 9, 2014, a chemical storage tank owned by Freedom Industries, Inc. leaked two substances used for processing coal, 4-methylcyclohexane methanol, or MCHM, and PPH, a mix of polyglycol ethers, into the Elk River near the West Virginia-American Water Company ("WVAWC") treatment plant intake in Charleston, West Virginia. After having been alerted to the leak of MCHM by the West Virginia Department of Environmental Protection ("DEP"), (Freedom Industries first notified DEP on January 21, 2014 that PPH was also leaked), WVAWC took immediate steps to gather more information about MCHM, augment its treatment process as a precaution, and begin consultations with federal, state and local public health officials. As soon as possible after it was determined that the augmented treatment process would not fully remove the MCHM, a joint decision was reached in consultation with the West Virginia Bureau for Public Health to issue a "Do Not Use" order to approximately 300,000 people in parts of nine West Virginia counties. The order addressed the use of water for drinking, cooking, washing and bathing, but did not affect continued use of water for sanitation and fire protection. Over the next several days, WVAWC and an interagency team of state and federal officials engaged in extensive sampling and testing to determine if levels of MCHM were below one part per million (1 ppm), a level that the U.S. Centers for Disease Control and Prevention ("CDC") and U.S. Environmental Protection Agency indicated would be protective of public health. Beginning on January 13, 2014, based on the results of the continued testing, the Do Not Use order was lifted in stages to help ensure the water system was not overwhelmed by excessive demand, which could have caused additional water quality and service issues. By January 18, 2014, none of WVAWC's customers were subject to the Do Not Use order, although CDC guidance suggesting that pregnant women avoid consuming the water until the chemicals are at non-detectable levels remained in place. In addition, based on re-analysis of previously saved samples, PPH was no longer detected at any sampling locations as of January 18, 2014. On February 21, 2014, WVAWC announced that all points of testing throughout its water distribution system indicated that levels of MCHM are below 10 parts per billion (10 ppb). The interagency team established 10 ppb as the "non-detect" level of MCHM in the water distribution system based on the measurement capabilities of the multiple laboratories used. WVAWC is continuing sampling and testing in an effort to pinpoint its flushing activities and address odor issues.

To date, an aggregate of 50 lawsuits have been filed against WVAWC with respect to this matter in the United States District Court for the Southern District of West Virginia, and West Virginia Circuit Courts in Kanawha, Boone, and Putnam counties. Many of these lawsuits also name Freedom Industries (which is now in bankruptcy), and a few also name the Company or other Company affiliates. The plaintiffs include local businesses, individuals and a Putnam County municipality. The complaints generally seek class action status; raise claims based on a variety of tort,

statutory and contract theories; and seek a combination of compensatory damages, punitive damages, medical monitoring, and other equitable relief. Frequently cited causes of action include negligence, nuisance, trespass, strict liability, and violation of the West Virginia Consumer Credit and Protection Act. Additionally, investigations with respect to the matter have been initiated by the Chemical Safety Board, the U.S. Attorney's Office for the Southern District of West Virginia, the West Virginia Attorney General, and other governmental entities.

The Company and WVAWC believe that WVAWC has responded appropriately to, and has no responsibility for, the Freedom Industries spill and the Company, WVAWC and other Company-affiliated entities named in any of the lawsuits have valid, meritorious defenses to the lawsuits. The Company, WVAWC and the other Company affiliates intend to vigorously contest the lawsuits. Nevertheless, an adverse outcome in one or more of the lawsuits could have a material adverse effect on the Company's financial condition, results of operations, cash flows, liquidity and reputation. Moreover, WVAWC and the Company are unable to predict the outcome of the ongoing government investigations or any legislative initiatives that might affect water utility operations.

Periodically, the Company is involved in other proceedings or litigation arising in the ordinary course of business. We do not believe that the ultimate resolution of these matters will materially affect the Company's financial position or results of operations. However, litigation and other proceedings are subject to many uncertainties, and the outcome of individual matters is not predictable with assurance. It is possible that some litigation and other proceedings could be decided unfavorably to us, and that any such unfavorable decisions could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows.

ITEM 4. Mine Safety Disclosures

Not applicable

PART II

ITEM MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND
5. ISSUER PURCHASES OF EQUITY SECURITIES

Since April 23, 2008, our common stock has traded on the NYSE under the symbol "AWK." As of February 20, 2014, there were 178,722,663 shares of common stock outstanding and approximately 1,800 record holders of common stock.

The following table sets forth the per-share range of the high and low closing sales prices of our common stock as reported on the NYSE and the cash dividends paid and declared per share for the years ended December 31, 2013 and 2012.

	2013					2012				
	First Quarter*	Second Quarter	Third Quarter	Fourth Quarter	Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
Dividends paid per common share	\$0.00	\$0.28	\$0.28	\$0.28	\$0.84	\$0.23	\$0.23	\$0.25	\$0.50	\$1.21
Dividend declared per common share	\$0.00	\$0.28	\$0.56	\$0.28	\$1.12	\$0.23	\$0.25	\$0.25	\$0.25	\$0.98
Price range of common stock										
—High	\$41.44	\$42.74	\$43.50	\$43.49	\$43.50	\$34.47	\$34.95	\$38.35	\$38.17	\$38.35
—Low	\$37.33	\$39.40	\$39.90	\$39.13	\$37.33	\$31.38	\$33.01	\$34.67	\$36.20	\$31.38

*The dividend that would have normally been paid in the first quarter of 2013 was paid on December 28, 2012 to allow shareholders to take advantage of the existing 2012 tax rates.

For information on securities authorized for issuance under our equity compensation see Item 12, "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters."

ITEM 6. SELECTED FINANCIAL DATA

	For the Years Ended December 31,				
	2013	2012	2011	2010	2009
	(in thousands, except per share data)				
Statement of operations data:					
Operating revenues	\$2,901,858	\$2,876,889	\$2,666,236	\$2,555,035	\$2,290,446
Goodwill impairment charges	—	—	—	—	\$428,036
Operating income (loss)	\$945,849	\$924,973	\$803,136	\$728,122	\$183,835
Income (loss) from continuing operations	\$369,264	\$374,250	\$304,929	\$255,072	\$(219,998)

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Income (loss) from continuing operations

per basic common share (1)	\$2.08	\$2.12	\$1.74	\$1.46	\$(1.31)
Income (loss) from continuing operations					
per diluted common share (1)	\$2.06	\$2.11	\$1.73	\$1.46	\$(1.31)

	As of December 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Cash and cash equivalents	\$26,964	\$24,433	\$14,207	\$13,112	\$22,256
Utility plant and property, net of					
depreciation	\$12,244,359	\$11,584,944	\$10,872,042	\$10,241,342	\$9,708,885
Total assets	\$15,069,533	\$14,718,976	\$14,776,391	\$14,086,246	\$13,459,368
Short-term and long-term debt	\$5,855,712	\$5,574,763	\$5,882,956	\$5,658,473	\$5,434,463
Redeemable preferred stock	\$18,827	\$20,511	\$22,036	\$22,794	\$23,011
Total debt and redeemable preferred stock	\$5,874,539	\$5,595,274	\$5,904,992	\$5,681,267	\$5,457,474
Common stockholders' equity	\$4,727,804	\$4,443,268	\$4,235,837	\$4,127,725	\$4,000,859
Preferred Stock without mandatory					
redemption requirements	—	\$1,720	\$4,547	\$4,547	\$4,557
Total stockholders' equity	\$4,727,804	\$4,444,988	\$4,240,384	\$4,132,272	\$4,005,416

