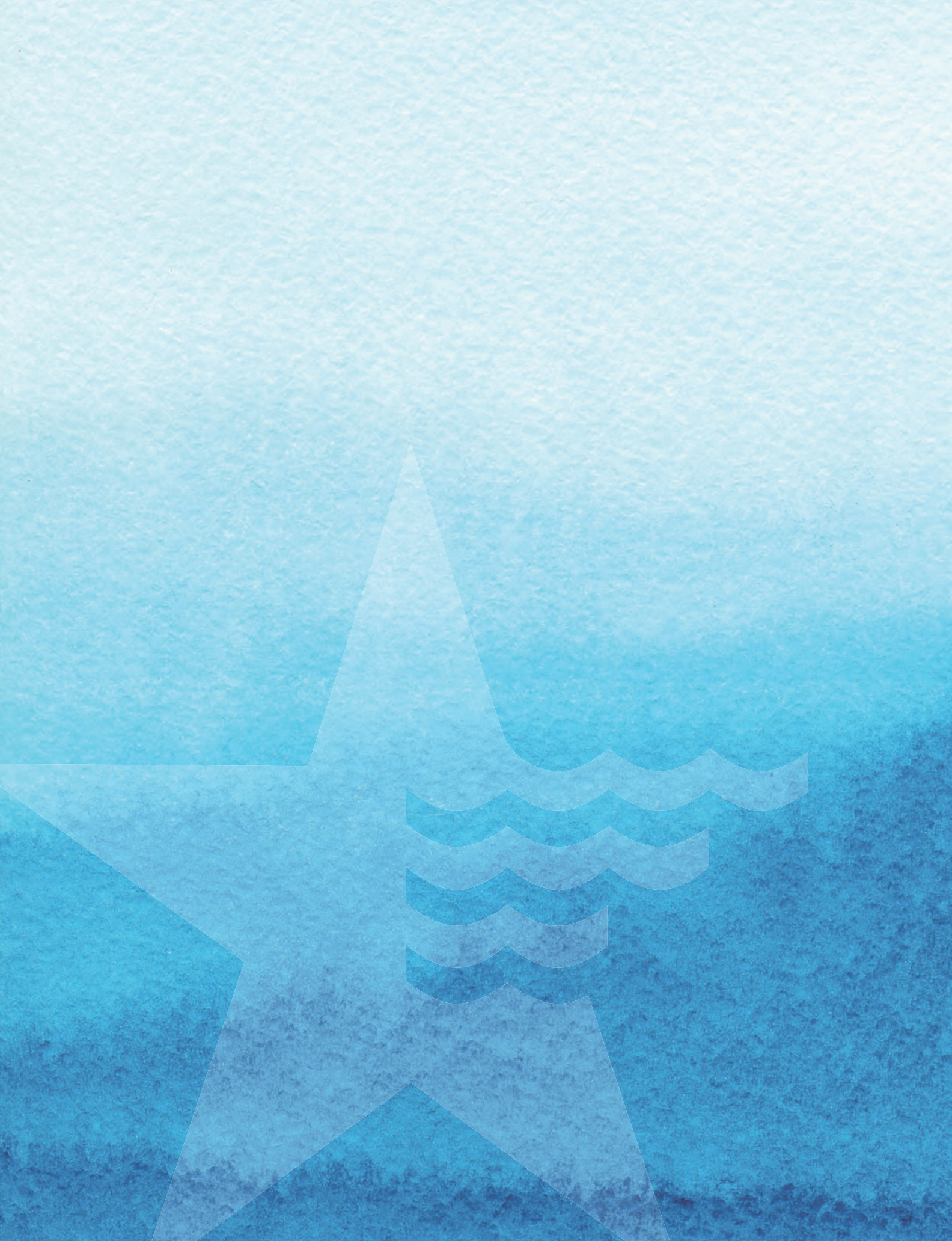


THE DIFFERENCE IS PEOPLE



AMERICAN WATER

2015 ANNUAL REPORT





Dear Fellow Stockholder,

Creating value for customers, communities, employees and shareholders is a driving force at American Water. American Water's **employees have created a company where customer focus and continuous improvement are fully ingrained into its culture.** This is reflected in the positive results that the company delivered in 2015.

American Water's 2015 financial performance, detailed in this report, gives the Board confidence that the company is well positioned to achieve its stated target of 7 to 10 percent long-term diluted earnings per share (EPS) growth. Additionally, in recognition of this financial performance, our Board continued its long-standing commitment of approving dividend payments that are commensurate with EPS growth. We increased the quarterly dividend by 10 percent in the second quarter, from \$0.31 to \$0.34 per share of common stock, for an annualized dividend of \$1.36 per share of common stock. This is consistent with our target payout ratio of 50 to 60 percent of earnings.

As an owner of American Water, you enjoyed **a total shareholder return (TSR) of 14.9 percent** during 2015—well above the TSR for the S&P 500 Index, which for 2015 was just 1.4 percent.

These results are an outcome of the sound execution of American Water's business strategy, which allowed the company to continue to provide **safe, clean, reliable and affordable water** and wastewater services. Through a continued focus on customers, communities and delivering company goals, American Water has a pathway to sustainable and profitable growth.

On behalf of the company and the Board, we want to thank you for your continued support and investment. I personally enjoyed meeting many of you at both our 2015 Annual Meeting of Stockholders as well as our well-attended Investor Day in New York City on December 15, 2015.

We look forward to what American Water will accomplish in 2016.

Sincerely,

A handwritten signature in black ink that reads "G. MacKenzie". The signature is written in a cursive, slightly stylized font.

George MacKenzie
Chairman of the Board

Dear Fellow Stockholder,

American Water celebrates its 130th anniversary in 2016. We are a company that is rich in heritage, with the promise of a bright future. We pride ourselves on keeping the best from our past while reaching out to that which will enable us to continue our success in the coming years.

In this report, you will see the results of another year of **strong financial performance**, with 2015 diluted earnings per share from continuing operations up 10.5 percent compared to full year 2014. But financial success is an outcome, and that alone does not explain why a company flourishes year after year. Our heritage, our success and our future are and will continue to be a direct result of the **talented people who work for American Water**, our customers and communities. Great people make great companies.

It all starts with the commitment our employees have to customers. From a historic drought in California to harsh winter months that resulted in a higher number of main breaks in the Midwest to achieving water quality results that are 13 times better than the industry average for meeting drinking water requirements, our tremendously talented and dedicated team of 6,700 professionals successfully dealt with many challenges in 2015.

Beyond overcoming challenges, our people really shine when it comes to delivering life-sustaining services every day. They not only understand why we do what we do, but also that how we do what we do is critically important. They operate safely because they care about one another. They strive to deliver the highest water quality because they know there is a family at the end of every faucet or tap. And they work efficiently because they see what affordable water services mean to our customers who live in their own communities.

In 2015, we invested almost \$1.2 billion in our water systems, and at the same time our employees continued to improve our efficiencies in how we operate. Why is this combination important? For every \$1 in operating and maintenance (O&M) costs we save, we can invest \$6 of capital without increasing our customers' bills. In our 2015 rate cases, our O&M expenses were on average 17 percent less than what we had spent on O&M in those states' previous rate cases. This allowed us to invest \$65 million into infrastructure without impacting our customers' bills. By maintaining effective cost controls in a fair and constructive regulatory environment, we can make a big infrastructure impact without a big bill impact, while ensuring that, for decades to come, our service will be safer and more reliable.

Our talented and deeply experienced people also drive innovation. In addition to our ongoing investment to replace aging infrastructure, our engineers are working to develop and deploy an intelligent water system that is more resilient and efficient, and provides more and better information for our customers. We are focused on a "one water" cycle, with a special emphasis on water reuse and recycling as we face water supply issues across the U.S.

Our scientists are working with the Environmental Protection Agency as well as water and wastewater research foundations and companies across the globe to continue technological advances in treating emerging water contaminants and addressing physical and cybersecurity challenges. And our leaders are working with state and federal officials to help the nation and our states tackle serious water infrastructure challenges beyond our company. In fact, since 2010, five of the states we serve have added legislation that directly helps communities address distressed water and wastewater systems.



Susan N. Story
President &
Chief Executive Officer

Additionally, it's our people in the communities we serve leading efforts such as United Way, Habitat for Humanity and the American Heart Association, just to name a few. More than 2,000 American Water employees also participated directly in 113 different community volunteer projects during our annual month of giving in 2015. **Our employees create a measurable, lasting impact on so many—their neighbors, their communities, our customers.**

Operating in the right way is also how we grow. **Through acquisitions and organic growth, we have added and have pending nearly 42,000 customers in our Regulated service areas through 2015 efforts.**

On the market-based side of the business, during 2015 we added our 12th military customer, Vandenberg Air Force Base; were awarded the operation and maintenance contract for the City of Camden, serving 13,000 water and wastewater customers; and grew our Homeowner Services business to 1.6 million contracts.

We welcome all of these new customers and bring to them the same dedication, commitment and service we have provided to all of our customers since 1886.

We also closed our acquisition of Keystone Clearwater Solutions. This acquisition added 300 tremendously talented people and an outstanding leadership team dedicated to providing safe and environmentally responsible water services to customers in the natural gas exploration and production market in the Appalachian basin. We believe Keystone will create opportunities for us to provide sustainable water solutions to the industry as the shale market in the Marcellus and Utica formations grows in the coming years.

Lastly, we have delivered leading total shareholder return. In 2015, our total shareholder return was almost 15 percent. Additionally, we continued to strengthen our balance sheet and increase our dividends.

We know when you choose to invest in American Water, as compared to other potential investments, you look at numerous metrics—and that is smart. We also know that any company's only sustainable competitive advantage is its people. I sincerely believe that we have the best in the business. Few people get the privilege of working with their heroes every day, and I am so fortunate that I am among those few.

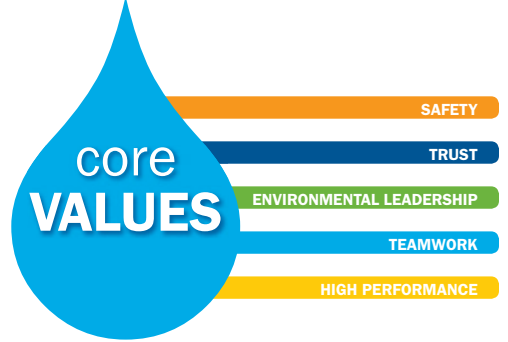
On behalf of the company and our 6,700 employees, I want to thank you for your continued support. We are proud of what our people achieved in our first 130 years—and we are even more excited about our future. We hope that you are too.

Sincerely,



Susan N. Story
President & Chief Executive Officer





What is a core value? For American Water, it is more than simply a guideline or a goal. As the name implies, it is a fundamental principle, embedded in the heart of an organization’s culture, that shapes its every action.

For us, safety is a paramount value—and not just for those whose jobs expose them to risk. Every one of the 6,700 employees of American Water all across the country is required to create personal safety goals and plans for carrying them out. In a given year, each employee receives an average of 16 hours of individual safety training, for a companywide total of more than 60,000 hours.

We believe that safety begins with prevention. All employees are expected to report real or potential hazards as quickly as possible so that they can be corrected and the information can be shared across the company. Even suppliers and contractors must meet the same stringent safety standards before we work with them.

Because our concern for the people of American Water extends well beyond the workplace, so too does our focus on safety. So it’s not surprising that American Water employees like Victor Munguia and Joe Simmons make these values part of their daily lives.

Quick thinking saves a baby

A constant theme in our safety training is the idea of situational awareness—being alert to what is going on around you at all times. It’s hard to imagine a more dramatic example of this than the day Victor Munguia saved a baby who had wandered onto a busy road in Monterey, California. Munguia, a service technician with California American Water, was driving to a job site when he saw a small object moving in the street. He stopped to look and realized it was a 9-month-old baby that had crawled unnoticed through a front door and an unlocked gate, down the driveway, and into the street. Munguia quickly picked up the child. When the frantic mother came rushing out, Munguia gently handed her the infant. Although he was nominated for a company award, Munguia didn’t want to claim all the credit. “My mom had recently passed away. When someone said, ‘There must have been an angel out there,’ I thought, ‘That must have been her.’”

Safety training proves lifesaving

On a routine drive with his son on an ordinary day in Dysartsville, North Carolina, Joe Simmons was suddenly confronted by a harrowing sight: Trying to avoid a car, a speeding motorcycle upended, flipped and flew into a nearby field. **Simmons, a wastewater plant operator with Contract Services Group’s Spruce Pine facility, leaped into action.** Telling his son to call 911, he ran to the unmoving cyclist. “He was bleeding from his nose and mouth and I couldn’t feel a pulse. So I unzipped his jacket and starting doing chest compressions.” After 20- to 25 compressions, the man took a breath and his pulse returned to his neck. An EMT team airlifted him to the nearest trauma center, where he was found to have been seriously injured with a broken back, but expected to survive. Simmons attributes his quick action to the CPR training he had received at work. “I just want to thank the company for providing me with such important training. Without it, I couldn’t have helped him.”



Joe Simmons

 OUR CORE VALUES

Victor Munguia

Members of the American Water Safety Council

SAFETY



Ruth Marfil-Vega,
Environmental Scientist

TRUST

We believe that trust is not given; it is earned, every time a tap is turned, a child's glass is filled or a baby's bath is drawn. American Water works hard to meet the highest-possible standards for water quality. Not only do we meet them, we often surpass them.

Our record of compliance for meeting all drinking water requirements is 13 times above the industry average. To date, American Water has received more than 65 Environmental Protection Agency awards for voluntarily surpassing drinking water standards.

How does a company meet such demanding standards of quality? By setting its own standards even higher. Our water quality control and testing laboratory in Belleville, Illinois, is one of the most technologically advanced facilities of its kind in the country. It houses a research team of scientists who are recognized as leaders in their fields, and who have been awarded nearly 80 research grants and five patents based on their work.

Because water is such a precious resource, we must not only be a supplier of water, we must be a steward as well. That is why many of the advances we make are shared with the water industry as a whole.

Last year, American Water's achievements in research and innovation were honored by the American Water Works Association (AWWA)—the largest scientific and educational institution dedicated to the management and treatment of water.

A recognition of leadership

The A.P. Black Award is given by the AWWA "to recognize outstanding contributions to water science and water supply over an appreciable period of time." The 2015 honoree, Mark W. LeChevallier, directs American Water's research and environmental compliance programs. He has also led the company's Innovation Development Process, which tests and develops new technologies for use within American Water and throughout the industry.

Dr. Mark LeChevallier



"American Water was different"

A microbiologist and the author or co-author of more than 100 research papers, LeChevallier joined American Water not long after the creation of the company's formal research group. "I found American Water to be different than other utilities I had worked with, in that they really wanted to know if there was an issue and wanted to improve as a result. It was that culture of learning that attracted me."

"Important problems to solve"

Today, LeChevallier believes research has never been more vital. "There are exciting and important problems to solve—including climate variability, aging infrastructure, environmental sustainability, system resiliency, big data analysis, customer satisfaction and more. The challenge is to bring new innovation to these problems and to use it to create cost-effective solutions that benefit both the company and our customers."

"Through the awarding of research grants to help offset our costs, as well as our ability to conduct research across 300 drinking water and 200 wastewater systems across the country, we can apply economies of scale to our research program. We have consistently generated a more than three-to-one return on every dollar invested in research."

"A noble profession"

"Working on water issues is a noble profession. One that meets basic human needs but also has a lasting impact on communities and civilizations. It is one of those professions where, at the end of your career, you can look back and say that you've made a difference."

They're repair crews, construction workers, and project managers. Scientists, engineers, and technicians. Systems analysts, human resources managers, and accountants. Customer service representatives, dispatchers, and drivers—and more.

They're the people of American Water. And what makes them remarkable is not just the vast range of the jobs they do every day, but their ability to merge their many skills into one. They work as a team unified by a single mission: providing every customer clean, affordable, and reliable water when and where they need it.

At American Water, we understand that every team is only as strong as the individuals within it. That's why we encourage every employee to strive for professional and personal growth; provide our people with the tools and training they need to excel; and recognize their achievements and contributions.

We promote and support a diverse culture that works together to meet common goals. We hold each other accountable and challenge each other to reach new goals. And, because we believe that transparency and teamwork go hand in hand, we share information with our people and value their feedback. At American Water, teamwork is both a core value and a shared one—at every level.

“Road Warriors” help battle historic drought

At California American Water's Sacramento office, Operations Supervisor Becky Cassidy and Operations Specialists Karen Wilhelm and Kurt Corothers have been dubbed the “road warriors.” Through their routine visits to customers' homes, they have become the face of the company in the local community.

As the most severe drought in California's history intensified, their role became even more critical. Their water use audits, which feature checks for leaks in sinks and toilets, have made residents aware of the many ways in which water can be conserved, even down to turning off the tap while brushing their teeth. With their visits, the teams often provide a free kit that can include low-flow showerheads, garden hose nozzles, and conservation recommendations.

The “Road Warriors” also make sure to attend after-hours and weekend community events to help share water-saving tips and techniques with local residents. The team's passion for conservation is paying off. With the help of their efforts, water demand in the Sacramento area was 11 percent less than the prior year. “Conserving water isn't just a California problem or even a national one,” said Wilhelm. “It's a precious resource that we need to protect the world over.”

Teamwork without borders: Forging a new partnership.

The spirit of teamwork at American Water isn't always contained within the company.

Last year, our Homeowner Services (HOS) subsidiary announced a partnership with the Orlando Utilities Commission (OUC) to offer Home Warranty Protection programs to residents in Orlando, St. Cloud and nearby communities in Florida.

