

Keynote Address
21st Annual National Low Income Energy Conference

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June 5, 2007

Good afternoon. I hope you have all enjoyed your lunch and that you have had a chance to talk among yourselves about the conference thus far. Also, I hope you feel as I do -- that it is an honor to be participating in the National Low Income Energy Consortium Conference here in Nashville. It is great to be doing something that really makes a difference in people's lives. And that's what the Consortium does. You help people in an important, tangible way.

For over twenty years the Consortium has been working to help low-income consumers find a way to afford critical utility services. Your group has identified some great opportunities for the public, private and non-profit sectors to work together to meet personal needs that seldom get newspaper headlines, but make a huge difference in the lives of the beneficiaries. In addition, the "Low Income Consortium" highlights the importance of working together to find these solutions.

Today, I am particularly pleased with the focus and attention given to water. This might be a change of pace for this group. Since your water bill is usually the lowest utility cost in the household, people sometimes forget that for many, even this expense is a challenge. As the Chief Operating Officer for American Water, I am part of a dedicated team of employees that delivers water to approximately 17 million people across 29 states. I've worked in the water business for thirty years so water, literally and figuratively, flows through my veins – taking into account that water makes up 83% of our blood. Like many of you, we provide service 24 hours a day, seven days a week, and one of our goals is to make sure that something as basic as water is available to everyone who needs it. But, as with other utility providers, we face a myriad of challenges if we want to continue supplying such an essential product.

Indeed, it is becoming increasingly important to recognize the challenges the water industry faces: Namely, that the value of water is underappreciated and that the cost of water will have to rise if we are to continue providing it safely and reliably. I would like for all of you here today to walk away from this luncheon with three things:

- First, I want you to understand some of the critical challenges we have within the water industry as we strive to provide a most basic resource.
- Second, I want you to learn about some of the solutions that have been discussed by the industry and implemented at American Water in order to make water service affordable and accessible to people across all backgrounds.
- And finally, I challenge us to find a way for all utilities to work together and more effectively deliver our service and address affordability issues.

Starting with my first point, I would like to describe to you some of the challenges we in the water industry currently face.

As mentioned before, the value of water is often underappreciated. Indeed, many still believe that water is a right they should not have to pay for. Water falls from the sky so it should be free. What other business has free inventory? However, while water sources such as rivers, lakes and aquifers certainly belong to all of us and are held in the public trust, there is a cost to pump, treat and deliver this water. Additionally, water is a very unusual and surprisingly complex product when compared to other utilities: it is heavy and hard to move (requiring large energy input), its quality can change in transport, sometimes requiring re-treatment, and its consumption directly impacts public health. Compared to water, it is easier and cheaper to move electronics, digital telephone, cable signals and even high pressure gas long distances.

The issue that faces us today is that the cost of providing water service is significantly increasing. While there are a variety of factors impacting costs, I would like to focus on three:

The first cost driver is infrastructure. There are some serious facts regarding the condition of water infrastructure in this country. For example:

- Up to \$1 trillion is needed over the next twenty years to replace aging water infrastructure. Most of these assets are buried and have been out of sight and mind for many years.

- Another challenge is that hundreds of cities are currently scrambling to find the resources simply to maintain the status quo, let alone improve water service, stop leakage from aging pipes or get ahead of infrastructure replacement demands. We are replacing pipes at a frequency rate that requires an asset life of 300 years. Unfortunately, our pipes do not last that long.

- Additionally, new systems have to be created from the ground up to cope with the population growth throughout the country.

Our water supply system in the US consists of a pipe network that stretches 700,000 miles – more than 4 four times the length of the national highway system – and it is in serious need of upgrading. If not repaired and replaced, it will not continue to support our water needs. Indeed, a well-managed, relatively new water system loses about 10% of treated water through pipe leakage whereas older systems can lose up 30 to 50%. I am sure other utilities would have difficulty working with these levels of product losses before reaching the customer.