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	For the Years Ended December 31,				
	2013	2012	2011	2010	2009
	(in thousands, except per share data)				
Other data:					
Cash flows provided by (used in):					
Operating activities	\$896,162	\$955,598	\$808,357	\$774,933	\$596,156
Investing activities (2)	\$(1,053,294)	\$(382,356)	\$(912,397)	\$(746,743)	\$(703,611)
Financing activities (2)	\$159,663	\$(563,016)	\$105,135	\$(37,334)	\$120,169
Construction expenditures, included in					
investing activities	\$(980,252)	\$(928,574)	\$(924,858)	\$(765,636)	\$(785,265)
Dividends paid per common share (3)	\$0.84	\$1.21	\$0.90	\$0.86	\$0.82
Dividends declared per common share (4)	\$1.12	\$0.98	\$1.13	\$0.86	\$0.82

- (1) For the year ended December 31, 2009, there are no dilutive incremental common shares included in diluted earnings per share as all potentially dilutive instruments would be anti-dilutive.
- (2) The amount for the year ended December 31, 2012 includes net proceeds from the sale of our Arizona, New Mexico and Ohio subsidiaries of approximately \$561 million, with the majority of it used to pay down short-term debt. For further information, see “Item 7- Management Discussion and Analysis- Consolidated Results of Operations.”
- (3) 2012 includes one additional dividend payment of \$0.25 per common share paid on December 28, 2012 to all shareholders of record as of December 20, 2012 to allow them to take advantage of the existing 2012 tax rates.
- (4) Included in 2011 was a change in the timing of dividend declarations. As a result, five dividend declarations were made during 2011.

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read together with the financial statements and the notes thereto included elsewhere in this Form 10-K. This discussion contains forward-looking statements that are based on management’s current expectations, estimates and projections about our business, operations and financial performance. The cautionary statements made in this Form 10-K should be read as applying to all related forward-looking statements whenever they appear in this Form 10-K. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as a result of a number of factors, including those we discuss under “Risk Factors” and elsewhere in this Form 10-K. You should read “Risk Factors” and “Forward-Looking Statements.”

Executive Overview

General

American Water Works Company, Inc. (herein referred to as “American Water” or the “Company”) is the largest investor-owned United States water and wastewater utility company, as measured both by operating revenue and population served. Our approximately 6,600 employees provide drinking water, wastewater and other water related services to an estimated 14 million people in more than 40 states and in two Canadian provinces. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. Our Regulated Businesses that provide these services are generally subject to economic regulation by state regulatory agencies in the states in which they operate. The federal government and the states also regulate environmental, health and safety and water quality matters. Our Regulated

Businesses provide services in 16 states and serve approximately 3.2 million customers based on the number of active service connections to our water and wastewater networks. We report the results of these businesses in our Regulated Businesses segment. We also provide services that are not subject to economic regulation by state regulatory agencies. We report the results of these businesses in our Market-Based Operations segment. As noted under “Business Section,” our financial condition and results of operations are influenced by a variety of industry-wide factors, including but not limited to (i) economic utility regulation; (ii) economic environment; (iii) the need for infrastructure investment; (iv) an overall trend of declining water usage per customer; (v) weather and seasonality; and (vi) access to and quality of water supply.

In 2013, we continued the execution of our strategic goals. Our commitment to operational excellence led to continued improvement in our regulated operating efficiency, improved performance of our Market-Based Operations, and enabled us to provide increased value to our customers and investors. During the year, we focused on addressing regulatory lag, made more efficient use of capital and improved our regulated operation and maintenance (“O&M”) efficiency ratio. Also, in 2013, we expanded both our Regulated Businesses and Market-Based Operations.

2013 Financial Results

For the year ended December 31, 2013, we continued to increase our net income, while continuing to make significant capital investment in our infrastructure and implementing operational efficiency improvements necessary to offset increases in depreciation and general taxes. Aided by rate increases, lower O&M and despite the unfavorable weather conditions in the second and third quarters of 2013, we generated \$2,901.9 million in total operating revenue, and \$369.3 million in net income, or diluted earnings per share (“EPS”) of \$2.06 compared to total operating revenue of \$2,876.9 million, and \$358.1 million in net income in 2012, or diluted EPS of \$2.01. Net income from continuing operations was \$369.3 million for the year ended December 31, 2013 compared to net income from continuing operations of \$374.3 million for the year ended December 31, 2012. Net income and net income from continuing operations for 2013 included an after-tax charge of \$24.8 million, or diluted EPS of \$0.14 that was recorded in the fourth quarter to effect a tender offer that we announced in September of 2013. Diluted earnings from continuing operations per average common share was \$2.06 for the year ended December 31, 2013 as compared to \$2.11 for year ended December 31, 2012.

See “Consolidated Results of Operations and Variances” and “Segment Results” below for further detailed discussion of the consolidated results of operations, as well as our business segments. Also, note that all financial information in this Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”) reflects only continuing operations. In 2011, as part of our portfolio optimization initiative, we entered into agreements to sell our regulated subsidiaries in Arizona, New Mexico, Ohio and our regulated water and wastewater systems in Texas. The sale of our Texas subsidiary’s assets was completed in June 2011, while the sales of our regulated subsidiaries in Arizona, New Mexico and Ohio were completed during 2012. Additionally, on December 13, 2011, we completed the sale of Applied Water Management, Inc. which was part of our Contract Operations line of business within our Market-Based segment. Therefore, the financial results of all of these entities have been presented as discontinued operations for all periods, unless otherwise noted. See Note 3 to Consolidated Financial Statements for further details on our discontinued operations.

Addressing Regulatory Lag

In 2013, we received authorizations for additional annualized revenues from general rate cases, totaling \$41.4 million. During 2013, rate cases were approved for our Kentucky, West Virginia and Pennsylvania subsidiaries. Also, in 2013, we were granted \$36.1 million in additional annualized revenues, assuming constant sales volume, from infrastructure charges in several of our states.

On April 30, 2013, we filed a general rate case in our Iowa subsidiary requesting additional annualized revenues of \$6.4 million. On May 10, 2013, interim rates of \$2.7 million in annualized revenues were approved and put into effect as interim rates under bond and subject to refund. On February 4, 2014, the Iowa Utilities Board (IUB) held a verbal decision meeting that would allow our Iowa subsidiary a permanent annual base rate increase of \$3.9 million. The rate change would not become the final and binding decision of the IUB until its written decision is issued on or before February 28, 2014. The IUB does have the discretion to alter or reverse its position on the verbal decision in the final written order thus the permanent annual base rate increase of \$3.9 million may be adjusted. If the verbal IUB decision is confirmed by final written order after taking into account the interim increase of \$2.7 million such an award would result in an additional \$1.2 million over revenue generated by interim rates.