These programs offer protection from the costs of repairs to exterior sewer and water lines, as well as in-home plumbing problems and electric line failures that are not typically covered by homeowners insurance.

In its role as manager of the programs, HOS will establish a local contractor network, provide bilingual customer service and educate homeowners about their responsibilities.

“We are honored to partner with OUC to provide these customized protection programs to its customers,” said HOS President Malcolm Conner. “OUC shares in our commitment to reliability, dependability, customer service and community.”



California Road Warriors Kurt Corothers, Karen Wilhelm and Becky Cassidy

TEAMWORK



New Jersey American Water employees Kevin Bennett (left) and Fred DaSilva

*Rick Dixon,
Pennsylvania American Water*

ENVIRONMENTAL LEADERSHIP



As the nation's largest publicly traded water company, American Water strives to lead the way in safeguarding the quality of water we supply to our customers—and in helping to preserve the health of the environment that is its source. Because environmental health and water quality are so intertwined, we apply an integrated approach to managing them.

Take, for example, our initiatives to protect watershed biodiversity. As development infringes on these sensitive areas, water quality can be affected. To help promote more-robust ecosystems, each American Water facility has developed an Environmental Management Plan, which includes strategies for environmental stewardship—including biodiversity—with a focus on watersheds and local resource management.

We are also working hard to cut waste and reduce our carbon footprint. About 90 percent of the energy consumed by water companies is used to pump water. By steadily replacing or refurbishing older, less efficient pumps, we have reduced our greenhouse gas emissions by 18 percent since our 2007 baseline.

At American Water, our job is not just ensuring water quality for today, but protecting it for generations to come.

Water recycling creates new liquid assets

The environmental benefits of paper, plastic and metal recycling are well known, but the potential of water recycling is only just beginning to be realized. When wastewater is reclaimed and treated for uses that don't require potable water, such as industrial processes and landscape irrigation, it helps the environment in many ways. The stress on lakes and aquifers is reduced, and less energy is spent pumping, treating and transporting fresh water.

Fort Sill in Oklahoma is one of 12 military bases served by American Water's Military Services Group and one of the most affected by recent drought conditions.

The Fort's wastewater treatment plant discharges as much as two million gallons of treated wastewater every day. Now, with the help of American Water, it can use nearly half of that to irrigate the post's grounds. According to General Manager Ronnie Graves, use of reclaimed water on the base golf course alone cut usage by over 36 million gallons a year.

"We took a lot of steps," said Graves, "including exposing the water to ultraviolet light to eliminate pathogens, to ensure that water would be safe."



Aman Gonzalez

A partnership for river renewal

Built in 1921, California's San Clemente Dam had long outlived its usefulness. Sediment built up over the years had severely limited its water storage capacity, and its vulnerability to earthquakes and floods had made it a danger to downstream communities.

California American Water, which owned the dam, teamed up with California

State Coastal Conservancy, NOAA Marine Fisheries and California Department of Fish and Wildlife to embark on a massive, \$84 million multiyear project to first divert upstream rivers away from the dam and then remove the structure. Dam demolition began in 2015 and is expected to be completed in 2016.

The final step in the project will be California American Water's donation of over 900 acres around the dam for the creation of a recreational area.

"This has been one of the biggest and most important projects of my career," said the project's manager, Aman Gonzalez. "It protects residents by removing a seismically unsafe dam, and it also restores the Carmel River, which will help revive the populations of threatened species in the area."

When the product you provide is something as critical and invaluable as water, high performance means challenging yourself to the highest standards of quality and reliability—every minute, every hour, every day. And it means constantly innovating new ways to raise those standards even higher.

Every year, American Water invests an average of nearly \$4 million in research and development, with a special focus on safety, supplying clean and affordable water, and ensuring a sustainable supply. To further accelerate progress, we have created a program that is itself an innovation: our Innovation Development Process brings stakeholders from across the company to evaluate, explore and test new ideas.

Recent initiatives have included smart meters that use demand response to generate greater efficiencies in energy use; acoustic monitoring systems that detect leaks in pipelines before they become problems; new techniques and technologies for recycling and reusing wastewater; and many other exciting new ideas and possibilities.

For everyone at American Water—from research teams to repair crews—exceeding expectations is an individual goal. And a team effort.

Performing at flood stage

The rain began the day after Christmas, and just kept coming. By the time it ended on December 28, record floods covered much of the Missouri and Illinois area. The people of American Water rose to the challenge.

Even before the storm was over, crews in Missouri were filling up water tanks to maintain pressure and ensure supply, and constructing systems to draw water from sources untouched by the flooding. When rising waters threatened pumps, crews worked overtime to move them. Others delivered fuel by boat to keep backup generators running.

“Everyone chipped in during the holiday week,” said Cindy Hebenstreit, director of operations for St. Louis County. “Operations, engineering, water quality, safety, security, external and government affairs—it’s been a great example of teamwork.”

In central and northern Illinois, the flooding was compounded by a major ice storm that left 20,000 residents without power for several days. But thanks to recent electrical upgrades and new generators, water service continued without interruption.

“It was a tense and taxing situation,” said Mike Smyth, vice president of operations for Illinois American Water. “Our teams were not only working through flooding at our facilities, but also rising water on the roads.”

“The performance of our employees was outstanding. Their commitment to our customers and to each other is something we can learn from and take pride in.”

Missouri American Water employees Tim Pierce, Neil Massie, Mark Stumpe and Aaron Turner



Putting the power of technology to work

A geographic information system (GIS) is a computer system for capturing and displaying data related to positions on the earth’s surface. **The GIS team at New Jersey American Water** uses this powerful tool to pinpoint underground infrastructure, such as valves, hydrants, mains, service lines and manholes, as well as above-ground facilities like wells, treatment plants, tanks and pump stations.

Knowing the precise location of assets can make a critical difference when natural disasters strike. When Superstorm Sandy hit New Jersey in 2012, our teams were able to detect assets buried under deep sand within a foot of their location and help customers quickly recover water resources.

“GIS can be even more valuable in day-to-day operations” says Chris Kahn, Senior GIS Projects Manager. The better we understand the location of our assets and other environmental features, the better we can control our systems.”



HIGH PERFORMANCE



New Jersey
American Water
GIS Team

Providing Clean Water for Life is vital to our communities.

Our focus on our customers resulted in another year of effectively providing clean, safe, reliable and affordable water and water services to millions of people every day.

CORPORATE INFORMATION

**Independent Registered
Public Accounting Firm**
PricewaterhouseCoopers LLP
Two Commerce Square, Suite 1700
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Philadelphia, PA 19103-7042

Stock Transfer Agent
American Stock Transfer
& Trust Company, LLC
6201 15th Avenue
Brooklyn, NY 11219
Phone: 1-800-937-5449

BOARD OF DIRECTORS

Susan N. Story
President and Chief Executive Officer
of American Water Works Company, Inc.

George MacKenzie
Non-Executive Chairman of the Board
*Former Vice Chairman and Chief Financial
Officer of Hercules Incorporated*

Julie A. Dobson
Director
*Former Chief Operating Officer and
Founding Principal of TeleCorp PCS, Inc.*

Paul J. Evanson
Director
*Former Chairman, Chief Executive Officer
and President of Allegheny Energy, Inc*

Martha Clark Goss
Director
*Former Chief Operating Officer
and Chief Financial Officer of
Amwell Holdings/Hopewell Holdings, LLC*

Richard R. Grigg
Director
*Former Executive Vice President of
First Energy Corporation and President
of First Energy Utilities Group*

Veronica M. Hagen
Director
*Former Chief Executive Officer
of Polymer Group, Inc. (now known
as AVINTIV Specialty Materials Inc.)*

Julia L. Johnson
Director
President of NetCommunications, LLC

Karl F. Kurz
Director
*Former Chief Operating Officer,
Anadarko Petroleum Corporation*

William J. Marrasso*
Director
*President, WHYY, Inc.
Broadcasting*

*Not standing for re-election in 2016

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015

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
(State or other jurisdiction of
incorporation or organization)

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

51-0063696
(I.R.S. Employer
Identification No.)

08043
(Zip Code)

(856) 346-8200

(Registrant's telephone number, including area code)

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
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—\$7,839,400,000 as of June 30, 2015 (solely for purposes of calculating this aggregate market value, American Water has defined its affiliates to include (i) those persons who were, as of June 30, 2015, its executive officers, directors or known beneficial owners of more than 10% of its common stock, and (ii) such other persons who were deemed, as of June 30, 2015, to be controlled by, or under common control with, American Water or any of the persons described in clause (i) above).

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—178,008,765 shares as of February 19, 2016.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the American Water Works Company, Inc. definitive proxy statement for the 2016 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission within 120 days after December 31, 2015 are incorporated by reference into Part III of this report.

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FORWARD-LOOKING STATEMENTS

We have made statements in Item 1—Business, Item 1A—Risk Factors, and Item 7—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, as amended, Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), 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,” “assume,” “forecast,” “outlook,” “future,” “pending,” “goal,” “objective,” “potential,” “continue,” “seek to,” “may,” “can,” “should,” “will” and “could” or the negative of such terms or other variations or similar expressions. Forward-looking statements may relate to, among other things, our future financial performance, including our operation and maintenance (“O&M”) efficiency ratio, cash flows, our growth and portfolio optimization strategies, our projected capital expenditures and related funding requirements, our ability to repay debt, our projected strategy 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 or assurances of any outcomes, financial results or levels of activity, performance or achievements, and you are cautioned not to place undue reliance upon them. These forward-looking statements are subject to a number of estimates and assumptions, and known and unknown risks, uncertainties and other factors. Our actual results may vary materially from those discussed in the forward-looking statements included herein as a result of the factors discussed under Item 1A—Risk Factors, and the following important factors:

- the decisions of governmental and regulatory bodies, including decisions to raise or lower rates;
- the timeliness of regulatory commissions’ actions concerning rates, permitting and other decisions;
- 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 safety, water quality and public utility regulations and policies;
- weather conditions, patterns, events or natural disasters, including drought or abnormally high rainfall, strong winds, coastal and intercoastal flooding, earthquakes, landslides, hurricanes and tornados;
- the outcome of litigation and government action related to the Freedom Industries spill in West Virginia;
- our ability to appropriately maintain current infrastructure, including our technology systems, 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;
- the intentional or unintentional actions of a third party, including contamination of our water supplies and attacks on, or infiltration of, our computer systems or other critical infrastructure;
- 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 meet growth projections for our business and capitalize on growth opportunities, including our ability to, among other things:
- acquire and integrate water and wastewater systems into our regulated operations; and
- enter into contracts and other agreements with, or otherwise acquire, new customers in our market-based businesses, including with respect to the provision of water services to customers in the natural gas exploration and production market;
- cost overruns relating to improvements in or the expansion of our operations;
- our ability to maintain safe work sites;
- our exposure to liabilities related to environmental law and similar matters resulting from, among other things, the provision of water services to customers in the natural gas exploration and production market;
- changes in general economic, business and financial market conditions;
- access to sufficient capital on satisfactory terms and when and as needed to support operations and capital expenditures;
- 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;
- changes in federal or state income tax laws, including tax reform, the availability of tax credits and tax abatement programs, and our ability to utilize our U.S. and state net operating loss carryforwards;
- migration of customers into or out of our service territories;
- the use by municipalities of the power of eminent domain or other authority to condemn our systems;
- difficulty in obtaining, or the inability to obtain, insurance at acceptable rates and on acceptable terms and conditions;
- the incurrence of impairment charges related to our goodwill or other assets;
- labor actions, including work stoppages and strikes;
- ability to retain and attract qualified employees; and
- civil disturbances or terrorist threats or acts, or public apprehension about future disturbances or terrorist threats or acts.

These forward-looking statements are qualified by, and should be read together with, the risks and uncertainties set forth above and the risk factors included in Item 1A—Risk Factors and other statements contained in this Form 10-K, and you should refer to such risks, uncertainties and risk factors in evaluating such forward-looking statements. Any forward-looking statements we make speak only as of the date this Form 10-K was filed with the United States Securities and Exchange Commission (“SEC”). Except as required by the federal securities laws, 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. New factors emerge from time to time, and it is not possible for us to predict all such factors. Furthermore, it may not be possible to assess the impact of any such factor on our businesses, either viewed independently or together, or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. The foregoing factors should not be construed as exhaustive.

PART I

ITEM 1. BUSINESS

Our Company

Founded in 1886, American Water Works Company, Inc. (the “Company” or “American Water”) is a holding company incorporated in Delaware. American Water is the largest and most geographically diverse investor owned publicly-traded United States water and wastewater utility company, as measured by both operating revenues and population served. We employ approximately 6,700 professionals who provide drinking water, wastewater and other related services to an estimated 15 million people in 47 states, the District of Columbia and Ontario, Canada.

Operating Segments

We conduct our business primarily through our Regulated Businesses segment. We also operate several market-based businesses that provide a broad range of related and complementary water and wastewater services, which include four operating segments that individually do not meet the criteria of a reportable segment in accordance with generally accepted accounting principles in the United States (“GAAP”). These four non-reportable operating segments are collectively presented as our “Market-Based Businesses,” which is consistent with how management assesses the results of these businesses. Additional information can be found in Item 7—Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note 19—Segment Information in the Notes to Consolidated Financial Statements.

Regulated Businesses

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. Our subsidiaries that provide these services operate in approximately 1,600 communities in 16 states in the United States and are generally subject to regulation by certain state commissions or other entities engaged in utility regulation, referred to as Public Utility Commissions or (“PUCs”). The federal and state governments also regulate environmental, health and safety, and water quality matters. We report the results of the services provided by our utilities in our Regulated Businesses segment.

Our Regulated Businesses segment’s operating revenues were \$2,743 million for 2015, \$2,674 million for 2014 and \$2,594 million for 2013, accounting for 86.8%, 88.8% and 90.1%, respectively, of total operating revenues for the same periods.

The following table summarizes our Regulated Businesses’ operating revenues, number of customers and estimated population served by state, each as of December 31, 2015:

	<u>Operating Revenues (In millions)</u>	<u>% of Total</u>	<u>Number of Customers</u>	<u>% of Total</u>	<u>Estimated Population Served (In millions)</u>	<u>% of Total</u>
New Jersey	\$ 704	25.7%	660,580	20.3%	2.7	22.3%
Pennsylvania	614	22.4%	672,407	20.7%	2.3	19.0%
Illinois (a)	270	9.8%	313,058	9.6%	1.3	10.7%
Missouri	269	9.8%	473,245	14.5%	1.5	12.4%
Indiana	206	7.5%	295,994	9.1%	1.3	10.7%
California	198	7.2%	174,942	5.4%	0.6	5.0%
West Virginia (b)	129	4.7%	169,037	5.2%	0.6	5.0%
Subtotal (Top Seven States)	<u>2,390</u>	<u>87.1%</u>	<u>2,759,263</u>	<u>84.8%</u>	<u>10.3</u>	<u>85.1%</u>
Other (c)	353	12.9%	493,428	15.2%	1.8	14.9%
Total Regulated Businesses	<u>\$2,743</u>	<u>100.0%</u>	<u>3,252,691</u>	<u>100.0%</u>	<u>12.1</u>	<u>100.0%</u>

(a) Includes Illinois-American Water Company and American Lake Water Company.

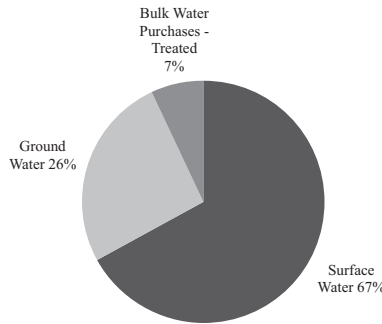
(b) Includes West Virginia-American Water Company and its subsidiary Bluefield Valley Water Works Company.

(c) Includes data from our utilities in the following states: Georgia, Hawaii, Iowa, Kentucky, Maryland, Michigan, New York, Tennessee and Virginia.

Water Supply and Wastewater Services

Our Regulated Businesses generally own the physical assets used to store, pump, treat and deliver water to our customers and collect, treat, transport and recycle wastewater. 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. We are dependent on a defined source of water supply and obtain our water supply from surface water sources such as reservoirs, lakes, rivers and streams; from ground water sources, such as wells; and water purchased from third party water suppliers.

The following chart depicts the sources of water supply as of December 31, 2015:



The percentages of finished water supply by source type for our top seven states based on our Regulated Businesses operating revenues for 2015 were as follows:

	<u>Surface Water</u>	<u>Ground Water</u>	<u>Purchased Water</u>
New Jersey	72%	23%	5%
Pennsylvania	92%	7%	1%
Illinois	52%	37%	11%
Missouri	80%	19%	1%
Indiana	43%	56%	1%
California	—	65%	35%
West Virginia	100%	—	—

Our ability to meet the existing and future water demands of our customers depends on an adequate water supply. Drought, governmental restrictions, overuse of sources of water, the protection of threatened species or habitats, contamination, or other factors may limit the availability of ground and surface water. We employ a variety of measures in an effort to obtain adequate sources of water supply, both in the short-term and over the long-term. The geographic diversity of our service areas may mitigate some of the economic effect on the water supply associated with weather extremes we might encounter in any particular service territory. For example, in any given summer, some areas may experience drier than average weather, which may reduce the amount of source water available, while other areas we serve may experience wetter than average weather.