The second cost driver is Environmental Protection Agency regulation. The EPA is continuously updating regulations on water safety and we applaud their efforts in ensuring water quality remains high. That said, increasingly stringent EPA regulations require treatment processes to be continually updated and tested. Compliance demands advanced levels of technology and operator skills. As such, compliance is becoming increasingly difficult and costly to meet. And while affordability is considered when developing water quality regulation, historically, EPA believed that as long as the water bill was less than 2.5% of the mean household income in a community (not above \$1000/yr) water was affordable. Therefore, no proposed water quality regulation has been found to be not affordable. However, most of us and many of our customers know differently.

Finally, a third cost driver relates to the landscape of the water industry itself. With approximately 53,000 water systems across America, the water industry is extremely fragmented, particularly if you compare it to electric with 3,200 systems or gas with 2,700 systems. Over 60% of water systems (or 30,000 systems) serve less than 500 people. Small customer bases mean that many communities do not benefit from the economies of scale that larger utilities can provide. Fortunately, systems operated by

American Water, for example (serving approximately 6% of the U.S. population), benefit from scale and have access to highly specialized scientists and engineering experts.

So what are the different ways we try to resolve these challenges? Here again, there are a multitude of initiatives and ideas that the water industry engage in every day.

Our experience tells us that in order to meet industry needs in the future we must consider consolidation as one possible solution to address the challenge of fragmentation in our industry. Consolidation, though, is not just about acquisition. It can also include common management, public-private partnerships or other innovative solutions. Ultimately, our goal is to have all interested parties work together to effectively meet the country's water challenges and overcome the issues of fragmentation.

As regards the infrastructure challenges: with 85% of the nation's water serviced by the public sector, the burden to finance the upgrades rests mainly on municipalities and ultimately, state and local governments. While the federal and state government has set up funds to help finance the infrastructure improvements with low interest loans to fix aging water infrastructure – funding is not even close to meeting the estimated \$1 trillion needed. One way to supplement this funding gap is for the public and private sector to work together. At American Water we have numerous Public-Private Partnerships where we assist in the design, build-and-rebuild and operation of a publicly-owned water system. Public-Private-Partnerships offer one of the most viable ways in which cash-strapped cities, towns and communities can access the capital and industry expertise of the private-sector. We believe and the USEPA believe these partnerships will play an increasingly critical role in helping the U.S. overcome its water infrastructure challenges.

I currently serve on USEPA National Drinking Water Advisory Council. As a member of that group, I recently spent two years as a member of an Affordability Work Group. Given that the water bill has the potential to increase to over \$1000/yr in the next decade (and much quicker for smaller systems), some creative and disturbing solutions have been discussed to address the consumer affordability issue. One idea was to not invest capital until Federal grant money is available to fund the infrastructure requirements. Unfortunately, adequate Federal funds will never be available. Federal funding for drinking water and wastewater treatment has declined 24% since 2001. Additionally, Federal grants subsidize all customers (regardless of financial needs) and

do not specifically target those with true financial needs at and below the poverty level. As with any industry, solutions to general problems only offer solutions to the general population. That's one reason American Water has always supported programs targeted toward low-income families rather than general grants and loans targeted to entire cities and towns.

An even more disturbing approach for achieving affordability is to allow a multi-tier service approach. Many small water systems are requesting USEPA to allow them to not comply with "expensive" water quality regulation or delay their compliance. This could mean that less affluent systems might be allowed to have 3 times the arsenic levels in their water than that required by regulation. This approach leads to some difficult questions. Who decides whether a community has an inferior water quality due to affordability issues? How is the public educated on the cost and risks associated with this decision? Since everyone on a water system must have the same water service regardless of income level, could this decision divide a community or impact those moving into a community? At American Water, we believe everyone should have access to safe, regulatory-compliant water. In our transient world, Americans should be able to turn on a faucet anywhere and be assured that the water is safe for themselves and their family. While desperate time can lead to desperate measure, we need to find other solutions to affordability that do not threaten public health.

Unfortunately low-income consumers are very much a reality in the U.S. The 2003 US census estimates that 12.5% of the population lives below the federal poverty level, about 18% of which are children. Right here in Tennessee 13.5% of the population live below the federal poverty level and about 20% of them are children. And because of the way the water industry is structured, low-income families do not have the choice of getting a cheaper supply of water somewhere else. This is where American Water strives for solutions that can meet the different needs of our customers.