On January 24, 2014, we filed a general rate case in Indiana requesting additional annualized revenues of \$19.6 million. The rate case filing is using a fully forecasted test year for the first time.

On January 1, 2014, additional annualized revenues of \$0.9 million, \$10.1 million and \$2.1 million resulting from infrastructure charges in our New York, New Jersey and Illinois subsidiaries became effective. On January 17, 2014 and January 31, 2013 we filed for additional annualized revenue of \$0.7 million and \$0.2 million, respectively, from infrastructure charges in our New York subsidiary. On February 25, 2014 our Missouri subsidiary filed for additional revenues from infrastructure charges in the amount of \$3.1 million.

Other regulatory activities occurring in 2013 that allow us to address regulatory lag include our Tennessee subsidiary which on October 4, 2013 filed for approval of a Qualified Infrastructure Investment Program Rider, an Economic Development Investment Rider and a Safety and Environmental Compliance Rider totaling \$0.5 million. Our Tennessee subsidiary is also filing for approval of a Production Costs and Other Pass-Throughs mechanism which cover over or under collection of authorized expenses for purchased power, chemicals, waste disposal, purchased water including wheeling charges, and the Tennessee Regulatory Authority inspection fee. This petition is pending regulatory approval. Our Missouri subsidiary proposed a rule addressing an Environmental Cost Adjustment Mechanism to pass through expenses and capital costs of mandated environmental compliance measures by a utility. The rulemaking was unanimously approved by the Public Service Commission on April 4, 2013. It was adopted on January 3, 2014 and will become effective 30 days after publication in the Code of State Regulations.

As of February 25, 2014, we are awaiting final orders in three states requesting additional annualized revenue of approximately \$58.4 million.

Continuing Improvement in O&M Efficiency Ratio for our Regulated Businesses

We continued to improve on our O&M efficiency ratio during 2013. Our O&M efficiency ratio was 38.7% for the year ended December 31, 2013 compared to 40.1% and 42.4% for the years ended December 31, 2012 and 2011, respectively. Our O&M efficiency ratio (a non-GAAP measure) is defined as our regulated operation and maintenance expense divided by regulated operating revenues, where both O&M expense and operating revenues are adjusted to eliminate purchased water expense. We also exclude from the O&M expense the allocable portion of non-O&M support services cost, mainly depreciation and general taxes, that are reflected in the Regulated Businesses segment as O&M costs but for consolidated financial reporting purposes are categorized within other lines in the Statement of Operations. Management believes that this calculation better reflects the Regulated Businesses segment's O&M efficiency ratio. We evaluate our operating performance using this measure, as it is the primary measure of the efficiency of our regulated operations. This information is intended to enhance an investor's overall understanding of our operating performance. O&M efficiency ratio is not a measure defined under GAAP and may not be comparable to other companies' operating

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measures or deemed more useful than the GAAP information provided elsewhere in this report. The following table provides a reconciliation between operation and maintenance expense and operating revenues, as determined in accordance with GAAP, and to those amounts utilized in the calculation of our O&M efficiency ratio for the years ended December 31, 2013, 2012 and 2011:

Regulated O&M Efficiency Ratio (a Non-GAAP Measure)

	For the Years Ended December 31,		
	2013	2012	2011
	(In thousands)		
Total O&M expense	\$1,312,724	\$1,350,040	\$1,301,794
Less:			
O&M expense—Market-Based Operations	264,253	276,809	278,375
O&M expense—Other	(56,973)	(56,755)	(69,192)
Total Regulated O&M expense	1,105,444	1,129,986	1,092,611
Less:			
Regulated purchased water expense	111,119	110,173	99,008
Allocation of internal O&M costs	34,635	35,067	30,590
Adjusted Regulated O&M expense (a)	\$959,690	\$984,746	\$963,013
Total Operating Revenues	\$2,901,858	\$2,876,889	\$2,666,236
Less:			
Operating revenues—Market-Based Operations	325,463	330,329	327,815
Operating revenues—Other	(17,523)	(17,874)	(30,470)
Total Regulated operating revenues	2,593,918	2,564,434	2,368,891
Less: Regulated purchased water expense*	111,119	110,173	99,008
Adjusted Regulated operating revenues (b)	\$2,482,799	\$2,454,261	\$2,269,883
Regulated O&M efficiency ratio (a)/(b)	38.7	% 40.1	% 42.4

*Note calculation assumes purchased water revenues approximate purchased water expenses.

Making Efficient Use of Capital

We invested approximately \$950 million and \$983 million in Company-funded capital improvements in 2013 and 2012, respectively. These capital investments are needed on an ongoing basis to comply with existing and new regulations, renew aging treatment and network assets, provide capacity for new growth and ensure system reliability, security and quality of service. The need for continuous investment presents a challenge due to the potential for regulatory lag, or the delay in recovering our operating expenses and earning an appropriate rate of return on our invested capital and obtaining a return of our invested capital. In conjunction with our capital investment program, management continued its focus on reducing regulatory lag during 2013.

In May 2013, we implemented the first wave of Phase II of our business transformation project in certain of our regulated subsidiaries. In October 2013, we implemented Phase II in our remaining regulated subsidiaries. Phase II consisted of the roll-out of a new Enterprise Asset Management system, which will manage an asset's lifecycle, and a Customer Information System, which will contain all billing and data pertaining to American Water's customers for our Regulated segment. With the final implementation of Phase II in October 2013, our business transformation project was substantially complete at December 31, 2013. Through December 31, 2013, we have spent \$322.8 million, including AFUDC, on this business transformation project with \$65.8 million of that amount spent in 2013.

Expanding Markets and Developing New Offerings

During 2013, our Regulated Business completed the purchase of ten water systems and five wastewater systems. These acquisitions added approximately 30,000 customers to our regulated operations. The largest of these acquisitions was the acquisition of Dale Service Corporation (“Dale”) by our Virginia subsidiary on November 14, 2013. The service area of Dale overlapped with Virginia American Water’s existing water service in Prince William County. With the Dale acquisition, we added approximately 20,100 wastewater customers to our existing customer base. Also, during 2013, our Market-Based Operations, through our Homeowner Services Group (“HOS”) expanded its water and sewer line protection programs into 10 additional states and Washington, D.C.

In January, 2014, our Military Services Group, part of our Contract Operations Group within the Market-Based Operations was awarded a contract for ownership, operation and maintenance of the water and wastewater systems at Hill Air Force Base in Utah. According to the agreement the award is estimated at approximately \$288 million over a 50-year period. We have begun the transition of the facility, which will be fully transitioned to us by September 1, 2014, when we will commence our operations of the facility under the contract. Also, in January 2014, HOS announced that it has expanded its water line and sewer line protection programs into three additional states, Maine, Minnesota and Oklahoma.