In our long-term planning, we evaluate quality, quantity, growth needs and alternate sources of water supply as well as transmission and distribution capacity. Water supply is seasonal in nature and weather conditions can have a pronounced effect on supply. In order to ensure that we have adequate water supply, we use long-term 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 ground water 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. An example of our use of long-term planning to ensure that we have adequate water supply is our involvement in the Monterey Peninsula Water Supply Project (the “Water Supply Project”) in California. The Water Supply Project involves the construction of

a desalination plant, owned by California-American Water Company, our wholly owned subsidiary (“Cal Am”), which includes the construction of wells that would supply water to the desalination plant. The Water Supply Project is intended, among other things, to fulfill obligations of Cal Am to eliminate unauthorized diversions from the Carmel River as required under orders of the California State Water Resources Control Board.

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 regulatory standards for wastewater before being returned to the environment. The solid waste by-product of the treatment process is disposed of, or recycled, in accordance with applicable standards and regulations.

Economic Regulation and Rate Making Process

The operations of our Regulated Businesses are generally subject to regulation and oversight by the PUCs in each of the states served by our utilities, with the primary responsibility of the PUCs to promote the overall public interest by balancing the interest of customers and utility investors. Specific authority might differ from state to state, but in most states PUCs approve rates charged to customers, accounting treatments, long-term financing programs and cost of capital, capital expenditures, O&M expenses, taxes, transactions and affiliate relationships, reorganizations and mergers and acquisitions. Regulatory policies vary from state to state and could potentially change over time. These policies will affect the timing, as well as the extent, of recovery of expenses and the realized return on invested capital.

The process to obtain approval for a change in rates generally occurs by way of a rate case filed by the utility with the PUC on a periodic basis. The timing of rate case filings are typically determined by either periodic requirements in the regulatory jurisdiction or by the utility’s need to increase its revenue requirement to recover capital investment costs, changes in operating revenues, operating costs or other market conditions.

Our rate case management program is guided by the principles of obtaining timely recovery of capital investment costs, recognition of declining sales resulting from reduced consumption and appropriate recovery of utility operating and maintenance costs, including costs incurred for compliance with environmental regulations. The program attempts to minimize the delay, or “regulatory lag” between the time our Regulated Businesses make a capital investment or incur an operating expense increase and the time when those costs are reflected in rates. The management team at each of our utilities understands 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.

Our Regulated Businesses support regulatory practices at the PUCs and state legislatures that mitigate the adverse impact of regulatory lag. Examples of approved regulatory practices include:

<u>Regulatory Practices</u>	<u>Description</u>	<u>States Allowed</u>
Infrastructure replacement surcharges	Allows rates to change periodically, outside a general rate proceeding, to reflect recovery of investments made to replace infrastructure necessary to sustain safe, reliable and affordable services for our customer.	IL, IN, MO, NJ, NY, PA, TN
Future test year	A test period used for setting rates, which extends beyond the date a rate request is filed. This allows current or projected revenues, expenses and investments to be collected on a more timely basis.	CA, HI, IL, IN, KY, NY, PA, TN, VA
Hybrid test year	Allows an update to historical data for “known and measurable” changes that occur subsequent to the historical test year.	MO, NJ
Utility plant recovery mechanisms	Allows recovery of the full return on utility plant costs during the construction period, instead of capitalizing an allowance for funds used during construction. 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 may assess the prudence of such projects.	CA, IL, KY, NY PA, TN, VA
Expense mechanisms	Allows changes in certain operating expenses, which may fluctuate based on conditions beyond the utility’s control, to be recovered outside of a general rate proceeding or deferred until the next general rate proceeding.	CA, IL, MD, MO, NJ, NY, PA, TN, VA, WV
Revenue stability mechanisms	Separates a water utility’s cost recovery from the amount of water it sells. Such a mechanism adjusts rates periodically to ensure that a utility’s revenue will be sufficient to cover its fixed costs regardless of sales volume, while providing an incentive for customers to use water more efficiently.	CA, NY
Consolidated tariffs	Use of a unified rate structure for multiple water systems owned and operated by a single utility, which may or may not be physically interconnected. The consolidated tariff pricing structure may be used fully or partially in a state and is generally used to moderate the impact of periodic fluctuations in local costs while lowering administrative costs for customers. Pennsylvania also permits a blending of water and wastewater rate structures.	IA, IL, IN, KY, MD, MO, NJ, PA, WV

We pursue or seek enhancement to these regulatory practices as part of our rate case management program to facilitate efficient recovery of our costs and investments, in order to provide safe, reliable and affordable services to our customers. The ability to seek regulatory treatment as described above does not guarantee that the state PUCs will accept our proposal in the context of a particular rate case, and these practices may reduce, but not eliminate, regulatory lag associated with traditional rate making processes. It is also our strategy to expand their use in areas where they may not currently apply.

We also support state legislation that enables the consolidation of the largely fragmented water and wastewater industries. Legislation in certain states has generally enabled sales between interested parties, has allowed a reasonable market valuation of purchased property, and has enabled consolidation of water and wastewater rates.

Customers

Our Regulated Businesses have a large and geographically diverse customer base. A customer is a person, corporation, municipality or any other entity that purchases our water or wastewater system as of the last business day of a reporting period. Also, a single customer may purchase our services for use by multiple individuals or businesses in the case of many homes, apartment complexes, businesses and governmental entities.

Residential customers make up the majority of our customer base in all of the states in which we operate. In 2015, residential customers accounted for 91.1% of our customer base, 59.2% of the billed water sales and 56.0% of the operating revenues of our Regulated Businesses. We also serve commercial customers, such as offices, retail stores and restaurants; 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 through our distribution systems 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 to other water utilities in the form of bulk water supplies for distribution to their own customers.

The vast majority of our regulated water customers are metered, which allows us to measure and bill for our customers' water usage, typically on a monthly basis. We employ a variety of methods of customer meter reading to monitor consumption. These methods range 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. Our wastewater customers are billed either a flat rate or based on their water consumption.

The following table summarizes the number of water and wastewater customers we served by class as of December 31:

	2015		2014		2013	
	Water	Wastewater	Water	Wastewater	Water	Wastewater
Residential	2,829,170	132,870	2,813,715	117,602	2,813,601	117,584
Commercial	218,798	7,308	218,314	6,221	219,510	6,287
Industrial	3,765	17	3,793	17	3,822	16
Public & other	60,421	342	59,249	281	58,420	259
Total	<u>3,112,154</u>	<u>140,537</u>	<u>3,095,071</u>	<u>124,121</u>	<u>3,095,353</u>	<u>124,146</u>

Customer growth in our Regulated Businesses is primarily driven by the following factors:

- adding new customers to our regulated customer base by acquiring water and/or wastewater utility systems;
- organic population growth or decline in our authorized service areas; and
- the sale of water to other community water systems.

Generally, we add customers through acquisitions of small and medium water and/or wastewater systems in close geographic proximity to areas where we operate our Regulated Businesses, which we refer to as "tuck-ins." The proximity of tuck-in opportunities to our regulated footprint allows us to integrate and manage the acquired systems and operations primarily using our existing management and to achieve operational efficiencies. Pursuing tuck-ins has been and continues to be 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, in certain United States markets where we do not currently operate our Regulated Businesses. We will also selectively seek 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 providing safe, reliable and affordable services to our customers.

Seasonality

Customer demand for our water service is affected by weather and is generally greater during the summer months primarily due to increased usage for irrigation systems and other outdoor water use. As such, we typically expect our operating revenues to be the highest in the third quarter of each year compared to any of the other quarters. However, varying summer weather conditions can impact our third quarter financial results. Summer weather that is cooler and/or 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.

Competition

In our Regulated Businesses, we generally do not face direct competition in our existing markets because: (i) we operate in 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 high barrier to market entry. However, 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 Company S.A.), American States Water Company and California Water Service Group. From time to time, we also face competition from infrastructure funds, multi-utility companies and others, such as Algonquin Power and Utilities Corp. and Corix.

All or portions of our regulated 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 actively monitor condemnation activities that may affect us as developments occur. We do not believe that condemnation poses a material threat to our ability to operate our Regulated Businesses, either individually or taken as a whole.

Market-Based Businesses

Through our Market-Based Businesses, we provide services to military bases, municipalities, exploration and production companies, commercial, industrial and residential customers that are not subject to economic regulation by state PUCs and do not require substantial infrastructure investment. For 2015, operating revenues for our Market-Based Businesses was \$434 million, or 13.7% of total operating revenues.

Our Market-Based Businesses is comprised of four operating segments:

- Military Services Group, which enters into long-term contracts, generally 50 years, with the U.S. Department of Defense for the O&M of the water and wastewater systems on certain military bases;
- Homeowner Services Group, which primarily provides warranty-type services to homeowners and smaller commercial customers to protect against the cost of repairing broken or leaking water pipes or clogged or blocked sewer pipes, located inside and outside their premise, as well as interior electric line repairs;
- Contract Operations Group, which enters into contracts primarily to operate and maintain water and wastewater facilities and other related services mainly for municipalities and the food and beverage industry; and
- Keystone, which provides customized water sourcing, transfer services, pipeline construction, water and equipment hauling and water storage solutions, for natural gas exploration and production companies.

In November 2014, we disposed of our Class B Biosolids operating segment by selling our subsidiary, Terratec Environmental Ltd (“Terratec”), which provided biosolids management, transport and disposal services to municipal and industrial customers in Ontario, Canada. The results of Terratec are presented as discontinued operations and, as such, have been excluded from continuing operations and operating segment results for all periods presented. See Note 3—Acquisitions and Divestitures in the Notes to Consolidated Financial Statements for additional details on our discontinued operations.

Military Services Group

Our Military Services Group has twelve 50-year contracts with the U.S. Department of Defense for the O&M of the water and wastewater systems on certain military bases. All of these contracts 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 termination provisions applicable to these contracts, 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 nine 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. Three contracts are subject to annual price adjustments under a mechanism similar to price redetermination, called “Economic Price Adjustment.” During the contract term, we may make limited short-term working capital investments under our contracts with the U.S. Department of Defense.

Homeowner Services Group

Our Homeowner Services Group, through our Service Line Protection Program, provides services to domestic homeowners and smaller commercial customers to protect against the cost of interior and external water and sewer line repairs and interior electric line repairs. Our LineSaver™ program involves partnering with municipalities to offer our protection programs to homeowners serviced by the municipalities. As of December 31, 2015, our Homeowner Services Group had approximately 1.6 million customer contracts in 43 states and the District of Columbia.

Contract Operations Group

Our Contract Operations Group enters into public/private partnerships, including: (i) O&M; (ii) Design; Build and Operate; and (iii) Design, Build, Finance, Operate and Maintain contracts for the provision of services to water and wastewater facilities for municipalities, the food and beverage industry and other customers. We are

party to 58 contracts, varying in size and scope across the United States and Canada, ranging in terms from one to 30 years. Historically, we have made minimal long-term capital investment under these contracts with municipalities and other customers; instead we perform our services for a fee. Occasionally, we provide our customers with financing for capital projects as part of a long-term operations and maintenance partnership.

Keystone

Our Keystone business commenced in July 2015 through the acquisition of a ninety-five percent interest in Water Solutions Holdings, LLC, including its wholly owned subsidiary, Keystone Clearwater Solutions, LLC (collectively referred to as “Keystone”). Keystone is a water management solution company currently focused on exploration and production companies in the Appalachian Basin. Keystone primarily provides customized water sourcing, transfer, storage, transport and pipeline construction services for natural gas exploration and production companies. As of December 31, 2015, Keystone served 46 customers.

Competition

We face competition in our Market-Based Businesses from a number of service providers, including Veolia Environnement, American States Water Company, Operations Management International, Inc. and Southwest Water Company, 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 primarily from HomeServe USA and Utility Service Partners, Inc.

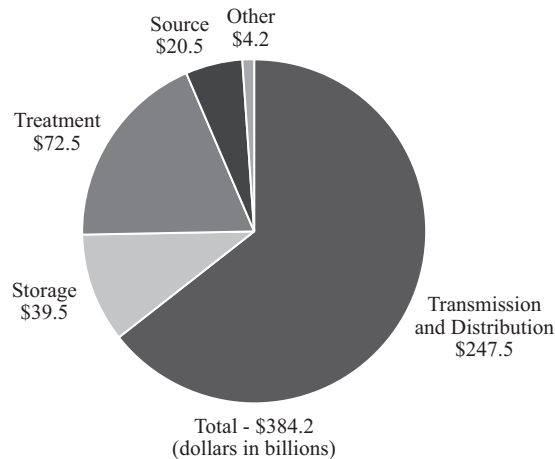
Keystone currently faces competition from water service providers that typically provide particular segments of the water management cycle, such as Rockwater Energy Solutions, Select Energy Services and Fluid Delivery Solutions, LLC.

Industry and Regulatory Matters

Overview

The aging water and wastewater infrastructure in the United States is in 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. In 2007, the U.S. Environmental Protection Agency (the “EPA”) estimated that approximately \$390.0 billion of capital spending would be necessary over the then next 20 years to replace aging infrastructure and ensure quality wastewater systems across the United States. In 2011, the EPA also 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. Additionally, in 2013 the American Society of Civil Engineers (“ASCE”) published its *Report Card for America’s Infrastructure*, in which it gave the water and wastewater infrastructure a grade of “D” because much of the infrastructure is nearing the end of its useful life. The ASCE report concluded that there will be an investment gap between 2013 and 2020 of \$84 billion for drinking water and wastewater infrastructure.

The following chart depicts estimated aggregate capital expenditure needs from 2011 through 2030 for United States drinking water systems:



Note: Numbers may not total due to rounding
 Source: U.S. Environmental Protection Agency's 2011 Drinking Water Infrastructure Needs Survey and Assessment

Environmental, Health and Safety, and Water Quality Regulation

Our water and wastewater operations, including the services provided by both our Regulated Businesses and Market-Based Businesses, are subject to extensive U.S. 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, recycle and dispose of wastewater. These regulations include the Safe Drinking Water Act, the Clean Water Act and other U.S. 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 U.S. 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 increasingly 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 operations are subject. In the past, our Regulated Businesses have generally been able to recover costs associated with compliance related to environmental, health and safety standards; however, this recovery is affected by regulatory lag and the corresponding uncertainties surrounding rate recovery. We estimate that we will make capital expenditures of \$42 million during 2016 and \$89 million during 2017 for environmental control facilities, which we define for this purpose as any project (or portion thereof) that involves the preservation of air, water or land.

We maintain an environmental program 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 compliance with regulatory requirements. Across our 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 2015, we achieved a score of greater than 99% for drinking water compliance and according to the EPA's statistics, American Water's performance has been far better than the industry average over the last several years. In fact, in 2015, American Water was 13 times better than the industry average for compliance with drinking water requirements.

We participate in the Partnership for Safe Water, EPA's voluntary program to meet more stringent goals for reducing microbial contaminants. With 68 of our 81 surface water plants receiving the program's "Director" award, which recognizes utilities that have completed a comprehensive self-assessment report, created an action plan for continuous improvement and produces high quality drinking water, we account for approximately one-third of the plants receiving such awards nationwide. In addition, 64 American Water plants have received the "Five-Year Phase III" award, while 59 have been awarded the "Ten-Year Phase III" award. Additionally, 25 plants received the inaugural "Fifteen-Year Phase III" award, which recognizes plants that have met the Director award status for 15 years.

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 have recently completed 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 by-products 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 in January 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 be effective in April 2016. The EPA is actively considering regulations for a number of contaminants, including strontium, hexavalent chromium, fluoride, nitrosamines, perchlorate, some pharmaceuticals and certain volatile organic compounds. We do not anticipate that any of these regulations will require implementation in 2016. In July 2014, the State of California implemented a primary drinking water standard of 10 micrograms per liter for hexavalent chromium. We are in compliance with this new standard.

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 and other similar laws 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 the state 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, which must be renewed every five years. Pursuant to the NPDES permit program, the EPA or implementing states set maximum discharge limits for wastewater effluents and overflows from wastewater collection systems. Discharges that exceed the limits specified under NPDES permits can lead to the imposition of penalties, and persistent non-compliance could lead to significant penalties and compliance costs. In addition, the difficulty of obtaining, complying with NPDES permits and renewing expiring permits may impose time and cost burdens on our operations. 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. The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (“CERCLA”), authorizes the EPA, and comparable state laws authorize state environmental authorities, to issue orders and bring enforcement actions to compel responsible parties to investigate and take remedial actions at any site that is determined to present an actual or potential threat to human health or the environment because of an actual or threatened release of one or more hazardous substances. Parties that generated or transported hazardous substances to such sites, as well as the owners and operators of such sites, may be deemed liable, without regard to fault, under CERCLA or comparable state laws. 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 U.S. Occupational Safety and Health Act and are subject to inspections thereunder. For further information, see Item 1—Business—Research and Development.

Certain of our subsidiaries are involved in pending legal proceedings relating to environmental matters. Further description of these proceedings can be found in Item 3—Legal Proceedings.

Research and Development

We have a research and development program, which seeks to improve 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 our research and development activities through testing and analysis.

We continue to collaborate with the EPA to achieve effective environmental, health and safety, and water quality regulation. This relationship includes 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 provides us with early insight into emerging regulatory issues and initiatives, thereby allowing us to anticipate and to accommodate our future compliance requirements.

Approximately one-quarter of our research budget is funded by competitively awarded outside research grants. Such grants reduce the cost of research and allow collaboration with leading national and international researchers. In 2015, we spent \$4 million, including \$1 million funded by research grants. Spending, net of research grant funding, amounted to \$3 million in 2014 and 2013.