The solution at American Water is known as H2O. Developed over 15 years ago in partnership with the \$1 Energy Fund, H2O – standing for "Help to Others" – was created to assist our low-income customers pay their water bills. The program was first offered in Pennsylvania.

Working in cooperation with regulators, H2O offers low-income customers assistance grants, discounts on monthly service fees, and water conservation devices and educational pamphlets. The program is funded by American Water, which matches customer contributions up to a certain amount.

To give you a better idea of how H2O works, let's look at Pennsylvania American Water, the first of our subsidiaries to offer this program. Pennsylvania American offers grants of up to \$500 per year per customer. Last year we provided a combined \$197,000 in assistance grants to 526 individuals and families, with the average grant at \$368. Customer contributions were matched up to \$100,000. Pennsylvania American also offers a 50% discount on its monthly service fee and currently there are 5,300 people enrolled in this program. In addition, Pennsylvania American delivers water saving devices that can be installed in the home as well as literature on how to conserve water, free of charge. Since Pennsylvania American's program was launched in 1991, more than \$1.6 million has been provided in grants to over 9,000 families.

Let me add, however, that the program is not considered a hand-out. To qualify, eligible customers must have made at least \$100 worth of payments in the last 90 days. And as a prerequisite for their participation, customers enrolled in the monthly discount program must agree to be customers in good standing with regard to regular bill payments.

Qualified customers find that the H2O Program is more than a means to overcoming financial hardships. It also gives them the tools and motivation to make changes in lifestyle habits and the habits of their family members—changes that can reduce water bills by eliminating water waste. Done effectively, these changes can benefit customers—not just once, but month after month and year after year.

The program also benefits American Water. By assisting customers who might not otherwise be able to pay their bills, American Water reduces the number of delinquent accounts, leading to fewer write-offs, collection efforts and red-tape. It also creates a feeling of good will among our customers – both to those that contribute and those that receive.

Another benefit of the H2O Program is that it connects customers with other sources of aid in the community by informing them of other assistance programs for

which they might qualify. This enables customers to better budget their income and leads to more manageable utility bills. By helping customers through tough times, we offer them a chance to work through their financial challenges and ultimately become self-sufficient.

Currently operating in Pennsylvania and New Jersey, we are also in discussion to bring H2O to Arizona, Virginia, West Virginia, and right here in Tennessee.

So where do we go from here? First, as a member of the American Water team, I say in earnest that we must continue bringing programs like H2O to more of our customers. As long as we have low-income consumers and people living below the poverty level, we must find ways to enable members of our communities to afford basics such as water.

Second, as a member of the water industry, we need to find more ways to make water affordable to individuals while still addressing some of the challenges I just outlined here today. We can achieve this goal by engaging in public-private partnerships with municipalities to help upgrade their infrastructure. We can do it by working with EPA to help develop better programs for cash-strapped communities to meet compliance. And we can attain it by consolidating the industry to create economies of scale, and by finding more way for communities to access capital and finance the increasing costs of water.

Finally, as a participant in this Consortium, I would like to see more ways for all of us here to work together and positively impact people's lives. The "Low-Income Consortium" is meaningful because progress requires coordination among all of the groups present here today. I believe that working together can be a powerful model for how to address increasing costs regarding the infrastructure challenges we all face. Indeed, energy, communications, and water are interdependent. Eight (8) percent of the energy demand in the U.S. is used to treat, move and heat water. If one utility fails, the other will too. As such, our solutions – whether they are as broad as our infrastructure needs or as specific as our low-income consumers' needs – must be developed interdependently if we are to create the kinds of synergies we need. Given that many of us work with and through similar regulators and legislators we may want to consider initiating a task force that can develop and discuss such solutions. Ultimately, it is in the

interest of all of us to find ways to work together both here at the NLIEC and beyond in addressing service and customer affordability issues.

Thank you for your attention and I hope you have a productive and enjoyable time at the conference. American Water is very pleased to host tonight's event, "The Sounds of Tennessee", which promises to be fun-filled and in an atmosphere that is conducive to networking. I look forward to seeing you there.