Other matters

West Virginia Event

On January 9, 2014, a chemical storage tank owned by Freedom Industries, Inc. leaked two substances used for processing coal, 4-methylcyclohexane methanol, or MCHM, and PPH, a mix of polyglycol ethers, into the Elk River near the West Virginia-American Water Company ("WVAWC") treatment plant in Charleston, West Virginia. After having been alerted to the leak by the DEP, WVAWC took immediate steps to gather more information about the chemical, augment its treatment as a precaution, and begin consultations with federal, state, and local public health officials. As soon as possible after it was determined that the augmented treatment process would not fully remove the chemical, a joint decision was reached in consultation with the West Virginia Bureau for Public Health to issue a "Do Not Use" order to approximately 300,000 people in parts of nine West Virginia counties. The order addressed the use of water for drinking, cooking, washing and bathing, but did not affect continued use of water for sanitation and fire protection. Over the next several days, WVAWC and an interagency team of state and federal officials engaged in extensive testing to determine if levels of MCHM were below one part per million (1 ppm), a level that the U.S. Centers for Disease Control and Prevention (CDC) and U.S. Environmental Protection Agency indicated would be protective of public health. Based on the results of continued testing, the Do Not Use order was lifted in stages, beginning on January 13, 2014. By January 18th, none of WVAWC's customers were subject to the Do Not Use order, although CDC guidance suggesting that pregnant women avoid consuming the water until the chemicals are at non-detectable levels remained in place. In addition, based on re-analysis of previously saved samples, PPH was no longer detected at any sampling locations as of January 18, 2014. On February 21, 2014, WVAWC announced that all points of testing throughout its water distribution system indicated that levels of MCHM are below 10 parts per billion (10 ppb). The interagency team established 10 ppb as the "non-detect" level of MCHM in the water distribution system based on the measurement capabilities of the multiple laboratories used. WVAWC is continuing sampling and testing in an effort to pinpoint its flushing activities and address odor issues.

To date, an aggregate of 50 lawsuits have been filed against WVAWC with respect to this matter in the United States District Court for the Southern District of West Virginia, and West Virginia Circuit Courts in Kanawha, Boone, and Putman counties, many of which also name Freedom Industries (which is now in bankruptcy) and a few also name the Company or other Company affiliates. The complaints generally seek class action status; raise claims based on a variety of tort, statutory and contract theories; and seek a combination of compensatory damages, punitive damages, medical monitoring, and other equitable relief. Additionally, investigations with respect to the matter have been initiated by the Chemical Safety Board, the U.S. Attorney's Office for the Southern District of West Virginia, the West Virginia Attorney General, and other governmental entities.

The Company and WVAWC believe that WVAWC has responded appropriately to, and has no responsibility for, the Freedom Industries spill, and the Company, WVAWC and other Company-affiliated entities named in any of the lawsuits have valid, meritorious defenses to the lawsuits. The Company, WVAWC and the other Company affiliates intend to vigorously contest the lawsuits. Nevertheless, an adverse outcome in one or more of the lawsuits could have a material adverse effect on the Company's financial condition, results of operations, cash flows, liquidity and reputation. Moreover, the WVAWC and the Company are unable to predict the outcome of the ongoing government

investigations or any legislative initiatives that might affect water utility operations.

National Benefits Agreement

In September 2010, we declared “impasse” in negotiations of our national benefits agreement with most of the labor unions representing employees in our Regulated Businesses. The prior agreement expired on July 31, 2010; however, negotiations did not produce a new agreement. We implemented our “last, best and final” offer on January 1, 2011 in order to provide health care coverage for our employees in accordance with the terms of the offer. The unions have challenged our right to implement our last, best, and final offer. In this regard, following the filing by the Utility Workers Union of America of an unfair labor practice charge, the NLRB issued a complaint against us in January 2012, claiming that we implemented the last, best and final offer without providing sufficient notice of the existence of a dispute with the Federal Mediation and Conciliation Service, a state mediation agency, and several state departments of labor. We have asserted that we did, in fact, provide sufficient notice.

On October 16, 2012, the NLRB Administrative Law Judge hearing the matter ruled that, although we did provide sufficient notification to the Federal Mediation and Conciliation Service, we did not provide notice to state agencies, in violation of the National Labor Relations Act. The Administrative Law Judge ordered, among other things, that we cease and desist from implementing the terms of our last, best and final offer and make whole all affected employees for losses suffered as a result of our implementation of

our last, best and final offer. The “make whole” order, if upheld on appeal, would require us to provide back-pay plus interest, from January 1, 2011 through the date of the final determination by the NLRB. Based on current estimates and assumptions, we estimate the cash impact could be in the range of \$3.5 to \$4.5 million per year, with the total impact dependent on the length of time the issue remains unresolved. On November 2012, we filed an exception to the decision of the Administrative Law Judge in order to obtain a review by the full NLRB. We expect to hear from the NLRB during 2014.

2014 and Beyond

Our strategy for the future will continue to focus on customer satisfaction and service, expansion through targeted growth, environmental sustainability, and constructive regulatory and public policy. We will also continue to modernize our infrastructure and to focus on operational efficiencies, while bolstering a culture of continuous improvement.

For 2014 and beyond, we expect our earnings growth drivers to be 1) our Regulated Business investment; 2) growth from acquisitions; 3) growth in Market-Based businesses; and lastly 4) potential growth opportunities in serving the shale industry. Also, in 2014, we anticipate savings from corporate expense reductions attributable to lower SAP-related implementation costs, lower pension costs, further reduced headcount and lower interest expense resulting from our 2013 debt refinancings.

In 2014, we will continue to concentrate on our customers by achieving established customer satisfaction and service quality targets. In regards to environmental sustainability, we are committed to maximizing our protection of the environment, reducing our carbon and waste footprints and water lost through leakage. Specific goals established for 2014 are to:

- 1) Optimize capital spend
- 2) Continue to promote constructive regulatory frameworks
- 3) Improve our O&M efficiency ratio
- 4) Execute our regulated acquisition strategy; and
- 5) Continue to grow our Market-Based Operations.

We will optimize our capital spend by not only focusing on how much we spend but the efficiency with which we spend it. We estimate our capital expenditure plan for 2014 through 2018 will be approximately \$5.8 billion. Of the \$5.8 billion, \$5.1 billion is expected to be utilized to upgrade our infrastructure and systems. In addition to these capital expenditures, we are also estimating additional capital investment over the five-year period for acquisitions and strategic capital of approximately \$400 million and \$300 million, respectively. Strategic investments could include opportunities in the unregulated shale arena or a major concession. Our total capital plan for 2014 is estimated to be approximately \$1.1 billion with approximately \$900 million allocated to upgrading our infrastructure and systems, \$100 million for acquisitions and \$100 million for strategic investment purposes.