We believe that continued research and development activities are critical for providing safe, reliable and affordable services, as well as maintaining our leadership position in the industry, which provides 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 support services and corporate governance for our operating subsidiaries. These services are provided predominantly to our Regulated Businesses under the terms of contracts with these subsidiaries that have been approved by state PUCs, where necessary. These services are also provided to our Market-Based Businesses organized under American Water Enterprises. They are only provided to Keystone upon request. These services, which are provided at cost, may include accounting and finance, administration, business development, communications, education and training, engineering, health and safety, human resources, information systems, internal audit, investor relations, legal, operations, procurement, rates support, security, risk management, treasury, water quality and research and development. We also operate two national customer service centers, which are located in Alton, Illinois and Pensacola, Florida, that provide customer relations, operations and field service support. The services are provided at cost and enable our Regulated Businesses and Market-Based Businesses to fulfill their responsibilities in a more cost-effective manner.

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 periodically 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 as a preventative measure against unauthorized access to company information systems. These controls are aimed at assuring the continuity of business processes that are dependent upon automation; seek to ensure the integrity of our data; support regulatory and legislative compliance requirements; and aimed at maintaining safe and reliable service to our customers. While we do not make public comments on the details of our security programs, we are in contact with U.S. 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

As of December 31, 2015, approximately 46% of our workforce is represented by unions. As of that date we had 75 collective bargaining agreements in place with 17 different unions representing our unionized employees. Also, we have 4 union contracts beyond expiration that affect approximately 700 employees, all of which are actively working under the old agreements. During 2016, 32 of our local union contracts will expire.

On October 13, 2014, we entered into a settlement agreement with the Utility Workers Union of America (“UWUA”) designed to resolve a dispute between our company and the labor unions representing employees in the Regulated Businesses (the “Unions”). Among other things, the settlement agreement provides for a new 2014-2018 National Benefits Agreement that will be in effect generally until July 31, 2018. In addition, we agreed to make a \$10 million lump-sum payment, to be distributed in accordance with procedures set forth in the settlement agreement.

The Unions approved the settlement agreement on October 30, 2014, and the National Labor Relations Board (the “NLRB”) approved the settlement agreement on October 31, 2014. We, the NLRB and the UWUA filed a joint stipulation to dismiss the petition for review. The Seventh Circuit voluntarily dismissed all the parties’ appeals on December 16, 2014. In 2015, the NLRB dismissed the unfair labor practice charge pending on the national benefits dispute upon receipt of our \$10 million lump-sum payment.

The majority of the distributions were used to reimburse active employees for medical claims, which were incurred during the relevant period and were funded by the Group Insurance Plan for Active Employees of American Water Works Company, Inc. and Its Designated Subsidiaries and Affiliates, to which we previously made contributions.

Executive Officers

The following table summarizes the name, age, offices held and business experience for each of our executive officers, as of February 24, 2016:

<u>Name</u>	<u>Age</u>	<u>Office and Experience</u>
Susan N. Story	56	President and Chief Executive Officer. Ms. Story has served as President and Chief Executive Officer of the Company since May 2014. Ms. Story served as Senior Vice President and Chief Financial Officer of the Company from April 2013 until May 2014. Prior to joining American Water, she served as President and Chief Executive Officer of Southern Company Services, a subsidiary of Southern Company, from January 2011 until March 2013 and President and Chief Executive Officer of Gulf Power Company, also a subsidiary of Southern Company, from 2003 until December 2010. Since 2008, Ms. Story has served as a member of the board of directors of Raymond James Financial, Inc., a diversified financial services company.
Sharon Cameron	59	President of American Water Enterprises. Ms. Cameron has been President of American Water Enterprises since September 2010 and served as President of Homeowner Services since 2002. Prior to joining American Water, Ms. Cameron was Principal of Marketing Solutions, a marketing consulting firm she launched in 1998.
Mark Chesla	56	Vice President and Controller. Mr. Chesla has been our Vice President and Controller since November 2007. From 2001 to November 2007, Mr. Chesla was Vice President and Controller of Oglethorpe Power Corporation, in Atlanta, Georgia, where he served as that company's chief accounting officer. In this capacity, he was responsible for all aspects of the accounting, internal financial management, regulatory and SEC reporting functions. Mr. Chesla was Vice President, Administration/Controller of SouthStar Energy Services LLC, in Atlanta, Georgia, from 1998 to 2001. Earlier, he held management positions with several other companies, including Piedmont Natural Gas Co., Inc., Aegis Technologies, Inc., Deloitte & Touche LLP and Carolina Power & Light Company.
Deborah Degillio	44	Vice President and Treasurer. Ms. Degillio has served as the Company's Vice President and Treasurer since January 2015. Ms. Degillio served as Vice President of Finance of American Water Enterprises from November 2013 to February 2015, as a Vice President in the Company's Finance team for its Eastern Division from June 2009 until October 2013, and as Director of Financial Planning and Analysis for America Water's then Western states, from April 2007 until May 2009.
Brenda J. Holdnak	62	Senior Vice President of Human Resources. Ms. Holdnak has served as the Company's Senior Vice President Human Resources since January 1, 2016 and its Vice President Human Resources from January 19, 2015 to December 31, 2015. Prior to joining American Water, she served as President of Holdnak and Associates Consulting, a human resources consulting firm, from June 2014 to December 2014. Prior to that time, she served as Director of Talent Management of The Babcock & Wilcox Company, from March 2011 to June 2014. Previously, she served as Director of Change Management and Organizational Development of Medtronic, Inc. from May 2010 to March 2011

<u>Name</u>	<u>Age</u>	<u>Office and Experience</u>
		and an Executive Consultant/Principal of the Henly Consulting Group from July 2006 to January 2011.
Walter J. Lynch	53	Executive Vice President and Chief Operating Officer. Mr. Lynch has served as the Company’s Executive Vice President and Chief Operating Officer since January 1, 2016, as Chief Operating Officer of Regulated Operations from February 26, 2010 to December 31, 2015, and President of Regulated Operations from July 2008 to December 31, 2015. Mr. Lynch joined us in 2001. In addition, Mr. Lynch is on the Board of Directors of the National Association of Water Companies and serves on its Executive Committee.
Michael Sgro	57	Executive Vice President, General Counsel and Secretary. Mr. Sgro has served as the Company’s Executive Vice President, General Counsel and Secretary since January 1, 2016 and its Senior Vice President, General Counsel and Secretary from February 2015 to January 2016. Prior to that, he served as the Company’s Interim General Counsel and Secretary from January 2015 until February 2015 and as Vice President, General Counsel and Secretary of American Water’s Northeast Division beginning in 2002.
Mark F. Strauss	64	Senior Vice President of Corporate Strategy and Business Development. Mr. Strauss has been our Senior Vice President of Corporate Strategy and Business Development since September 2010. From December 2006 to September 2010, Mr. Strauss served as President of American Water Enterprises. In January 2016, Mr. Strauss was appointed to the Board of Directors of Fulton Financial Corporation, a Lancaster, Pennsylvania-based financial holding company.
Linda G. Sullivan	52	Executive Vice President and Chief Financial Officer. Ms. Sullivan has served as the Company’s Executive Vice President and Chief Financial Officer since January 1, 2016 and the Company’s Senior Vice President and Chief Financial Officer from May 2014 to December 31, 2015. Prior to joining American Water, Ms. Sullivan served as the Senior Vice President and Chief Financial Officer of Southern California Edison Company, a subsidiary of Edison International, from July 2009 until May 2014, and Vice President and Controller of both Edison International and Southern California Edison Company, from July 2004 until July 2009.
Loyd “Aldie” Warnock	56	Senior Vice President of External Affairs, Communications and Public Policy. Mr. Warnock has served as the Company’s Senior Vice President of External Affairs, Communications and Public Policy since April 2014. Prior to joining the Company, he served as Senior Vice President of External Affairs at Midwest Independent System Operator, Inc., a non-profit, self-governing organization, from March 2011 to April 2014. Prior to that, he served as Vice President of External Affairs for Allegheny Energy, Inc. from December 2005 to February 2011 and Senior Vice President of Governmental and Regulatory Affairs at Mirant Corporation from July 2004 to November 2005.

Each executive officer is elected annually by the Board of Directors and serves until his or her respective successor has been elected and qualified or his or her earlier death, resignation or removal.

Available Information

We are subject to the reporting requirements of the Exchange Act. We file or furnish annual, quarterly and current reports, proxy statements and other information with the 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, and any website references included herein are not intended to be made through active hyperlinks. We recognize this website as a key channel of distribution to reach public investors and as a means of disclosing material non-public information to comply with our disclosure obligations under SEC Regulation FD.

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 its 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 may be obtained by calling the SEC at 1-800-732-0330. 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 its 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 stockholder 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, cash flows and liquidity.

Risks Related to Our Industry and Business Operations

Our utility operations are subject to extensive economic regulation by state PUCs and other regulatory agencies, which significantly affects our business, financial condition, results of operations and cash flows. Our utility operations also may be subject to fines, penalties and other sanctions for the inability to meet these regulatory requirements.

Our Regulated Businesses provide water and wastewater services to our customers through subsidiaries that are subject to economic regulation 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, including, but not limited to, operating and maintenance costs, depreciation, financing costs and taxes, and provide us the opportunity to earn an appropriate rate of return on invested capital.

Our ability to successfully implement our business plan and strategy depends on 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. Our rate increase requests may or may not be approved, or may be partially approved, and any approval may not occur 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 with an opportunity to earn an appropriate rate of return on our investment.

Approval of the PUCs is also required in connection with other aspects of our utilities' operations. State PUCs are empowered to impose financial penalties, fines and other sanctions for non-compliance with applicable rules and regulations. Our utilities are also required to have numerous permits, approvals and certificates from the PUCs that regulate their businesses. Although we believe that each utility subsidiary has obtained or sought renewal of the material permits, approvals and certificates necessary for its existing operations, we are unable to predict the impact that future regulatory activities may have on our business.

In any of these cases, our business, financial condition, results of operations, cash flows 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 to the extent permitted by state PUCs. This could occur if certain conditions exist, including but not limited to, if water usage is less than the level anticipated in establishing rates, or if our investments or expenses prove to be higher than the level 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 us to substantial liabilities and costs.

Our water and wastewater operations, as well as the operations of our Market-Based Businesses, are subject to extensive 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 CERCLA, the Clean Water Act and the Safe Drinking Water Act, and similar state and Canadian laws and regulations. For example, CERCLA authorizes the EPA to issue orders and bring enforcement actions to compel responsible parties to investigate and take remedial actions with respect to actual or threatened releases of hazardous substances, and can impose joint and several liability, without regard to fault, on responsible parties for the costs thereof. We are also required to obtain various environmental permits from regulatory agencies for our operations.

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 reduce requested rate increases or 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 that would enable us 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 cease and desist order (the “2009 Order”) of the California State Water Resources Control Board that requires Cal Am to significantly decrease its diversions from the Carmel River in accordance with a reduction schedule presently 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. In November 2015, Cal Am filed an application with the State Water Resources Control Board to modify the 2009 Order to extend the deadline for compliance to December 31, 2020. We cannot predict whether Cal Am will be able to extend the 2016 Deadline or secure alternative sources of water, or if Cal Am will be exposed to liabilities if it is unable to meet the 2016 Deadline under the 2009 Order. If Cal Am or any of our other subsidiaries are 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. See Item 3—Legal Proceedings in this report, which includes additional information regarding this matter.

The current regulatory rate setting structure may result in a significant delay, also known as “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, known as “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 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 flows and liquidity.

We endeavor 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 our 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 in less time after 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 seek expansion of programs to mitigate regulatory lag, some state PUCs which govern our regulated operations have not approved such programs. Furthermore, PUCs may fail to adopt new surcharge programs and existing programs may not continue in their current form, or at all. 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, or even if successful they may not completely address our regulatory lag, in which case our business, financial condition, results of operations, cash flows and liquidity may be materially and adversely affected.

Changes in laws and regulations over which we do not control and changes in certain agreements can significantly affect our business, financial condition, results of operations, cash flows and liquidity.

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 could have the following consequences, among others:

- 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;
- 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;
- negatively impacting the deductibility of expenses under federal or state tax laws, the amount of tax credits or tax abatement benefits that may be available, the amount of taxes owed, or the ability to utilize our net operating loss carryforwards;
- 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 with respect to the sharing of information and participation in transactions by or between a regulated subsidiary and us or our other affiliates, including our service company and any of our other subsidiaries;
- 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.

Any of the foregoing consequences could have an adverse effect on our business, financial condition, results of operations, cash flows and liquidity.

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

Service interruptions due to severe weather events are possible across all our service areas. These include winter storms and freezing conditions, high wind conditions, hurricanes, tornados, earthquakes, landslides, coastal and intercoastal floods or high water conditions, including those in or near designated flood plains, and severe electrical storms. Weather events such as these 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. For example, 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.

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, results of operations and cash flows. 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 a four-year period of reduced rainfall and overall dry conditions throughout the State of California, Cal Am has been closely monitoring its owned and purchased water supplies. In April 2015, the Governor of California mandated water usage restrictions to reduce overall water usage by 25% in the state compared to 2013 usage levels. Although such restrictions are scheduled to expire in February 2016, the Governor of California issued an executive order in November 2015 extending the restrictions through October 31, 2016 if drought conditions persist through January 2016. While expenses incurred in implementing water conservation and rationing plans in Cal Am's districts are generally recoverable provided the California Public Utilities Commission (the "CPUC") determines they were reasonable, Cal Am cannot assure that such expenses will, in fact, be fully recovered. Moreover, reductions in water consumption, including those resulting from installation of equipment or changed consumer behavior, may persist even after drought restrictions are repealed and the drought has ended, which could adversely affect our business, financial condition, results of operations and cash flows.

Some scientific experts are predicting a worsening of weather volatility in the future. Changing severe weather patterns could require additional expenditures to reduce the risk associated with any increasing storm, flood and drought occurrences. The issue of climate change is receiving increased attention worldwide. Many climate change predictions, if true, present several potential challenges to water and wastewater utilities, such as: increased frequency and duration of droughts, increased precipitation and flooding, potential degradation of water quality, and changes in demand for services. Because of the uncertainty of weather volatility related to climate change, we cannot predict its potential impact on our business, financial condition, results of operations, cash flows and liquidity.

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 capital intensive. We invest significant amounts of capital to add, replace and maintain property, plant and equipment. In 2015, we invested \$1.2 billion 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 expect to 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. We may not be able to access the debt and equity capital markets, when necessary or desirable to fund capital improvements on favorable terms or at all.

In addition, we could be limited in our ability to both pursue growth and pay dividends in accordance with our dividend policy. In order to fund construction expenditures, 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.

The ability to obtain financing at reasonable rates is contingent upon our credit ratings and general market conditions. If we do not obtain sufficient financing, we could be unable to maintain our existing property, plant and equipment, fund our capital investment strategies, meet our growth targets and expand our rate base to enable us to earn satisfactory future returns on our investments. Even with adequate financial resources to make required capital expenditures, we face the additional risk that we will not complete our major capital projects on time, as a result of construction delays, permitting delays, labor shortages or other disruptions, environmental restrictions, or other obstacles. Each of these outcomes could adversely affect our financial condition, results of operations and cash flows.

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 increased water usage for irrigation systems, swimming pools, cooling systems and other applications. 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.

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, treatment or disposal 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. 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, financial condition, results of operations and cash flows. Moreover, if we are deemed liable for any damage caused by overflow or disposal operations, 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.

Contamination of our sources of water could result in service limitations and interruptions and exposure to substances not typically found in potable water supplies, and could subject our subsidiaries to reduction in usage and other responsive obligations, government enforcement actions and private litigation.

The water supplies that flow into our treatment plants and are 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, chemical spills or other accidents that result in contaminants entering the water source, and possible terrorist attacks. If one of our water supplies is contaminated, depending on the nature of the contamination, we may have to take responsive actions that could include, among other things (1) continuing limited use of the water supply under a “Do Not Use” protective order that enables continuation of basic sanitation and essential fire protection, or (2) interrupting the use of that water supply. If service is disrupted, 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 may be unable 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 subject to claims for damages arising from government enforcement actions or toxic tort or other lawsuits arising out of interruption of service or 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 into the Elk River near the WVAWC treatment plant intake in Charleston, West Virginia. 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. Government investigations relating to the Freedom Industries spill have been initiated, state laws have been enacted, state and federal legislatures are considering changes to existing laws or rules associated with new laws, and there are 68 currently pending lawsuits against WVAWC and, in a few cases, against us or our affiliates. While American Water and WVAWC believe that WVAWC has responded appropriately to, and has no responsibility for, the Freedom Industries spill, and American Water and WVAWC believe they and other affiliates have valid, meritorious defenses to the lawsuits, WVAWC will incur defense costs that may not be recoverable. Moreover, an adverse outcome in one or more of the lawsuits could have a material adverse effect on our financial condition, results of operations, cash flows, liquidity and reputation. WVAWC and American Water are unable to predict the outcome of the ongoing government investigations or any legislative initiatives that might affect water utility operations. See Item 3—Legal Proceedings for additional information regarding this matter.

Since we engage in the business of providing drinking water to our customers, contamination of the water supply can result in substantial injury or damage to our customers, employees or others and we could be exposed to substantial claims and litigation. Such claims could relate to, among other things, personal injury, loss of life, business interruption, property damage, pollution, and environmental damage and may be brought by our customers or third parties. Litigation and regulatory proceedings are subject to inherent uncertainties and unfavorable rulings can and do occur. Pending or future claims against us could have a material adverse impact on our business, financial condition, results of operations and cash flows.