We will engage in appropriate legislative and regulatory policy changes by actively addressing regulatory lag that impacts return on our investments and promoting constructive regulatory frameworks. We expect to resolve three rate proceedings during 2014 and plan to file up to five general rate cases, including one which was already filed in January 2014. Additionally, we will file for infrastructure surcharges and continue to pursue other mechanisms, either as part of our general rate case filings or in separate filings, which will provide opportunities to expedite the return of capital outside of the general rate case and continue to close the gap between our allowed and our earned regulated return.

We also expect to continue to improve our regulated O&M efficiency ratio. We expect to achieve an O&M efficiency ratio equal to or below 35% by 2018. A significant component in both the optimization of capital spend and O&M

efficiency objectives is to optimize our supply chain process to provide more value for each dollar of capital and O&M spent.

Lastly, we will look to execute our regulated acquisition strategy and continue to grow our Market-Based Operations, in particular HOS and our military services contracts, while evaluating potential opportunities to assist the shale industry in the delivery of water to assist with their processes. We will expand our Regulated Business segment through focused acquisitions and/or organic growth, while expanding in our Market-Based segment from new core growth, expanded markets and new offerings. In regards to our Market-Based Operations, as noted above, in early January 2014, we added the Hill Air Force Base to our military contracts and have expanded our HOS service line protection programs into three additional states. We are committed to operating our business responsibly and managing our operating and capital costs in a manner that serves our customers and produces value for our shareholders. We are committed to an ongoing strategy that leverages processes and technology innovation to make ourselves more effective and efficient.

Consolidated Results of Operations

The following table sets forth our consolidated statement of operations data for the years ended December 31, 2013, 2012 and 2011:

	Years ended December 31,		
	2013	2012	2011
Operating revenues	\$2,901,858	\$2,876,889	\$2,666,236
Operating expenses			
Operation and maintenance	1,312,724	1,350,040	1,301,794
Depreciation and amortization	407,718	381,503	351,821
General taxes	234,642	221,212	210,478
(Gain) loss on asset dispositions and purchases	925	(839)	(993)
Total operating expenses, net	1,956,009	1,951,916	1,863,100
Operating income	945,849	924,973	803,136
Other income (expenses)			
Interest, net	(308,164)	(310,794)	(312,415)
Loss on extinguishment of debt	(40,583)	—	—
Allowance for other funds used during construction	12,639	15,592	13,131
Allowance for borrowed funds used during construction	6,377	7,771	5,923
Amortization of debt expense	(6,603)	(5,358)	(5,055)
Other, net	(4,045)	(926)	(1,040)
Total other income (expenses)	(340,379)	(293,715)	(299,456)
Income from continuing operations before income taxes	605,470	631,258	503,680
Provision for income taxes	236,206	257,008	198,751
Income from continuing operations	369,264	374,250	304,929
Income (loss) from discontinued operations	—	(16,180)	4,684
Net income	\$369,264	\$358,070	\$309,613
Basic earnings per share (a)			
Income from continuing operations	\$2.08	\$2.12	\$1.74
Income (loss) from discontinued operations	\$0.00	\$(0.09)	\$0.03
Net income	\$2.08	\$2.03	\$1.76
Diluted earnings per share (a)			
Income from continuing operations	\$2.06	\$2.11	\$1.73
Income (loss) from discontinued operations	\$0.00	\$(0.09)	\$0.03
Net income	\$2.06	\$2.01	\$1.75
Average common shares outstanding during the period			
Basic	177,814	176,445	175,484
Diluted	179,056	177,671	176,531
Dividends per common share	\$1.12	\$0.98	\$1.13

(a) Amounts may not sum due to rounding.

Comparison of consolidated Results of Operations for the Years Ended December 31, 2013 and 2012

Operating revenues. Consolidated operating revenues for the year ended December 31, 2013 increased \$25.0 million, or 0.9%, compared to the same period in 2012. This increase is the result of higher revenues in our Regulated Businesses of \$29.5 million, which was mainly attributable to rate increases partially offset by decreased consumption, primarily related to weather. For further information see the respective “Operating Revenues” discussions within the “Segment Results.”

Operation and maintenance. Consolidated operation and maintenance expense for the year ended December 31, 2013 decreased \$37.3 million, or 2.8%, compared to 2012. This change was mainly attributable to a \$24.5 million decrease in our Regulated Businesses' costs primarily related to a decrease in employee-related costs, primarily pension and group insurance expense as well as lower preventive maintenance expenses. For further information see the respective "Operation and Maintenance" discussions within the "Segment Results."

Depreciation and amortization. Depreciation and amortization expense increased by \$26.2 million, or 6.9%, for the year ended December 31, 2013 compared to the same period in the prior year as a result of additional utility plant placed in service including our business transformation project, which accounted for \$10.8 million of the incremental expense in 2013.

General taxes. General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$13.4 million, or 6.1%, for the year ended December 31, 2013 compared to the year ended December 31, 2012. This increase was principally due to incremental taxes in the first half of 2013 associated with the properties acquired in our New York acquisition in the second quarter of 2012. Also, 2012 property taxes were lower due to the recognition of credit adjustments in Indiana and Missouri which reduced property tax expense in the third quarter of 2012. Lastly, gross receipts taxes were higher in our New Jersey subsidiary by \$3.5 million.

Other income (expenses). Other expenses increased \$46.7 million, or 15.9%, for the year ended December 31, 2013 compared to the same period in the prior year. This increase is principally attributable to the recognition of a pre-tax loss on debt extinguishment of \$40.6 million in connection with the cash tender offer for our 6.085% Senior Notes due 2017. The loss consisted of a repurchase premium of \$39.4 million, transaction fees of \$0.7 million and a write-off of \$0.5 million for unamortized debt issuance costs. Also contributing to the increase was a reduction in allowance for funds used during construction ("AFUDC") of \$4.3 million resulting from decreased construction activities, compared to the same period in 2012, including the winding down of our business transformation project.

Provision for income taxes. Our consolidated provision for income taxes decreased \$20.8 million, or 8.1%, to \$236.2 million for the year ended December 31, 2013. The effective tax rates for the years ended December 31, 2013 and 2012 were 39.0% and 40.7%, respectively. The rate for the year ended December 31, 2013 includes a \$3.0 million tax benefit associated with a legal structure reorganization within our Market-Based Operations segment. This strategic restructuring allowed us to utilize state net operating loss carryforwards, which without the restructuring most likely would not have been utilized prior to their expiration.

Income (loss) from discontinued operations, net of tax. As noted above, the financial results of our regulated water and wastewater systems in Arizona, New Mexico, Texas and Ohio and our Applied Water Management, Inc. subsidiary within the Market-Based Operations segment have been classified as discontinued operations for all periods presented. The loss in 2012 is primarily comprised of net losses recorded in connection with the disposition of our Arizona, New Mexico and Ohio subsidiaries.

Comparison of consolidated Results of Operations for the Years Ended December 31, 2012 and 2011

Operating revenues. Consolidated operating revenues for the year ended December 31, 2012 increased \$210.7 million, or 7.9%, compared to the same period in 2011. This increase is the result of higher revenues in our Regulated Businesses of \$195.5 million, which was mainly attributable to rate increases and increased sales volumes, primarily related to weather. For further information see the respective "Operating Revenues" discussions within the "Segment Results."

Operation and maintenance. Consolidated operation and maintenance expense for the year ended December 31, 2012 increased \$48.2 million, or 3.7%, compared to 2011. This change was mainly attributable to a \$37.4 million increase in our Regulated Businesses costs primarily related to an increase in production costs of approximately \$12.2 million to support higher customer demand as well as incremental contracted services costs attributable to various projects in support of improving processes and operating efficiency and effectiveness, including the support of the go-live of our Enterprise Resource Planning system, and the use of temporary labor to backfill positions, including those positions vacated by employees assigned to our business transformation project. Also, contributing to the increase was a \$7.0 million contribution made in 2012 to the American Water Charitable Foundation, a 501(c)(3) organization. For further information see the respective "Operation and Maintenance" discussions within the "Segment Results."

Depreciation and amortization. Depreciation and amortization expense increased by \$29.7 million, or 8.4%, for the year ended December 31, 2012 compared to the same period in the prior year as a result of additional utility plant placed in service.

General taxes. General taxes expense, which includes taxes for property, payroll, gross receipts, and other miscellaneous items, increased by \$10.7 million, or 5.1%, for the year ended December 31, 2012 compared to the year ended December 31, 2011. This increase was principally due to higher property taxes of \$7.3 million, most of which is the result of incremental taxes associated with our New York acquisition.

Other income (expenses). Other expenses decreased \$5.7 million, or 1.9%, for the year ended December 31, 2012 compared to the same period in the prior year. This decrease is attributable to an increase in AFUDC of \$4.3 million resulting from increased construction activity, including our business transformation project and a decrease in interest expense, net of interest income of \$1.6 million.

Provision for income taxes. Our consolidated provision for income taxes increased \$58.3 million, or 29.3%, to \$257.0 million for the year ended December 31, 2012. The effective tax rates for the years ended December 31, 2012 and 2011 were 40.7% and 39.5%, respectively. The rate for the twelve months ended December 31, 2011 includes a \$4.5 million tax benefit related to one of our operating companies contributing non-utility property to a county authority within its operating area.

Income (loss) from discontinued operations, net of tax. As noted above, the financial results of our regulated water and wastewater systems in Arizona, New Mexico, Texas and Ohio and our Applied Water Management, Inc. subsidiary within the Market-Based Operations segment have been classified as discontinued operations for all periods presented. The loss in 2012 is primarily comprised of net losses recorded in connection with the disposition of our Arizona, New Mexico and Ohio subsidiaries. The 2011 income amount reflects the operations for the discontinued subsidiaries and an after-tax benefit of \$15.1 million related to the cessation of depreciation for our Arizona, New Mexico, and Texas subsidiaries. Under GAAP, operations that are considered discontinued cease to depreciate their assets. Partially offsetting the 2011 income from discontinued operations, net of tax amount was \$25.1 million after tax write-downs recorded in 2011 to reduce the net asset values of certain of our discontinued operations.

Segment Results of Operations

We have two operating segments, which are also our reportable segments: the Regulated Businesses and the Market-Based Operations. These segments are determined based on how we assess performance and allocate resources. We evaluate the performance of our segments and allocated resources based on several factors, with the primary measure being income from continuing operations before income taxes.

Regulated Businesses Segment

The following table summarizes certain financial information for our Regulated Businesses for the periods indicated:

	For the Years Ended December 31,		
	2013	2012	2011
	(in thousands)		
Operating revenues	\$2,593,918	\$2,564,434	\$2,368,891
Operation and maintenance expense	1,105,444	1,129,986	1,092,611
Operating expenses, net	1,700,052	1,685,734	1,609,276
Income from continuing operations before income taxes	654,834	649,117	535,445

Operating Revenues. Our primary business involves the ownership of water and wastewater utilities that provide services to residential, commercial, industrial and other customers. This business is subject to state regulation and our results of operations can be impacted significantly by rates authorized by the state regulatory commissions in the states in which we operate. The table below details additional annualized revenues awarded, including step increases and assuming a constant volume, resulting from rate authorizations granted in 2013, 2012 and 2011:

State	Years Ended December 31,		
	2013	2012	2011
	(in millions)		
General Rate Cases:			
Pennsylvania (1)	\$ 26.0	\$ —	\$ 62.1
New Jersey	—	30.0	—
Kentucky (2)	6.9	—	—
Missouri	—	24.0	—
Illinois	—	17.9	—
Indiana	—	1.9	—
California (3)	3.5	32.9	—
West Virginia (4)	8.5	—	5.1
Virginia(5)	—	2.6	4.8
Tennessee	—	5.2	5.6
Iowa	—	2.8	—
New York(6)	—	5.6	—
Other	0.1	0.2	1.2
Total—General Rate Cases	\$ 45.0	\$ 123.1	\$ 78.8

(1) On December 19, 2013, a rate case settlement was approved with an effective date of January 1, 2014. This rate increase combined, in part, wastewater and water rates.

(2) Final order was received on October 25, 2013. The increase approximated the interim rates, net of the reserve that had been recorded since July 27, 2013.

(3) Second step increase from the 2012 rate case became effective on April 1, 2013.

(4) Final order issued on September 26, 2013 by the West Virginia Public Service Commission. New rates were put into effect October 11, 2013.

(5) The new rates provided additional annualized revenue of \$2.3 million in 2012 and \$4.3 million in 2011 for jurisdictional customers, and \$0.3 million in 2013 and \$0.5 million in 2011 for non-jurisdictional customers, which are not subject to commission approval.

(6) Amount includes a \$3.0 million increase effective April 1, 2012, with the remainder of \$1.4 million and \$1.2 million becoming effective April 1, 2013 and April 1, 2014, respectively.

The effective dates for the more significant increases granted in 2012 were January 1, 2012, April 1, 2012, May 1, 2012 and October 1, 2012 for our California, Missouri, New Jersey, and Illinois subsidiaries, respectively. The effective date for the 2011 Pennsylvania rate increase was November 11, 2011. The 2011 increase in Virginia was effective in March 2011 while the Tennessee and West Virginia increases were effective in April 2011.

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As previously noted, an increasing number of states are permitting rates to be adjusted outside of a general rate case for certain costs, such as mechanisms that permit a return on capital investments to replace aging infrastructure. The following table details additional annualized revenue authorized through infrastructure surcharge mechanisms which were granted in 2013, 2012 and 2011. As these surcharges are typically rolled into the new base rates and therefore are reset to zero when new base rates are effective, certain of these charges may also be reflected in the total general rate case amounts awarded in the table above if the order date was following the infrastructure surcharge filing date:

	Years Ended December 31,		
	2013	2012	2011
	(in millions)		
Infrastructure Charges:			
Pennsylvania (1)	\$ 19.8	\$ 10.5	\$ 16.4
New Jersey (2)	4.0	—	—
Missouri (3)	7.9	4.2	5.8
Indiana (4)	3.9	3.7	—
Illinois (5)	0.5	—	3.7
Other	—	—	0.3
Total—Infrastructure Charge	\$ 36.1	\$ 18.4	\$ 26.2

(1) Quarterly filings made with PUC. \$6.7 million, \$3.7 million, \$2.9 million and \$6.5 million effective October 1, 2013, July 1, 2013, April 1, 2013 and January 1, 2013, respectively.