We may sustain losses that exceed or are excluded from our insurance coverage or for which we are not insured.

We maintain insurance coverage as part of our overall legal and risk management strategy to minimize potential liabilities arising from our utility operations, as well as the operations of our Market-Based Businesses. Our insurance programs have varying coverage limits, exclusions and maximums, and insurance companies may seek to deny claims we might make. Generally, our insurance policies cover property damage, worker's compensation, employer's liability, general liability, terrorism risks and automobile liability. Each policy includes deductibles or self-insured retentions and policy limits for covered claims. As a result, we may sustain losses that exceed or that are excluded from our insurance coverage or for which we are not insured.

Although in the past we have been generally able to cover our insurance needs, there can be no assurances that we can secure all necessary or appropriate insurance in the future, or that such insurance can be economically secured. For example, catastrophic events can result in decreased coverage limits, more limited coverage, increased premium costs or deductibles.

We are subject to adverse publicity and reputational risks, which make us vulnerable to negative customer perception and could lead to increased regulatory oversight or other sanctions.

Water and wastewater utilities, including our regulated subsidiaries, have a large consumer customer base and as a result are exposed to public criticism regarding, among other things, the reliability of their water and

wastewater services, the quality of water provided, and the timeliness and accuracy of bills that are provided for such services. Adverse publicity and negative consumer sentiment may render legislatures and other governing bodies, state PUCs and other regulatory authorities, and government officials less likely to view companies such as American Water and its regulated subsidiaries in a favorable light, and may cause American Water and its regulated subsidiaries to be susceptible to less favorable legislative and regulatory outcomes, as well as increased regulatory oversight and more stringent regulatory requirements. Unfavorable regulatory outcomes may include the enactment of more stringent laws and regulations governing our operations, as well as fines, penalties or other sanctions or requirements. The imposition of any of the foregoing could have a material negative impact on American Water and each of our regulated subsidiaries' business, financial condition, results of operations and cash flows.

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

The properties of our Regulation Businesses segment include 81 dams, a failure of any of which 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 or upgrades can be and has been material. The federal and state agencies that regulate our operations may adopt rules and regulations requiring us to dismantle our dams, which also could entail material costs. Although in most cases, the PUC has permitted recovery of expenses and capital investment related to dam rehabilitation, we might not be able to recover costs of repairs, upgrades or dismantling through rates in the future. The inability to recover these 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.

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.

An important part of our growth strategy is the acquisition of water and wastewater systems. Any further 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 of water and wastewater systems in order to broaden our current, and move into new, service areas. We may not be able to acquire other businesses if we cannot identify suitable acquisition opportunities or reach mutually agreeable terms with acquisition candidates. Further, competition for acquisition opportunities from other regulated utilities, governmental entities, and strategic and financial buyers may hinder our ability to expand our business.

The negotiation of potential acquisitions as well as the integration of acquired businesses with our existing operations could require us to incur significant costs and cause diversion of our management's time and resources. Future acquisitions by us could result in, among other things:

- incurrence of debt, contingent liabilities, environmental liabilities and assumption of liabilities of an acquired business, including liabilities that were unknown at the time of acquisition;
- failure to recover of acquisition premiums;
- unanticipated capital expenditures;
- issuances of our equity securities;
- failure to maintain effective internal control over financial reporting;
- recording goodwill and other intangible assets at values that ultimately may be subject to impairment charges;
- fluctuations in quarterly results;
- unanticipated acquisition-related expenses;
- failure to realize anticipated benefits, such as cost savings and revenue enhancements; and
- difficulties assimilating personnel, services and systems.

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 anticipated sales and profitability, and any difficulties we encounter in the integration process could interfere with our operations, reduce our operating margins and adversely affect our internal control over financial reporting.

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 expand through acquisitions. In addition, our competitors may impede our growth by purchasing water utilities adjacent to or near our existing service areas, thereby impairing our ability to geographically expand the affected service areas. 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 areas. Our growth could be hindered if we are not able to compete effectively for new companies and/or service areas 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, results of operations and cash flows.

The assets of our Regulated Businesses are subject to condemnation through eminent domain or other similar authorized process.

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, or another similar authorized process. Should a municipality or other government subdivision or a citizen group seek to acquire our assets through eminent domain or such other process, either directly or indirectly as a result of a citizen petition, we may resist the acquisition.

Contesting an exercise of condemnation through eminent domain or other process, or responding to a citizen petition, may result in costly legal proceedings and may divert the attention of the affected Regulated Businesses' management from the operation of its business. Moreover, our efforts to resist the condemnation or process 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 or other process, 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 technology to facilitate the management of our business and customer and supplier relationships, and a disruption of these systems could adversely affect our business.

Our technology systems, particularly our information technology (“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. For example, 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 completed in the fourth quarter of 2013 the business transformation implementation for our Enterprise Resource Planning, Enterprise Asset Management (“EAM”) and Customer Information (“CIS”) systems, and we are in the process of implementing a similar system for our American Water Enterprises business, 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 cybersecurity 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;
- 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 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 outdated existing technology to enable us to continue to operate at our current level of efficiency.

We may be subject to physical and/or cyber attacks.

As operators of critical infrastructure, we may face a heightened risk of physical and/or cyber attacks. Our water and wastewater systems may be vulnerable to disability or failures as a result of physical or cyber acts of war or terrorism, vandalism or other causes. Our corporate and information technology systems may be vulnerable to unauthorized access due to hacking, viruses, acts of war or terrorism, and other causes. Unauthorized access to confidential information located or stored on these systems could negatively and materially impact our customers, employees, suppliers and other third parties.

If, despite our security measures, a significant physical attack or cyber breach occurred, we could have our operations disrupted, property damaged, and customer information stolen; experience substantial loss of revenues, response costs, and other financial loss; and be subject to increased regulation, litigation, and damage to our reputation, any of which could have a negative impact on our business, results of operations and cash flows.

Our inability to efficiently optimize and stabilize new IT systems 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, and are in the process of implementing with respect to our American Water Enterprises business, improvements to our business processes and upgrading our legacy core information technology systems. These enterprise-wide initiatives support our broader strategic initiatives and are intended to optimize workflow throughout our field operations, improve our back-office operations and enhance our customer service capabilities. Any technical or other difficulties in optimizing and stabilizing new IT systems and other technology may increase the costs of the project beyond those anticipated and have an adverse effect on our operations and reporting processes, including our internal control over financial reporting. Although efforts are being 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 IT systems that are in various stages of integration, sometimes leading to inefficiencies. Therefore, delays in stabilization and optimization of these systems 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.

Our business has inherently dangerous workplaces. If we fail to maintain safe work sites, we can be exposed to financial losses as well as penalties and other liabilities.

Our safety record is critical to our reputation. We maintain health and safety standards to protect our employees, customers, vendors and the public. Although we intend to adhere to such health and safety standards it is unlikely that we will be able to avoid accidents at all times.

Our business sites, including construction and maintenance sites, often put our employees and others in close proximity with large pieces of equipment, moving vehicles, pressurized water, chemicals and other regulated materials. On many sites we are responsible for safety and, accordingly, must implement safety procedures. If we fail to implement such procedures or if the procedures we implement are ineffective or are not followed by our employees or others, our employees and others may be injured or die. Unsafe work sites also have the potential to increase employee turnover and raise our operating costs. Any of the foregoing could result in financial losses, which could have a material adverse impact on our business, financial condition, results of operations and cash flows.

In addition, our operations can involve the handling and storage of hazardous chemicals, which, if improperly handled, stored or disposed of, could subject us to penalties or other liabilities. We are also subject to regulations dealing with occupational health and safety. Although we maintain functional employee groups whose primary purpose is to ensure we implement effective health, safety, and environmental work procedures throughout our organization, including construction sites and maintenance sites, the failure to comply with such regulations could subject us to liability.

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

As of December 31, 2015, approximately 46% of our workforce was represented by unions, and we had 75 collective bargaining agreements in place with 17 different unions representing our unionized employees. These collective bargaining agreements are subject to periodic renewal and renegotiation. We may 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.

While we have developed contingency plans to be implemented as necessary if a work stoppage or strike does occur, a strike or work stoppage may have a material adverse impact on our financial position, results of operations and cash flows.

Our continued success is dependent upon our ability to hire, retain, and utilize qualified personnel.

The success of our business is dependent upon our ability to hire, retain, and utilize qualified personnel, including engineers, craft personnel, and corporate management professionals who have the required experience and expertise. From time to time, it may be difficult to attract and retain qualified individuals with the expertise and in the timeframe demanded for our business needs. In certain geographic areas, for example, we may not be able to satisfy the demand for our services because of our inability to successfully hire and retain qualified personnel.

In addition, as some of our key personnel approach retirement age, we need to have appropriate succession plans in place and to successfully implement such plans. If we cannot attract and retain qualified personnel or effectively implement appropriate succession plans, it could have a material adverse impact on our business, financial condition, results of operations and cash flows.

Financial and Market-Related Risks

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, 2015, our indebtedness (including preferred stock with mandatory redemption requirements) was \$6.6 billion, 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 variable rates;
- 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;
- 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, 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.

In order to meet our capital expenditure needs, we may be required to make additional borrowings under our revolving credit facility or issue new short-term and long-term debt securities. Moreover, additional borrowings may be required to refinance outstanding indebtedness. Debt maturities and sinking fund payments in 2016, 2017 and 2018 will be \$54 million, \$573 million and \$457 million, respectively. We can provide no assurance that we will be able to access the debt capital markets on favorable terms, if at all. Moreover, 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 largely 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, reduce capital investments, 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 financial condition, operating results and prospects to be affected adversely.

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 primarily on our revolving credit facility, commercial paper programs, and the capital markets to satisfy our liquidity needs. In this regard, our principal external sources of short-term liquidity are our commercial paper program and our \$1.25 billion revolving credit facility. Our revolving credit facility expires in accordance with its terms in June 2020. We regularly use our commercial paper program under this revolving credit facility as a principal source of short-term borrowing due to the generally more attractive rates we generally can obtain in the commercial paper market. As of December 31, 2015, American Water Capital Corp. (“AWCC”), our wholly owned financing subsidiary, had no outstanding borrowings under the revolving credit facility, and had \$626 million of commercial paper outstanding and \$82 million in outstanding letters of credit.

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. Our lenders may not meet their existing commitments and we may not be able to access the commercial paper or loan markets in the future on terms acceptable to us or at all. Furthermore, our inability to maintain, renew or replace commitments under this facility could materially increase our cost of capital and adversely affect our financial condition, results of operations and liquidity. 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 or failure of our lenders to meet their commitments that result from financial market disruptions could expose us to increased interest expense, require us to institute cash conservation measures or otherwise adversely and materially affect our business, financial condition, results of operations, cash flows and liquidity.

American Water may be unable to meet its ongoing and future financial obligations and to pay dividends on its common stock if its subsidiaries are unable to pay upstream dividends or repay funds to American Water.

American Water is a holding company and, as such, American Water has no operations of its own. Substantially all of our consolidated assets are held by subsidiaries. American Water's ability to meet its financial obligations and to pay dividends on its common stock is primarily dependent on the net income and cash flows of its subsidiaries and their ability to pay upstream dividends to American Water or repay indebtedness to American Water. Prior to funding American Water, American Water's regulated subsidiaries must comply with regulatory restrictions and financial obligations that must be satisfied, including among others, debt service and preferred and preference stock dividends, as well as applicable corporate, tax and other laws and regulations and agreements and covenants made by American Water and its subsidiaries. American Water's subsidiaries are separate legal entities and have no obligation to provide American Water with funds. An inability of any of these subsidiaries to pay such dividends or repay intercompany obligations could have a material adverse impact on American Water's liquidity and its ability to pay dividends on its common stock and meet its other obligations.

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

As of December 31, 2015, we had U.S. federal and state net operating loss ("NOL") carryforwards of approximately \$1.1 billion and \$534 million, respectively. Our federal NOL carryforwards will begin to expire in 2028, and our state NOL carryforwards began to expire in 2016 and will continue to expire until 2034. Our ability to utilize our NOL carryforwards is primarily dependent upon our ability to generate sufficient taxable income. 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, 2015, \$60 million of the state NOL carryforwards have been offset by a valuation allowance because we do 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 the 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.

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 \$1.3 billion of goodwill at December 31, 2015. The goodwill is primarily associated with the acquisition of American Water by an affiliate of our previous owner in 2003, the acquisition of E'Town Corporation by a predecessor to our previous owner in 2001, and the acquisition of Keystone, which was completed in July 2015. Goodwill represents the excess of the purchase price the purchaser paid over the fair value of the net tangible and other 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.

We may be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to our performance or the performance of an acquired business. These market conditions 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, market price performance of our common stock that compares unfavorably to our peer companies, decreases in control premiums, or, with respect to Keystone, fluctuations in the level of exploration and production activities in the Marcellus and Utica shale regions served by Keystone, a prolonged depression of natural gas prices or other factors that negatively impact our forecast operating results, cash flows or key

assumptions in the future. A decline in the results forecasted in our business plan due to events such as changes in rate case results, capital investment budgets or interest rates, could also result in an impairment charge. Recognition of impairments of goodwill would result in a charge to income in the period in which the impairment occurred, which may negatively affect our financial condition, results of operations and total capitalization. The effects of any such impairment 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.

Market conditions may 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. The value of these assets is 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. Additionally, our 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 and increasing trends in health care costs may also increase our funding requirements. Future increases in pension and other postretirement costs as a result of reduced plan assets may not be fully recoverable in rates, in which case 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, results of operations and cash flows.

Additional Risks Related to Our Market-Based Businesses

We (excluding our regulated subsidiaries) provide performance guarantees with respect to certain obligations of our Market-Based Businesses, including financial guarantees or deposits, to our public-sector and public clients, which may seek to enforce the guarantees if our Market-Based Businesses do not satisfy these 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 Businesses, including financial guarantees or deposits. In the event our Market-Based Businesses 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, 2015, we had remaining performance commitments as measured by remaining contract revenue totaling approximately \$3.6 billion and this amount is likely to increase if our Market-Based Businesses expand. The presence of these commitments may adversely affect our financial condition and make it more difficult for us to secure financing on attractive terms.

American Water Enterprises' 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 financial condition, results of operations and cash flows.

American Water Enterprises operates a number of water and wastewater systems under O&M contracts and faces the risk that the owners of those systems may fail to provide capital to properly maintain those systems, which may negatively affect American Water Enterprises as the operators of the systems.

American Water Enterprises operates a number of water and wastewater systems under O&M contracts. Pursuant to these contracts, American Water Enterprises operates the system according to the standards set forth in the applicable contract, and it is generally the responsibility of the owner of the system to undertake capital improvements. In some cases, American Water Enterprises 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 American Water Enterprises as the operator of the system and us, and damage our reputation, and in some cases, may result in liability to us to the same extent as if we were the owner.

Our Market-Based Businesses 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 Businesses enter into long-term contracts under 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 specified major maintenance for some of those facilities, in exchange for an annual fee. These Market-Based Businesses 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. Losses under these contracts or guarantees may adversely affect our financial condition, results of operations, cash flows and liquidity.

Keystone's operations may expose us to substantial costs and liabilities with respect to environmental laws and matters.

Keystone's operations, and the operation generally of natural gas and oil exploration and production facilities by Keystone's customers, are subject to stringent federal, state and local laws, rules, regulations and ordinances governing the release of materials into the environment or otherwise relating to environmental protection. These provisions may require the acquisition by Keystone of permits or licenses before providing its services to customers, prohibit the release of substances defined thereunder as hazardous in connection with these activities, and impose substantial liabilities for the violation thereof that may result from these operations. Failure to comply with these laws, rules, regulations and ordinances may result in substantial environmental remediation and other costs to Keystone, the assessment of administrative, civil and criminal penalties or the issuance of injunctions restricting or prohibiting certain activities. Under existing environmental laws and regulations, Keystone could be held strictly liable for the removal or remediation of previously released materials or property contamination regardless of whether the release resulted from its operations, or whether its operations were in compliance with all applicable laws at the time they were performed. While the Company has attempted to structure and maintain its ownership and control of Keystone's operations in such a way as to insulate the Company, its regulated subsidiaries and its Market-Based Businesses from any liabilities associated with Keystone's operations, including liabilities for environmental matters, there can be no assurance that such efforts will be sufficient to prevent the Company from incurring liability for the operations of Keystone.

Changes in environmental laws and regulations occur frequently, and any changes to these or other laws governing the natural gas and oil exploration industry that result in more stringent or costly water or wastewater handling, storage, transport, disposal or cleanup requirements could require Keystone to make significant expenditures to maintain compliance with such requirements, may harm Keystone's business and results of operations by reducing the demand for Keystone's water and related services, and may otherwise have a material adverse effect on Keystone's competitive position, financial condition, results of operations and cash flows.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our properties consist of transmission, distribution and collection pipes, water and wastewater treatment plants, pumping wells, tanks, meters, supply lines, dams, reservoirs, buildings, vehicles, land, easements, software rights and other facilities and equipment. Our properties are 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.

The properties of our Regulated Businesses segment primarily include 81 dams and 81 surface water treatment plants along with approximately 500 groundwater treatment plants, 1,100 groundwater wells, 100 wastewater treatment facilities, 1,200 treated water storage facilities, 1,400 pumping stations, and 49,000 miles of mains and collection pipes. We have ongoing infrastructure renewal programs in all states in which our Regulated Businesses segment operate. These programs consist of both rehabilitation of existing mains and other equipment and replacement of mains and other equipment that are damaged or have reached, or are near, the end of their useful service lives. The properties of our Market-Based Businesses consist mainly of office furniture and IT equipment and are primarily located in New Jersey. Approximately 51% of all properties that we own 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.

We believe that our properties are generally maintained in good operating condition and in accordance with current standards of good water and wastewater industry practice.

ITEM 3. LEGAL PROCEEDINGS

Alternative Water Supply in Lieu of Carmel River Diversions

In 1995, the California State Water Resources Control Board issued an administrative order (the "1995 Order") requiring Cal Am to implement an alternative water supply in lieu of diversions from the Carmel River. In response to claims that Cal Am had not diligently pursued establishing an alternative water supply as required by the 1995 Order, the State Water Resources Control Board adopted the 2009 Order, finding that Cal Am had 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 Cal Am significantly decrease its yearly diversions from the Carmel River according to a set reduction schedule through 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.

In December 2010, the CPUC approved the Regional Desalination Project (the "RDP"), involving the construction of a desalination facility in the City of Marina, north of Monterey. The RDP 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 Cal Am. The RDP was intended to eliminate unauthorized diversions from the Carmel River as required under the 1995 Order and the 2009 Order, in addition to other obligations.

The RDP 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”). In July 2011, MCWRA advised MCWD and Cal Am that the Agreements were void as a result of the conduct of the Former Director. On September 28, 2011, Cal Am terminated the Agreements as a result of MCWRA’s anticipatory repudiation of the Agreements by stating they were void. Following unsuccessful mediation efforts, Cal Am publicly announced that it had withdrawn support of the RDP. In July 2012, the CPUC closed the proceedings relating to the RDP and stated that it would examine the recoverability of costs related to the RDP in other proceedings.

In December 2012, Cal Am, MCWRA and the County of Monterey entered into a settlement agreement under which Cal Am will forgive approximately \$1.9 million loaned by Cal Am under the Agreements, and Cal Am will make additional payments of up to approximately \$1.5 million to MCWRA. On April 15, 2015, the CPUC issued a final decision approving, in part, the settlement agreement by authorizing Cal Am’s recovery of \$1.9 million of costs advanced to MCWRA. The CPUC denied without prejudice the recovery of approximately \$765 thousand due to insufficient information for the CPUC to determine the reasonableness of such amount. Cal Am may file another application for recovery at a future date. On April 17, 2015, MCWD filed an application with the CPUC for a rehearing of the settlement approval, which was denied on October 22, 2015. On November 20, 2015, MCWD filed with the California Supreme Court a petition for writ of review of the CPUC approval and the order denying MCWD’s rehearing application.

In October 2012, Cal Am filed a Complaint for Declaratory Relief (the “2012 Complaint for Declaratory Relief”) in the Monterey County Superior Court (subsequently transferred to the San Francisco 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 June 1, 2015, the court entered its final judgment declaring that four of the five Agreements are void and one, the credit line agreement, is not void (the “Void Judgment”). On June 30, 2015, MCWD filed its notice of appeal of the Void Judgment. The court awarded Cal Am approximately \$1.4 million in costs and attorneys’ fees in connection with the 2012 Complaint for Declaratory Relief. Appeals of these awards remain pending.

On July 1, 2015, Cal Am and MCWRA filed a Complaint, subsequently amended on July 17, 2015 (the “Cal Am Complaint”) in San Francisco County Superior Court, against MCWD and RMC Water and Environment, a private engineering consulting firm (“RMC”), seeking to recover compensatory, consequential and incidental damages associated with the failure of the RDP, which have been alleged in the Cal Am Complaint to be in excess of \$10.0 million, as well as punitive and treble damages, statutory penalties and attorneys’ fees. On July 30, 2015, MCWD filed a Complaint (the “MCWD 2015 Complaint”) in San Francisco County Superior Court against Cal Am, MCWRA and certain unidentified individual defendants. MCWD is seeking to recover compensatory damages associated with the failure of the RDP in an amount to be proven at trial, which have been alleged in the MCWD 2015 Complaint to be at least \$18.0 million, as well as exemplary damages and attorneys’ fees. On August 12, 2015, RMC filed a Complaint for Damages (the “RMC Complaint,” and, together with the Cal Am Complaint and the MCWD 2015 Complaint, collectively, the “Damages Actions”) in San Francisco County Superior Court against Cal Am and MCWRA seeking to recover damages associated with the failure of the RDP of at least \$697 thousand, plus an unspecified amount of punitive damages against Cal Am. On December 16, 2015, the court issued an order granting a motion by RMC to consolidate the Damages Actions and a motion by MCWD to stay the Damages Actions pending the resolution of the appeal of the Void Judgment.

In April 2012, Cal Am filed an application with the CPUC for approval of the Monterey Peninsula Water Supply Project (the “Water Supply Project”). The Water Supply Project involves construction of a desalination plant, owned by Cal Am, intended to reduce water diversions from the Carmel River. In addition, the Water

Supply Project may include Cal Am's purchase of water from a groundwater replenishment project (the "GWR Project") between the Monterey Regional Water Pollution Control Agency ("MRWPCA") and the Monterey Peninsula Water Management District ("MPWMD"). The desalination plant size is expected to vary depending on whether the GWR Project is included. Without the GWR Project included, a 9.6 million gallon per day ("mgd") plant size is proposed, and with the GWR Project included, a 6.4 mgd plant size is proposed. The Water Supply Project also would involve aquifer storage and recovery through an existing aquifer storage and recovery program between Cal Am and the MPWMD.

In July 2013, Cal Am entered into a settlement agreement with 15 other parties that have intervened in the CPUC proceedings with respect to the Water Supply Project, including several Monterey County government entities, the Office of Ratepayer Advocates of the CPUC and several interest groups (the "WSP Settlement"). Under the WSP Settlement, the parties have agreed on several matters relating to the Water Supply Project. The WSP Settlement is subject to the pending approval of the CPUC.

A preliminary step to building the Water Supply Project desalination plant is the construction and operation of a test slant well, as well as monitoring well clusters, to confirm the suitability of the property on which permanent intake wells will be located to draw water from under Monterey Bay. The site of the test slant well is on a property owned by one or more affiliates of Cemex, Inc. (collectively, "Cemex"). Cal Am and Cemex have entered into an agreement under which Cal Am acquired a temporary investigative easement to construct and operate the test slant well and a four year option to purchase a permanent easement for construction and operation of slant wells and related pipelines for the Water Supply Project on portions of the Cemex property when the final configuration of the new wells are approved by the California Coastal Commission (the "Coastal Commission").

In November 2014, the Coastal Commission approved a coastal development permit for the test slant well on the Cemex property and a second coastal development permit, enabling Cal Am to construct the portion of the test slant well that will be under state lands (beneath the ocean floor), provided that Cal Am acquires a lease from the California State Lands Commission (the "State Lands Commission"), which owns the state lands. The State Lands Commission executed the required lease on January 22, 2015. On October 6, 2015, the Coastal Commission approved an amendment to Cal Am's permits to operate the test slant well on the Cemex property.

In December 2014, each of MCWD and the Ag Land Trust, an agricultural land conservancy, filed petitions (collectively, the "Test Slant Well Petitions") against the Coastal Commission and Cal Am, which were ultimately transferred to the jurisdiction of the Santa Cruz County Superior Court. These petitions sought, among other things, a peremptory writ of mandate commanding the Coastal Commission to vacate its decision to approve the coastal development permit relating to the Cemex property, and a permanent injunction restraining Cal Am and the Coastal Commission from taking any action to implement the test slant well project, pending full compliance with the California Environmental Quality Act ("CEQA") and the California Coastal Act (the "Coastal Act"). After a trial on the merits, the court denied the Test Slant Well Petitions in their entirety. MCWD has appealed this decision, which appeal remains pending.

On January 15, 2015, MCWD filed a Petition for Writ of Mandate and Complaint for Declaratory and Injunctive Relief in Santa Cruz County Superior Court against the State Lands Commission and Cal Am (the "January 2015 Petition"), seeking relief similar to that sought in its Test Slant Well Petition. On October 1, 2015, pursuant to a stipulation among the parties, the court entered an order staying a hearing on the January 2015 Petition until the appeal regarding the denial of MCWD's Test Slant Well Petition is resolved.

On November 5, 2015, MCWD filed a Petition for Writ of Mandate and Complaint for Declaratory and Injunctive Relief against the Coastal Commission and Cal Am challenging the October 6, 2015 amendment by the Coastal Commission of the permits to operate the test slant well and seeking the issuance of an injunction against further test well pumping until this petition is resolved. This proceeding remains pending.

In addition to the foregoing matters, Cal Am's ability to move forward on the Water Supply 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 WSP Settlement. On August 19, 2015, the statutory deadline for resolving the application related to the Water Supply Project was extended to December 31, 2016 and a procedural schedule was subsequently approved calling for evidentiary hearings to be held in April 2016, with CPUC action on the GWR Project anticipated to occur as early as August 2016. On January 22, 2016, Cal Am submitted testimony that it had reached substantial completion of a water purchase agreement with MRWPCA and MPWMD for the GWR Project, which if approved by the CPUC would result in the smaller plant size of 6.4 mgd. Based on the foregoing, Cal Am estimates that the earliest date by which the Water Supply Project desalination plant could be completed is sometime in 2018. There can be no assurance that Cal Am's application for the Water Supply Project will be approved or that the Water Supply Project will be completed on a timely basis, if ever.

The projected completion date of the Water Supply Project is beyond the December 31, 2016 deadline for Cal Am to terminate unpermitted diversions from the Carmel River, and Cal Am does not expect to have sufficient other alternative sources of water available by the December 31, 2016 deadline. As a result, on November 20, 2015, Cal Am, along with several Monterey County government agencies, filed an application with the State Water Resources Control Board to modify the 2009 Order to extend the deadline for compliance to December 31, 2020. There can be no assurance that the deadline will be extended or that Cal Am 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. While Cal Am believes that its discussions with the State Water Resources Control Board staff have been constructive, there can be no assurance that the deadline will be extended.

Overflow of Diesel Fuel Tank

On March 2, 2015, Virginia-American Water Company ("VAWC")—Hopewell District had an overflow of a diesel fuel day tank at its low lift pump station located along the Appomattox River in Hopewell, Virginia. Approximately 500 gallons of diesel fuel overflowed the day tank and onto the ground and a portion of the fuel ultimately entered the river. VAWC notified first responders and retained Clean Harbors, an emergency response company, to control the overflow area and perform clean-up at the site and in the river. On March 4, 2015, the EPA issued an Emergency Removal/Response Administrative Order directing the performance by VAWC of removal actions to mitigate the release. VAWC and Clean Harbors conducted removal efforts under the order subject to oversight by the EPA and the Virginia Department of Environmental Quality ("VDEQ"), and on May 11, 2015, the EPA issued a notice of completion of the work required under the order. VAWC also has received and responded to a request from the EPA for information regarding the overflow of the diesel fuel tank.

On April 1, 2015, VDEQ issued a Notice of Violation ("NOV") alleging violations arising from this incident without providing a specific fine or penalty amount. The NOV also alleged violations relating to discharges of chlorinated water into the river that were identified during the course of the response to the Hopewell diesel overflow. VAWC has taken steps to prevent any potential for such discharges going forward. In the second quarter of 2015, VDEQ issued to VAWC a consent order and assessed a civil charge of approximately \$20 thousand with respect to this matter. VAWC has signed the consent order and paid the civil charge.

West Virginia Elk River Freedom Industries Chemical Spill

On January 9, 2014, a chemical storage tank owned by Freedom Industries, Inc. leaked two substances, 4-methylcyclohexane methanol, or MCHM, and PPH/DiPPH, a mix of polyglycol ethers, into the Elk River near the 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"), 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 for all of its approximately 93,000 customer accounts in parts of nine West Virginia counties served by the Charleston treatment plant. 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 EPA 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 were at non-detectable levels remained in place. In addition, based on saved samples taken on or before January 18, 2014, PPH/DiPPH was no longer detected in the water supply 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 were 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 continued to work with laboratories to test down to below 2 ppb of MCHM and announced on March 3, 2014, that it had cleared the system to below this level.

To date, there are 68 pending cases against WVAWC with respect to this matter in the United States District Court for the Southern District of West Virginia or West Virginia Circuit Courts in Kanawha, Boone and Putnam counties. Fifty-three of the state court cases naming WVAWC, and one case naming both WVAWC and American Water Works Service Company, Inc. (“AWWSC,” and together with WVAWC and the Company, the “American Water Defendants”) were removed to the United States District Court for the Southern District of West Virginia. On December 17, 2015, the federal district court entered orders remanding 52 of the previously removed cases back to the West Virginia Circuit Courts for further proceedings (two of the previously removed cases had been dismissed in the interim). Following that order, seven additional cases were filed against WVAWC in West Virginia Circuit Courts in Kanawha and Putnam counties with respect to this matter. On January 28, 2016, all of the state court cases were referred to West Virginia’s Mass Litigation Panel for further proceedings.

Four of the cases pending before the federal district court were consolidated for purposes of discovery, and an amended consolidated class action complaint for those cases (the “Federal action”) was filed on December 9, 2014 by several plaintiffs who allegedly suffered economic losses, loss of use of property and tap water or other specified adverse consequences as a result of the Freedom Industries spill, on behalf of a purported class of all persons and businesses supplied with, using, or exposed to water contaminated with Crude MCHM and provided by WVAWC in Logan, Clay, Lincoln, Roane, Jackson, Boone, Putnam, and Kanawha Counties and the Culloden area of Cabell County, West Virginia as of January 9, 2014. The amended consolidated complaint names several individuals and corporate entities as defendants, including the American Water Defendants. The plaintiffs seek unspecified damages for alleged business or economic losses; unspecified damages or a mechanism for recovery to address a variety of alleged costs, loss of use of property, personal injury and other consequences allegedly suffered by purported class members; punitive damages and certain additional relief, including the establishment of a medical monitoring program to protect the purported class members from an alleged increased risk of contracting serious latent disease.

On April 9, 2015, the court in the Federal action denied a motion to dismiss all claims against the Company for lack of personal jurisdiction. A separate motion to dismiss filed by AWWSC and WVAWC (and joined by the Company) asserting various legal defenses in the Federal action was resolved by the court on June 3, 2015. The court dismissed three causes of action but denied the motion to dismiss with respect to the remaining causes of actions and allowed the plaintiffs to continue to pursue the various claims for damages alleged in their amended consolidated complaint.

On July 6, 2015, the plaintiffs in the Federal action filed a motion seeking certification of a class defined to include persons who resided in dwellings served by WVAWC’s Kanawha Valley Treatment Plant (“KVTP”) on

January 9, 2014, persons who owned businesses served by the KVTP on January 9, 2014, and hourly employees who worked for such businesses. The plaintiffs sought a class-wide determination of liability against the American Water Defendants, among others, and of damages to the three groups of plaintiffs as a result of the “Do Not Use” order issued after the Freedom Industries spill.

A court-directed mediation was held at the end of September 2015 with the assistance of private mediators. Representatives of the American Water Defendants, Eastman Chemical, the Federal action plaintiffs, and the plaintiffs in the 53 state court cases as to which removal to Federal court had been sought, as well as insurance carriers for certain of the defendants, participated in the mediation. No resolution was reached and no further mediation discussions have been scheduled to date.

On October 8, 2015, the court in the Federal action granted in part and denied in part the plaintiffs’ class certification motion. The court certified a class addressing the alleged fault of Eastman Chemical for tort claims and the alleged fault of the American Water Defendants for tort and breach of contract claims, as well as the comparative fault of Freedom Industries. However, the court granted the joint motion by defendants to exclude certain expert testimony, disallowing the testimony of plaintiffs’ economic damages experts, and denied class certification as to any damages, including punitive damages. Thus, determination or quantification of damages, if any, would be made in subsequent proceedings on an individual basis.

On December 17, 2015, the court in the Federal action entered a scheduling order that provides for the trial on class issues to begin in July 2016. During the first week of January 2016, three additional cases were filed against one or more of the American Water Defendants, as well as others, in the U.S. District Court for the Southern District of West Virginia with respect to this matter.

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 the Public Service Commission of West Virginia (the “PSC”). As a result of the U.S. Attorney’s Office investigation, Freedom Industries and six former Freedom Industries employees (three of whom also were former owners of Freedom Industries), pled guilty to violations of the federal Clean Water Act.

On May 21, 2014, the PSC issued an Order initiating a General Investigation into certain matters relating to WVAWC’s response to the Freedom Industries spill. Three parties have intervened in the proceeding, including the Consumer Advocate Division of the PSC and two attorney-sponsored groups, including one sponsored by some of the plaintiffs’ counsel involved in the civil litigation described above. WVAWC has filed testimony regarding its response to the spill and is subject to discovery from PSC staff and the intervenors as part of the General Investigation. Several disputes have arisen between the WVAWC and the intervenors regarding, among other things, the scope of the discovery and the maintenance of confidentiality with regard to certain WVAWC emergency planning documents. In addition, the intervenors and PSC staff filed expert testimony in support of their assertions that WVAWC did not act reasonably with respect to the Freedom Industries spill, and WVAWC has asserted that some of the testimony is outside the scope of the PSC proceeding. The PSC has deferred setting a revised procedural schedule and has not set a final hearing date on the matter.

The Company, WVAWC and the other Company-affiliated entities named in any of the lawsuits 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 affiliated entities 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 these lawsuits, the ongoing government investigations or any legislative initiatives that might affect water utility operations.