(2) Effective July 1, 2013.

(3) \$5.4 million effective June 21, 2013 and \$2.5 million effective December 14, 2013.

(4) Effective December 18, 2013.

(5) Effective October 1, 2013.

Comparison of Results of Operations for the Years Ended December 31, 2013 and 2012

Operating revenues increased by \$29.5 million, or 1.1%, for the year ended December 31, 2013 compared to the same period in 2012. The increase in revenues was primarily due to rate increases obtained through rate authorizations for a number of our operating companies of which the impact was approximately \$72.4 million. Additionally revenues increased by \$16.4 million due to increased surcharge and amortization of balancing accounts. Lastly, revenues were higher by \$9.9 million as a result of acquisitions, with the most significant being the result of our New York acquisition in the second quarter of 2012 (additional four months of revenue in 2013 compared to 2012) and the acquisition of Dale by our Virginia subsidiary in the fourth quarter of 2013. These increases were partially offset by decreased revenues of approximately \$64.5 million as a result of lower demand, principally driven by the hot and dry weather conditions in the central and northeast portions of the country in 2012 versus cooler and wetter weather conditions in 2013.

The following table sets forth the amounts and percentages of Regulated Businesses' revenues and billed water sales volume by customer class:

For the Years Ended December 31,							
		Increase				Increase	
2013	2012	(Decrease)	Percentage	2013	2012	(Decrease)	Percentage
Operating Revenues				Billed Water Sales Volume			
(dollars in thousands)				(gallons in millions)			

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Customer Class									
Water service									
Residential	\$1,465,174	\$1,465,803	\$(629)	(0.0 %)	180,976	188,927	(7,951)	(4.2 %)	
Commercial	520,875	518,253	2,622	0.5 %	80,392	84,226	(3,834)	(4.6 %)	
Industrial	118,939	121,902	(2,963)	(2.4 %)	37,107	39,429	(2,322)	(5.9 %)	
Public and other	211,591	212,289	(698)	(0.3 %)	51,009	54,202	(3,193)	(5.9 %)	
Other water									
revenues	118,323	120,988	(2,665)	(2.2 %)	—	—	—	—	
Billed water									
services	2,434,902	2,439,235	(4,333)	(0.2 %)	349,484	366,784	(17,300)	(4.7 %)	
Unbilled water									
services	30,142	4,484	25,658	572.2 %					
Total water									
revenues	2,465,044	2,443,719	21,325	0.9 %					
Wastewater									
revenues	82,831	78,168	4,663	6.0 %					
Other revenues	46,043	42,547	3,496	8.2 %					
	\$2,593,918	\$2,564,434	\$ 29,484	1.1 %					

Water Services— Consistent with the above discussion, water service operating revenues for the year ended December 31, 2013 totaled \$2,465.0 million, a \$21.3 million increase, or 0.9%, over the same period of 2012. However, the mix between billed

revenues/billed volumes to unbilled revenues/unbilled volumes have changed significantly principally as a result of our CIS implementation. Unbilled revenue has increased \$25.7 million compared to the same period in the prior year mainly as a result of delayed invoicing to customers. With the implementation, we made a decision to increase the level of scrutiny and verification around bills being generated by the new system, in particular larger and/or more complex bills. As such bills that exceed certain tolerance levels are being held until verification can be performed. As such, the timing of issuance of bills has caused a decrease in billed volumes in 2013 when compared to 2012, with a corresponding increase in unbilled usage. For our residential and commercial customers, we believe that the majority of the decline in billed volumes is attributable to the weather abnormalities between 2012 and 2013 as well as the implementation of our new CIS system by our regulated subsidiaries. For the remaining customer classes, we believe the decline in billed volumes is mainly due to the delay in invoicing the customer as a result of our CIS implementation.

Wastewater services— Our subsidiaries provide wastewater services in 10 states. Revenues from these services increased by \$4.7 million, or 6.0%, to \$82.8 million for the year ended December 31, 2013, from the same period of 2012. The increase was primarily attributable to rate increases in our Pennsylvania subsidiary as well as the Dale acquisition in November, 2013.

Other revenues—Other revenues, which includes such items as reconnection charges, initial application service fees, certain rental revenues, revenue collection services for others and similar items, increased \$3.5 million, or 8.2%, compared to the year ended December 31, 2012. The increase in revenues for the year ended December 31, 2013 as compared to the same period in the prior year was mainly due to the additional surcharge revenues offset by decreases in revenues related to billings for others, reconnection and late fees.

Operation and maintenance. Operation and maintenance expense decreased \$24.5 million, or 2.2%, for the year ended December 31, 2013, compared to the year ended December 31, 2012. Operation and maintenance expense for 2013 and 2012, by major expense category, were as follows:

	For the Years Ended December 31,			
	2013	2012	Increase	
	(Decrease)			Percentage
	(Dollars in thousands)			
Production costs	\$271,181	\$274,775	\$ (3,594)	(1.3 %)
Employee-related costs	455,690	472,075	(16,385)	(3.5 %)
Operating supplies and services	215,702	210,947	4,755	2.3 %
Maintenance materials and supplies	65,853	81,062	(15,209)	(18.8 %)
Customer billing and accounting	52,625	49,257	3,368	6.8 %
Other	44,393	41,870	2,523	6.0 %
Total	\$1,105,444	\$1,129,986	\$ (24,542)	(2.2 %)

Production costs including fuel and power, purchased water, chemicals and waste disposal costs decreased by \$3.6 million, or 1.3%, for 2013 compared to 2012. Production costs by major expense type were as follows:

	For the Years Ended December 31,			
	2013	2012	Increase	
	(Decrease)			Percentage
	(Dollars in thousands)			
Purchased water	\$111,119	\$110,173	\$ 946	0.9 %

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Fuel and power	86,337	89,282	(2,945)	(3.3 %)
Chemicals	47,901	49,334	(1,433)	(2.9 %)
Waste disposal	25,824	25,986	(162)	(0.6 %)
Total	\$271,181	\$274,775	\$ (3,594)	(1.3 %)

Overall, production costs decreased for the year ended December 31, 2013 compared to the prior year as a result of reduction in chemical and fuel and power costs resulting from decreased usage mainly attributable to lower consumption in most of our states.