On May 6, 2015, the Company received a pre-litigation demand letter from a purported stockholder seeking to have the Company’s Board of Directors, among other things, commence litigation against any and all persons

and entities responsible for matters relating to the Freedom Industries chemical spill, including the Company's officers and directors. A special committee of the Board of Directors of the Company, comprised of independent directors, investigated the claims made in the demand letter (and similar claims) with the special committee's legal advisor. After completing its investigation, the special committee concluded that the stockholder's claims were without merit and recommended to the Board of Directors that it was not in the best interests of the Company or its stockholders to pursue the demanded litigation. The Board of Directors reviewed the information considered by the special committee, and after careful consideration, accepted the recommendations of the special committee.

General

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

Since April 23, 2008, our common stock has traded on the NYSE under the symbol “AWK.” The following table summarizes the per share range of the high and low closing and intraday sales prices of our common stock as reported on the NYSE and the per share cash dividends paid and declared for the years ended December 31, 2015 and 2014:

	<u>Closing Market Prices</u>		<u>Intraday Market Prices</u>		<u>Per Share Dividends Paid</u>	<u>Per Share Dividends Declared</u>
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>		
2015						
Fourth Quarter	\$ 60.61	\$ 55.27	\$ 61.20	\$ 54.62	\$ 0.34	\$ 0.68
Third Quarter	55.08	49.17	55.63	48.52	0.34	0.34
Second Quarter	55.45	48.63	55.67	48.36	0.34	0.34
First Quarter	57.36	52.19	57.48	51.84	0.31	—
2014						
Fourth Quarter	\$ 55.86	\$ 47.92	\$ 56.19	\$ 47.58	\$ 0.31	\$ 0.31
Third Quarter	50.61	46.41	50.71	45.98	0.31	0.62
Second Quarter	49.45	45.16	49.50	44.86	0.31	0.31
First Quarter	45.56	41.16	45.86	41.07	0.28	—

As of February 19, 2016, there were 178,008,765 shares of common stock outstanding and approximately 2,345 record holders of common stock. Holders of the Company’s common stock are entitled to receive dividends when they are declared by the Board of Directors. When dividends on common stock are declared, they are typically paid in March, June, September and December. Future dividends are not guaranteed by the Company and will be dependent on future earnings, financial requirements, contractual provisions of debt agreements and other relevant factors.

In February 2015, the Board of Directors authorized an anti-dilutive common stock repurchase program to mitigate the dilutive effect of shares issued through our dividend reinvestment, employee stock purchase and executive compensation activities. The program allows us to purchase up to 10 million shares of our outstanding common stock over an unrestricted period of time in the open market or through privately negotiated transactions. The program is conducted in accordance with Rule 10b-18 of the Exchange Act, and to facilitate these repurchases, we have entered into a Rule 10b5-1 share repurchase plan with a third party broker, which allows us to repurchase shares at times when we may otherwise be prevented from doing so under insider trading laws or because of self-imposed trading blackout periods. Subject to applicable regulations, we may elect to amend or cancel the program or share repurchase parameters at our discretion to manage dilution.

The following table provides a summary of information about the shares of common stock we purchased during the three months ended December 31, 2015:

	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (a)</u>	<u>Maximum Number of Shares that May Yet Be Purchased Under the Plan or Program</u>
October 1—October 31, 2015	186,500	\$ 57.22	186,500	9,063,500
November 1—November 30, 2015 . . .	170,254	56.94	170,254	8,893,246
December 1—December 31, 2015	<u>1,143,246</u>	58.24	<u>1,143,246</u>	7,750,000
Total	<u>1,500,000</u>	57.45	<u>1,500,000</u>	

(a) From April 1, 2015, the date our repurchases under the program commenced, through December 31, 2015, we purchased an aggregate of 2,250,000 shares under our anti-dilutive common stock repurchase program.

ITEM 6. SELECTED FINANCIAL DATA

	<u>For the Years Ended December 31,</u>				
	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
	(In millions, except per share data)				
Statement of Operations Data					
Operating revenues	\$ 3,159	\$ 3,011	\$ 2,879	\$ 2,854	\$ 2,642
Income from continuing operations	\$ 476	\$ 430	\$ 371	\$ 374	\$ 303
Income from continuing operations per basic common share	\$ 2.66	\$ 2.40	\$ 2.08	\$ 2.12	\$ 1.73
Income from continuing operations per diluted common share	\$ 2.64	\$ 2.39	\$ 2.07	\$ 2.10	\$ 1.72
Balance Sheet Data					
Total assets (a) (b)	\$17,241	\$16,038	\$15,064	\$14,713	\$14,771
Short-term and long-term debt (a)	\$ 6,543	\$ 5,936	\$ 5,850	\$ 5,569	\$ 5,877
Redeemable preferred stock (c)	\$ 13	\$ 17	\$ 19	\$ 21	\$ 22
Other Data					
Aggregate dividends declared per common share (d)	\$ 1.36	\$ 1.24	\$ 1.12	\$ 0.98	\$ 1.13
Cash flows provided by operating activities	\$ 1,179	\$ 1,097	\$ 896	\$ 956	\$ 808
Capital expenditures included in cash flows used in investing activities	\$(1,160)	\$(956)	\$(980)	\$(929)	\$(925)

(a) This information has been revised to reflect the retrospective application of Accounting Standard Update 2015-15 Presentation of Debt Issuance Costs, which was adopted by the Company as of December 31, 2015.

(b) This information has been revised to reflect the retrospective application of Accounting Standard Update 2015-17 Income Taxes, which was adopted by the Company as of December 31, 2015.

(c) Includes the current portion of redeemable preferred stock, which is included in current portion of long-term debt in the Consolidated Balance Sheets.

(d) 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 consolidated 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 “Forward-Looking Statements,” Item 1A—Risk Factors and elsewhere in this Form 10-K.

Executive Overview

American Water is the largest and most geographically diverse investor-owned publicly-traded water and wastewater utility company in the United States, as measured both by operating revenues and population served. We employ approximately 6,700 professionals who provide drinking water, wastewater and other related services to an estimated 15 million people in 47 states, the District of Columbia and Ontario, Canada. Our primary business involves the ownership of utilities that provide water and wastewater services to residential, commercial, industrial, public 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 3.3 million customers based on the number of active service connections to our water and wastewater networks. We also operate several businesses that provide a broad range of related and complementary water and wastewater services in non-regulated markets, which includes four operating segments that individually do not meet the criteria of a reportable segment in accordance with GAAP. These four non-reportable operating segments are collectively presented as our Market-Based Businesses, which is consistent with how management assesses the results of these businesses.

2015 Strategic Focus & Achievements

For 2015, our focus was anchored on five central strategic themes:

- **Customers**—Our customers are at the center of everything we do.
 - In 2015, we achieved customer satisfaction ratings of 91% and service quality ratings of 85%. In addition, we continued to make needed infrastructure investment while implementing operational efficiency improvements to keep customer rates affordable.
- **Safety**—The health and safety of our employees, customers and the public is both a strategy and a value.
 - In 2015, we continued to move our safety culture forward. We implemented a “near miss” reporting program designed for accident prevention and risk education. In addition, our vendors joined us in numerous safety fairs demonstrating options available for protective equipment used across our business.
- **People**—Our employees and culture are paramount to our success.
 - In 2015, we demonstrated our commitment to employees by providing safety and technical training throughout our organization. We also provided business leadership training to virtually all of our front line supervisors across the company.
- **Growth**—We invested \$1.4 billion in 2015; a record level of annual investment, including:
 - \$1.2 billion to improve infrastructure in our Regulated Businesses;

- \$64 million for regulated acquisitions, adding approximately 24,000 water and wastewater customers; and
- \$133 million for the Keystone acquisition.
- Technology and Operational Efficiency—We drove continued cost savings in our regulated businesses.
 - We achieved an adjusted O&M efficiency ratio (a non-GAAP measure) of 35.9% in 2015.

2015 Financial Results

For the year ended December 31, 2015, we grew income from continuing operations more than 10%, while making capital investment in our infrastructure and implementing operational efficiency improvements to keep customer rates affordable.

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Income from continuing operations	\$ 2.64	\$ 2.39	\$ 2.07
Loss from discontinued operations, net of tax	\$ —	\$ (0.04)	\$ (0.01)
Diluted earnings per share	<u>\$ 2.64</u>	<u>\$ 2.35</u>	<u>\$ 2.06</u>

Income from continuing operations increased 25 cents per diluted share for year ended December 31, 2015 compared to the prior year. Excluding the 2014 costs related to the Freedom Industries chemical spill in West Virginia of 4 cents per diluted share, income from continuing operations increased 21 cents per diluted share, or about 8.8%. The increase was mainly due to continued growth in both our Regulated Businesses segment and Market-Based Businesses.

Discontinued operations represents the 2014 sale of our Terratec line of business, which was part of our Market-Based Businesses. The loss from discontinued operations, net of tax, reflected in the 2014 financial results includes the loss on the sale, an income tax valuation allowance and the 2014 operating results of the entity prior to the sale.

See “Comparison of Consolidated Results of Operations” and “Segment Results” below for further detailed discussion of the consolidated results of operations, as well as our business segments. All financial information in this Management’s Discussion and Analysis of Financial Condition and Results of Operations reflects continuing operations, unless otherwise noted. See Note 3—Acquisitions and Divestitures in the Notes to Consolidated Financial Statements for further details on our discontinued operations.

Regulatory Matters

The table below provides rate authorizations effective from 2013 through 2015. The table depicts annualized incremental revenues assuming a constant water sales volume:

	<u>For the Years Ended December 31,</u>		
	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(In millions)		
General rate cases by state			
Pennsylvania (a)	\$ —	\$ —	\$ 26
New Jersey (b)	22	—	—
Kentucky (c)	—	—	7
Indiana (d)	5	—	—
California (e)	5	2	3
West Virginia (f)	—	—	9
Iowa (g)	—	4	—
Other	1	—	—
Total General rate cases	<u>\$ 33</u>	<u>\$ 6</u>	<u>\$ 45</u>

- (a) On December 19, 2013, a rate case settlement was approved with an effective date of January 1, 2014.
- (b) Final order was received on September 11, 2015 with new rates effective September 21, 2015.
- (c) Final order was received on October 25, 2013 with rates effective July 27, 2013.
- (d) Final order issued on January 28, 2015 with new rates effective January 29, 2015.
- (e) Final order for test year 2015 issued April 9, 2015 with rates effective to January 1, 2015. The 2014 and 2013 increases are from step rate and attrition year filings with rates effective on April 1, 2014 and April 1, 2013, respectively.
- (f) Final order issued on September 26, 2013 by the West Virginia Public Service Commission. New rates were put into effect October 11, 2013.
- (g) Effective date of new rates was April 18, 2014. The increase included approximately \$3 million of interim rates that were effective May 10, 2013.

On April 30, 2015, our West Virginia subsidiary filed a general rate case requesting \$36 million in additional annualized water and wastewater revenues. On July 31, 2015, our Missouri subsidiary filed a general rate case requesting \$25 million in additional annualized revenue. Lastly, on October 30, 2015 our Virginia subsidiary filed a general rate case requesting \$9 of additional annualized revenue.

In July 2015, Cal Am filed an application with the CPUC to request changes to the present rate design and the emergency conservation and rationing plan for water customers in certain areas within its Monterey County service district. If approved, the proposed changes would allow: (i) recovery of existing under-collections of the net water revenue adjustment mechanism/modified cost balancing account (“WRAM/MCBA”) balance, amounting to approximately \$51 million as of December 31, 2015, over 20 years earning a pretax rate of 8.41%; (ii) an annual consumption true-up mechanism and rate design that provide for more timely collection of the cost of service; and (iii) modification of existing conservation and rationing plans. On November 4, 2015, Cal Am received an Assigned Commissioner’s Scoping Memo and Ruling (“Memo”) related to our WRAM filing. The Memo called for the suspension of the WRAM surcharges related to 2013 and 2014 under-collections and required Cal Am to retain an independent accounting firm to verify the actual customer water usage and billed revenue for the Monterey County service district for years ended December 31, 2013 and 2014. The results of the auditors verification was filed with the CPUC in January 2016. On February 1, 2016, Cal Am filed a motion with the CPUC to restart the surcharge collections for 2013 and 2014.

On February 16, 2016, the Commission’s Office of Ratepayer Advocates (“ORA”) issued a report on Cal Am’s requests to address Monterey rate design and the historical WRAM balances. The ORA recommends a disallowance of \$17 million of the Monterey WRAM balance and also recommends that the amortization occur over five years with no interest. Additionally, the ORA recommends the CPUC deny Cal Am’s request for annual consumption true up pilot program. We are in the process of reviewing the ORA proposal and will submit our response on March 4, 2016; however, we do not believe that the ORA proposals have merit. We expect a CPUC decision in mid to late 2016.

On December 30, 2015, our Indiana subsidiary filed a rate case true-up for additional annualized revenues in the amount of \$2 million which were authorized and effective on January 29, 2016. On January 21, 2016, our Illinois subsidiary filed a general rate case requesting an additional \$40 million in annualized revenues. On January 29, 2016, our Kentucky subsidiary filed a general rate case requesting an additional \$14 million in annualized water revenues. On February 1, 2016, Cal Am received approval from the CPUC to extend its cost of capital proceeding for an additional year. As such Cal Am’s current cost of capital will remain in place through 2017.

A number of states have authorized the use of regulatory mechanisms that permit rates to be adjusted outside of a general rate case for certain costs and investments, such as infrastructure surcharge mechanisms that permit recovery of capital investments to replace aging infrastructure. The following table details additional annualized revenues authorized through infrastructure surcharge mechanisms that were effective from 2013 through 2015:

	For the Years Ended December 31,		
	2015	2014	2013
	(In millions)		
Infrastructure charges by state			
Pennsylvania (a)	\$ 14	\$ —	\$ 20
New Jersey (b)	9	17	4
Missouri (c)	2	13	8
Indiana (d)	—	—	4
Illinois (e)	6	2	—
New York (f)	1	2	—
Tennessee (g)	2	1	—
Total Infrastructure charges	\$ 34	\$ 35	\$ 36

- (a) Quarterly filings made with PUC in 2015 for \$8 million, \$4 million and \$2 million effective October 1, 2015, July 1, 2015 and April 1, 2015, respectively. No infrastructure charges in 2014 as a result of general rate case effective January 1, 2014 utilized forecasted test year and therefore qualifying infrastructure improvements already reflected in rates. For 2013, \$7 million, \$4 million, \$3 million and \$6 million effective October 1, 2013, July 1, 2013, April 1, 2013 and January 1, 2013, respectively.
- (b) Semi-annual filings made with the PUC. For 2015, \$9 million effective January 1, 2015. For 2014, \$7 million and \$10 million effective July 1, 2014 and January 1, 2014, respectively. For 2013, \$4 million effective July 1, 2013.
- (c) For 2015, \$2 million effective June 27, 2015. For 2014, \$9 million and \$4 million effective December 31, 2014 and May 30, 2014, respectively. For 2013, \$5 million and \$3 million effective June 21, 2013 and December 14, 2013, respectively.
- (d) Effective December 18, 2013.
- (e) For 2015, \$1 million and \$5 million effective February 1, 2015 and January 1, 2015, respectively. For 2014, \$2 million effective January 1, 2014.
- (f) For 2015, \$1 million effective December 1, 2015. For 2014, \$1 million effective January 1, 2014 and March 3, 2014.
- (g) For 2015, \$2 million effective June 29, 2015. For 2014, \$1 million effective April 15, 2014.

On December 15, 2015, our Pennsylvania subsidiary filed for additional annualized revenues from infrastructure charges in the amount of \$11 million which were authorized and effective on January 1, 2016. On December 18, 2015, our Illinois subsidiary filed for additional annualized revenues from infrastructure charges in the amount of \$1 million, which were authorized and also effective on January 1, 2016. On January 14, 2016, our Indiana subsidiary filed for additional annualized revenues from infrastructure charges in the amount of \$3 million.

As of February 24, 2016, we are awaiting final general rate case orders in five states, requesting additional annualized revenue of \$123 million. We are also awaiting approval of \$5 million in additional annualized revenues for infrastructure charges. There is no assurance that all or any portion of these requests will be granted.

Technology and Operational Efficiency – Continuing Improvement in O&M Efficiency Ratio for our Regulated Businesses

We continued to improve on our O&M efficiency ratio. Our adjusted O&M efficiency ratio for the year ended December 31, 2015 was 35.9%, compared to 36.7% for the year ended December 31, 2014. The improvement in the 2015 O&M efficiency ratio over this period was attributable to both an increase in revenue and decreases in O&M expenses.

We evaluate our operating performance using this measure because management believes it is a direct measure of the efficiency of our Regulated Businesses’ operations. This information is intended to enhance an

investor's overall understanding of our operating performance. The O&M efficiency ratio is not a GAAP financial measure and may not be comparable to other companies' operating measures and should not be used in place of the GAAP information provided elsewhere in this report.

Our O&M efficiency ratio is defined as our regulated O&M expenses divided by regulated operating revenues, where both O&M expenses and operating revenues were adjusted to eliminate purchased water expense. Additionally, from the O&M expenses, we excluded 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 expenses but for consolidated financial reporting purposes are categorized within other line items in the accompanying Consolidated Statements of Operations. In addition, to the standard adjustments to the O&M efficiency ratio for the years ended December 31, 2014 and 2013, we have also excluded from operating revenues and O&M expenses the estimated impact from changes in consumption as a result of weather and the Freedom Industries chemical spill in West Virginia, as applicable. We excluded all the above items from the calculation as we believe such items are not reflective of management's ability to increase efficiency of the Company's regulated operations.