Employee-related costs including salaries and wages, group insurance, and pension expense decreased \$16.4 million, or 3.5%, for 2013 compared to 2012. These employee-related costs represented 41.2% and 41.8% of operation and maintenance expenses for 2013 and 2012, respectively, and include the categories shown in the following table:

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For the Years Ended December 31,
Increase

	2013	2012	(Decrease)	Percentage	
	(Dollars in thousands)				
Salaries and wages	\$323,022	\$326,370	\$ (3,348)	(1.0	%)
Pensions	48,374	56,299	(7,925)	(14.1	%)
Group insurance	65,872	71,103	(5,231)	(7.4	%)
Other benefits	18,422	18,303	119	0.7	%
Total	\$455,690	\$472,075	\$ (16,385)	(3.5	%)

The overall decrease in employee-related costs was primarily attributable to decreased salaries and wages, group insurance and pension expense. The decrease in salaries and wages was mainly the result of lower employee incentive and stock compensation expense of approximately \$5.9 million in addition to higher capitalization rates, due to increased capital investment, and a reduction in headcount partially offset by increased overtime and annual wage increases. The decrease in pension expense was primarily due to decreased contributions in certain of our regulated operating companies whose costs are recovered based on our funding policy, which is to fund at least the greater of the minimum amount required by the Employee Retirement Income Security Act of 1974 or the normal cost. The reduction in group insurance expense is mainly attributable to higher capitalization rates and reduced headcount.

Operating supplies and services include expenses for office operation, legal and other professional services, including transportation expenses, information systems rental charges and other office equipment rental charges. Overall, these costs increased \$4.8 million, or 2.3%, for the year ended December 31, 2013 compared to the same period in 2012.

For the Years Ended December 31,
Increase

	2013	2012	(Decrease)	Percentage	
	(Dollars in thousands)				
Contracted services	\$93,744	\$87,675	\$ 6,069	6.9	%
Office supplies and services	45,272	49,354	(4,082)	(8.3	%)
Transportation	20,620	22,917	(2,297)	(10.0	%)
Rents	15,830	16,943	(1,113)	(6.6	%)
Other	40,236	34,058	6,178	18.1	%
Total	\$215,702	\$210,947	\$ 4,755	2.3	%

The overall increase in operating supplies and services was primarily due to increased contracted services and higher other operating supplies and services. These increases were mainly due to incremental costs attributable to the continued maturity of our Enterprise Resource Planning system in conjunction with the implementation of Phase I and Phase II of our business transformation project. Additionally, contracted services increased due to the use of contractors for other specific projects. Other increases in the other operating supplies and services costs are related to a \$1.3 million increase in condemnation costs and a \$1.2 million increase in conservation expense as well as the inclusion in 2012 of a \$1.0 million reduction in anticipated insurance recovery of expenses incurred as a result of Hurricane Sandy and a \$2.1 million credit adjustment resulting from the finalization of rate decisions in California and are offset by \$1.6 million of insurance proceeds related to recovery of expenses related to Hurricanes Irene and Sandy received in 2013. The decrease in office supplies and services due to cost containment efforts primarily related to employee travel. Transportation costs decreased due to the reduction of leased vehicles.

Maintenance materials and services, which includes emergency repair as well as costs for preventive maintenance, decreased \$15.2 million, or 18.8%, for 2013 compared to 2012.

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For the Years Ended December 31,
Increase

	2013	2012	(Decrease)	Percentage
	(Dollars in thousands)			
Maintenance services and supplies	\$65,853	\$81,062	\$(15,209)	(18.8 %)

The decrease of \$15.2 million in 2013 is mainly attributable to 2012 including increased preventive maintenance expenses throughout our regulated subsidiaries, including hydrant and tank painting, meter testing, pump, tank and well maintenance, and paving costs.

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Customer billing and accounting expenses increased by \$3.4 million, or 6.8%, for 2013 compared to 2012.

	For the Years Ended December 31, Increase				
	2013	2012	(Decrease)	Percentage	
	(Dollars in thousands)				
Uncollectible accounts expense	\$26,443	\$22,541	\$ 3,902	17.3	%
Postage	12,757	12,694	63	0.5	%
Other	13,425	14,022	(597)	(4.3	%)
Total	\$52,625	\$49,257	\$ 3,368	6.8	%

The increase in the uncollectible accounts expense was primarily due to an increase in our Regulated Businesses' customer accounts receivable attributable to rate increases and an increase in the overall aging of receivables due to our CIS implementation.

Other operation and maintenance expenses include casualty and liability insurance premiums and regulatory costs. These costs increased by \$2.5 million, or 6.0%, for 2013 compared to 2012.

	For the Years Ended December 31, Increase				
	2013	2012	(Decrease)	Percentage	
	(Dollars in thousands)				
Insurance	\$35,406	\$31,883	\$ 3,523	11.0	%
Regulatory expenses	8,987	9,987	(1,000)	(10.0	%)
Total	\$44,393	\$41,870	\$ 2,523	6.0	%

Insurance costs in 2013 were higher, compared to 2012, primarily due to higher casualty insurance costs as a result of historical claims experience and retroactive adjustments.

Operating expenses. The increase in operating expenses for the year ended December 31, 2013 is primarily due to the higher O&M expenses as explained above, as well as higher depreciation and amortization expense of \$26.3 million and higher general tax expense of \$12.4 million. The increase in depreciation and amortization is primarily due to additional utility plant placed in service, including \$10.8 million of incremental expense resulting from the assets placed in service for our business transformation project. The increase in general tax expense is primarily due to higher property taxes in our New York subsidiary due to a full year of expense in 2013 on properties acquired in the second quarter of 2012 of \$5.2 million, the inclusion of property tax adjustments that reduced expense for our Indiana and Missouri subsidiaries by \$4.0 million in 2012, and higher 2013 gross receipts taxes in our New Jersey subsidiary of \$3.5 million.

Comparison of Results of Operations for the Years Ended December 31, 2012 and 2011

Operating revenues increased by \$195.5 million, or 8.3%, for the year ended December 31, 2012 compared to the same period in 2011. The increase in revenues was primarily due to rate increases obtained through rate authorizations for a number of our operating companies of which the impact was approximately \$128.7 million, and higher consumption in our mid-west and certain northeastern states in 2012 compared to 2011, which amounted to an increase of approximately \$39.1 million. The increased consumption is primarily attributable to the warmer/drier weather in our mid-western and certain of our northeastern states in the second and third quarters of 2012. Lastly,

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revenues were higher by \$26.7 million as a result of revenues from newly acquired systems, with the most significant being our New York acquisition in the second quarter of 2012.

The following table sets forth the amounts and percentages of Regulated Businesses' revenues and billed water sales volume by customer class:

Customer Class	For the Years Ended December 31,				Increase							
	2012		2011		Increase		2012		2011		Increase	
	Operating Revenues		Operating Revenues		(Decrease)	Percentage	Billed Water Sales Volume		Billed Water Sales Volume		(Decrease)	Percentage
	(dollars in thousands)				(gallons in millions)							
Water service												
Residential	\$1,465,803	\$1,338,671	\$127,132	9.5	%	188,927	180,916	8,011	4.4	%		
Commercial	518,253	473,904	44,349	9.4	%	84,226	81,455	2,771	3.4	%		
Industrial	121,902	114,096	7,806	6.8	%	39,429	39,295	134	0.3	%		
Public and other	212,289	206,290	5,999	2.9	%	54,202	52,069	2,133	4.1	%		
Other water revenues	120,988	117,598	3,390	2.9	%							