The following table provides the calculation and reconciliation that compares O&M expenses and operating revenues, as determined in accordance with GAAP, and to those amounts utilized in the calculation of our adjusted O&M efficiency ratio for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
	(In millions)		
Total operation and maintenance expenses	\$ 1,404	\$ 1,350	\$ 1,289
Less:			
Operation and maintenance expenses—Market-Based Businesses	358	289	241
Operation and maintenance expenses—Other	(49)	(51)	(57)
Total regulated operation and maintenance expenses	1,095	1,112	1,105
Less:			
Regulated purchased water expenses	117	122	111
Allocation of non-operation and maintenance expenses	35	39	35
Impact of Freedom Industries chemical spill in West Virginia	—	10	—
Estimated impact of weather (mid-point of range)	—	(2)	(2)
Adjusted regulated operation and maintenance expenses (a)	<u>\$ 943</u>	<u>\$ 943</u>	<u>\$ 961</u>
Total operating revenues	\$ 3,159	\$ 3,011	\$ 2,879
Less:			
Operating revenues—Market-Based Businesses	434	355	303
Operating revenues—Other	(18)	(18)	(18)
Total regulated operating revenues	2,743	2,674	2,594
Less:			
Regulated purchased water revenues*	117	122	111
Add:			
Impact of Freedom Industries chemical spill in West Virginia	—	1	—
Estimated impact of weather (mid-point of range)	—	17	15
Adjusted regulated operating revenues (b)	<u>\$ 2,626</u>	<u>\$ 2,570</u>	<u>\$ 2,498</u>
Adjusted O&M efficiency ratio (a)/(b)	35.9%	36.7%	38.5%

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

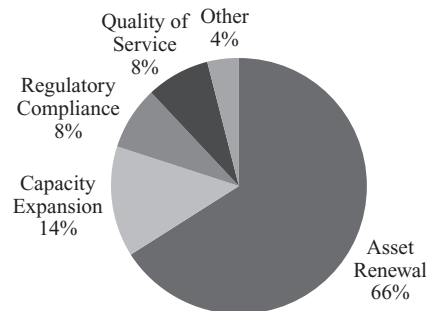
2016 and Beyond

Our future results continue to be anchored on the five central themes noted for 2015 with customers at the center of all we do. These five central themes are:

- **Customers.** Our focus continues to concentrate on our customers by achieving customer satisfaction and service quality targets. In addition, we will continue to make needed infrastructure investment while implementing operational efficiency improvements to strive to keep customer rates affordable.
- **Safety.** Our focus continues on driving safety in everything that we do. Our safety focus includes safety and health of our employees, customers and the public.
- **People.** Our focus on our employees and culture is paramount to our success going forward. We intend to also focus on ensuring we have strong relationships with our union represented employees, effective training and development and diversity of our workforce.
- **Growth.** We expect to invest \$6.4 billion over the next five years, with \$1.3 billion in 2016, as follows:
 - Capital investment to improve infrastructure in our Regulated Businesses segment of \$5.5 billion, with \$1.2 billion expected in 2016;
 - Growth from acquisitions in our Regulated Businesses segment of \$600 million to expand our water and wastewater customer base; and
 - Growth in our Market-Based Businesses from new core growth, expanded markets and new offerings, and evaluate potential opportunities to assist the natural gas exploration and production industry in the delivery of water to support their processes. We have estimated strategic capital investments of \$280 million.

The chart below presents our estimated percentage of projected capital expenditures over the period of 2016 to 2020 for improving infrastructure in our Regulated Businesses segment by purpose:

2016 - 2020 Average Regulated Capital Expenditures by Purpose



- **Technology & Operational Efficiency.** Continued commitment to operational efficiency, technology, innovation and environmental leadership. We intend to continue to modernize our infrastructure and focus on operational efficiencies, while bolstering a culture of continuous improvement. We have set a goal to achieve an adjusted O&M efficiency ratio equal to or below 34% by 2020. We are committed to environmental leadership while providing safe, reliable and cost-effective water and water related services to our customers.

Consolidated Results of Operations

The following table presents our consolidated results of operations for the years ended December 31:

	Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014	%	2014 vs. 2013	%
(In millions)							
Operating revenues	\$ 3,159	\$ 3,011	\$ 2,879	\$ 148	4.9	\$ 132	4.6
Operating expenses:							
Operation and maintenance	1,404	1,350	1,289	54	4.0	61	4.7
Depreciation and amortization	440	424	407	16	3.8	17	4.2
General taxes	243	236	234	7	3.0	2	0.9
(Gain) loss on asset dispositions and purchases	(3)	(2)	1	(1)	50.0	(3)	(300.0)
Total operating expenses, net	2,084	2,008	1,931	76	3.8	77	4.0
Operating income	1,075	1,003	948	72	7.2	55	5.8
Other income (expenses):							
Interest, net	(308)	(299)	(308)	(9)	3.0	9	(2.9)
Loss on extinguishment of debt	—	—	(41)	—	—	41	(100.0)
Other, net	15	6	9	9	150.0	(3)	(33.3)
Total other income (expenses)	(293)	(293)	(340)	—	—	47	(13.8)
Income from continuing operations before income taxes	782	710	608	72	10.1	102	16.8
Provision for income taxes	306	280	237	26	9.3	43	18.1
Income from continuing operations	476	430	371	46	10.7	59	15.9
Loss from discontinued operations, net of tax	—	(7)	(2)	7	(100.0)	(5)	250.0
Net income attributable to common stockholders	\$ 476	\$ 423	\$ 369	\$ 53	12.5	\$ 54	14.6

Comparison of Consolidated Results of Operations

Operating revenues. In 2015, operating revenues increased \$148 million, or 4.9%, primarily due to a:

- \$69 million increase in our Regulated Businesses segment primarily due to rate increases, infrastructure charges and increased demand, partially offset by decreased surcharges and balancing accounts in 2015;
- \$53 million increase in our Market-Based Businesses primarily due to incremental revenue from increased construction project activity in our Military Services Group and contract growth in our Homeowners Services Group; and
- \$26 million increase attributable to our Keystone acquisition, which is included in our Market-Based Businesses.

In 2014, consolidated operating revenues increased \$132 million, or 4.6%, primarily due to an:

- \$80 million increase in our Regulated Businesses segment primarily due to rate increases, incremental revenues from surcharges and balancing accounts and acquisitions, partially offset by reduced consumption in 2014; and
- \$52 million increase in our Market-Based Businesses primarily due to incremental revenue from increased construction project activity in our Military Services Group and organic growth in our Homeowner Services Group.

Operation and maintenance. In 2015, operation and maintenance expense increased \$54 million, or 4.0%, primarily due to a:

- \$45 million increase in our Market-Based Businesses primarily due to incremental costs in our Military Services Group and Homeowner Services Group corresponding with the increases in operating revenues discussed above;
- \$24 million increase attributable to our Keystone acquisition; partially offset by a
- \$17 million decrease in our Regulated Businesses segment primarily due to lower production costs, contract services and transportation costs, partially offset by higher casualty insurance costs.

In 2014, operation and maintenance expense increased \$61 million, or 4.7%, primarily due to a:

- \$49 million increase in our Market-Based Businesses primarily due to incremental costs in our Military Services Group and Homeowner Services Group corresponding with the increases in operating revenues discussed above; and
- \$6 million increase in our Regulated Businesses segment primarily due to increased production costs, uncollectible expense, maintenance expenses and costs associated with the Freedom Industries chemical spill in West Virginia partially offset by lower employee-related costs.

Depreciation and amortization. In 2015 and 2014, depreciation and amortization expense increased \$16 million and \$17 million, or 3.8% and 4.2%, respectively. The increase for both periods was primarily due to additional utility plant placed in service.

Other income (expenses). In 2014, other expenses decreased by \$47 million, or 13.8%, primarily due to the recognition of a pre-tax loss on debt extinguishment in 2013 of \$41 million in connection with the cash tender offer for our 6.085% Senior Notes due 2017. Also, contributing to the decrease was a reduction in interest expense resulting from interest savings as a result of our 2014 and 2013 refinancings. Partially offsetting these decreases was a reduction in allowance for funds used during construction, which was mainly attributable to our Customer Information and Enterprise Asset Management systems being placed into service in 2013.

Provision for income taxes. In 2015 and 2014, our provision for income taxes increased \$26 million and \$43 million, or 9.3% and 18.1%, respectively, due primarily to the increase in pre-tax income. The effective tax rates were 39.1%, 39.4% and 39.0% for the years ended December 31, 2015, 2014 and 2013, respectively.

In December 2015, the accelerated tax benefit for bonus depreciation was legislatively extended for 2015-2019. Bonus depreciation applies to certain qualified capital investments placed into service and allows for a bonus depreciation provision of 50% from 2015 through 2017, 40% in 2018 and 30% in 2019. We have federal NOL carryforwards of \$1.1 billion as of December 31, 2015. As such, the election of bonus depreciation will be annually determined on a state by state basis and will include, among other items, an evaluation of our ability to utilize our federal NOL carryforwards, charitable contribution carryforwards, and state regulatory practices. If we elect bonus depreciation for all years, we would not expect to pay federal income taxes until 2021.

Loss from discontinued operations, net of tax. As previously noted, the financial results of our Terratec line of business within our Market-Based Businesses was classified as discontinued operations for all periods presented. The sale of Terratec was completed in 2014. The 2014 loss from discontinued operations, net of tax includes the loss on sale, a tax valuation allowance and operating results.

Segment Results of Operations

Our segments are determined based on how we assess performance and allocate resources. We evaluate the performance of our segments and allocate resources based on several factors, with the primary measure being income from continuing operations.

We conduct our business primarily through one reportable segment, our Regulated Businesses segment. We also operate businesses that provide a broad range of related and complementary water and wastewater services in non-regulated markets, which includes four operating segments that individually do not meet the criteria of a reportable segment. These four non-reportable segments have been combined and are presented as Market-Based Businesses, which is consistent with how management assesses the results of our businesses.

Regulated Businesses Segment

The following table summarizes certain financial information for our Regulated Businesses segment:

(In millions)	For the Years Ended December 31,		
	2015	2014	2013
Operating revenues	\$ 2,743	\$ 2,674	\$ 2,594
Operation and maintenance	1,095	1,112	1,105
Operating expenses, net	1,732	1,726	1,700
Income from continuing operations	473	434	400

Operating revenues. The following tables and discussions provide explanation of the variances related to the three components of operating revenues—water revenues, wastewater revenues and other revenues:

(In millions)	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
	Operating Revenues			%		%	
Water service:							
Residential	\$ 1,536	\$ 1,515	\$ 1,465	\$ 21	1.4	\$ 50	3.4
Commercial	559	550	521	9	1.6	29	5.6
Industrial	130	132	119	(2)	(1.5)	13	10.9
Public and other	331	333	312	(2)	(0.6)	21	6.7
Other water revenues	39	26	18	13	50.0	8	44.4
Billed water services	2,595	2,556	2,435	39	1.5	121	5.0
Unbilled water services	(3)	(25)	30	22	(88.0)	(55)	(183.3)
Total water revenues	\$ 2,592	\$ 2,531	\$ 2,465	\$ 61	2.4	\$ 66	2.7

(In millions)	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
	Billed Water Sales Volume			%		%	
Water service:							
Residential (a)	175,653	176,975	180,976	(1,322)	(0.7)	(4,001)	(2.2)
Commercial	81,772	81,564	80,392	208	0.3	1,172	1.5
Industrial	38,991	39,833	37,107	(842)	(2.1)	2,726	7.3
Public and other	51,324	52,710	51,009	(1,386)	(2.6)	1,701	3.3
Billed water services	347,740	351,082	349,484	(3,342)	(1.0)	1,598	0.5

(a) The correlation between water service revenues and billed water sales volumes shown above is impacted by the California drought. California is experiencing a severe drought and in April 2015, the Governor mandated water usage restrictions to reduce overall water usage by 25% in the state compared to 2013 levels. Our California customers are largely meeting these conservation targets. Revenue in California is decoupled from sales volume, aligning our water conservation goals with those of the state and our customers and therefore these usage reductions do not impact earnings.

In 2015, water revenues increased \$61 million, or 2.4%, primarily due to a:

- \$45 million increase from rate increases and infrastructure charges;
- \$24 million increase from higher demand, mainly due to milder weather in 2014;

- \$5 million increase from acquisitions and organic growth; and
- \$3 million incremental revenues for late payment and reconnection fees; partially offset by a
- \$21 million decrease in surcharges and balancing accounts in our California subsidiary primarily related to the drought and the \$5 million charge associated with the July 2015 application filed with the CPUC.

In 2014, water revenues increased \$66 million, or 2.7%, primarily due to an:

- \$80 million increase from rate increases and infrastructure charges; and
- \$11 million increase in surcharges and balancing accounts; partially offset by a
- \$27 million decrease resulting from a decline in consumption, mainly due to milder weather in 2014.

	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
(In millions)	Operating Revenues			%		%	
Wastewater revenues	\$ 97	\$ 93	\$ 83	\$ 4	4.3	\$ 10	12.0
Other revenues	54	50	46	4	8.0	4	8.7

In 2015 and 2014, wastewater revenues increased primarily due to incremental revenues resulting from acquisitions.

In 2015 and 2014, other revenues increased primarily due to incremental revenues for late payments and reconnection fees, as well as insurance proceeds in 2014 for business interruption as a result of Hurricane Sandy.

Operation and maintenance. The following tables and discussions provide a detailed explanation of the variances related to the major components of operation and maintenance. In 2014, operation and maintenance was impacted by incremental costs of \$10 million related to the Freedom Industries chemical spill in West Virginia, which included \$6 million in other operation and maintenance, \$3 million in operating supplies and services, and \$1 million in employee-related costs.

	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
(In millions)				%		%	
Production costs	\$ 282	\$ 289	\$ 271	\$ (7)	(2.4)	\$ 18	6.6
Employee-related costs	430	430	456	—	—	\$(26)	(5.7)
Operating supplies and services	194	217	216	(23)	(10.6)	\$ 1	0.5
Maintenance materials and supplies	70	68	66	2	2.9	\$ 2	3.0
Customer billing and accounting	63	61	52	2	3.3	\$ 9	17.3
Other	56	47	44	9	19.1	\$ 3	6.8
Total	\$ 1,095	\$ 1,112	\$ 1,105	\$ (17)	(1.5)	\$ 7	0.6

Production costs

	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
(In millions)					%		%
Purchased water	\$ 117	\$ 121	\$ 111	\$ (4)	(3.3)	\$ 10	9.0
Fuel and power	89	92	86	(3)	(3.3)	6	7.0
Chemicals	48	46	48	2	4.3	(2)	(4.2)
Waste disposal	28	30	26	(2)	(6.7)	4	15.4
Total	<u>\$ 282</u>	<u>\$ 289</u>	<u>\$ 271</u>	<u>\$ (7)</u>	<u>(2.4)</u>	<u>\$ 18</u>	<u>6.6</u>

In 2015, production costs decreased \$7 million, or 2.4%, primarily due to a:

- \$9 million decrease primarily due to lower usage in our California subsidiary as a result of statewide conservation initiatives, including decreases of \$8 million in purchased water and \$1 million in fuel and power; partially offset by a
- \$4 million increase in purchased water primarily due to price increases in our Illinois and New Jersey subsidiaries.

In 2014, production costs increased \$18 million, or 6.6%, primarily due to a:

- \$10 million increase in purchased water costs primarily due to increased prices in our California subsidiary, and to a lesser extent, price increases in our Illinois subsidiary;
- \$6 million increase in fuel and power costs due to higher supplier prices in several of our operating facilities, as well as incremental costs as a result of the Dale acquisition in the fourth quarter of 2013; and
- \$4 million increase in waste disposal costs primarily due to an increase in the amount allowed by a cost recovery mechanism in one of our subsidiaries coupled with incremental costs related to the Dale acquisition.

Employee-related costs

	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
(In millions)					%		%
Salaries and wages	\$ 321	\$ 328	\$ 323	\$ (7)	(2.1)	\$ 5	1.5
Pensions	30	27	48	3	11.1	(21)	(43.8)
Group insurance	60	55	66	5	9.1	(11)	(16.7)
Other benefits	19	20	19	(1)	(5.0)	1	5.3
Total	<u>\$ 430</u>	<u>\$ 430</u>	<u>\$ 456</u>	<u>\$ —</u>	<u>—</u>	<u>\$ (26)</u>	<u>(5.7)</u>

In 2015, employee-related costs remained consistent primarily due to a:

- \$14 million reduction largely attributable to fewer employees and an increase in capital projects, which in turn resulted in higher capitalization rates; partially offset by a
- \$14 million increase in pension costs and postretirement benefits costs, which is included in the group insurance line above, primarily due to the adoption of new mortality assumptions and a decrease in the discount rate resulting in increased plan obligations.

In 2014, employee-related costs decreased \$26 million, or 5.7%, primarily due to a:

- \$32 million reduction in pension and postretirement costs principally due to the change in assumptions used for the discount rate, which in turn decreased contributions. The decrease in contributions occurred at those regulated operating companies whose costs are recovered based on our funding policy, which is to fund at least the minimum amount required by the Employee Retirement Income Security Act of 1974; partially offset by a
- \$5 million increase in salaries and wages primarily due to annual wage increases, increased overtime expense attributable to an increased number of main breaks as a result of harsh winter conditions and increases in severance expense as a result of the restructuring of certain functions.

Operating supplies and services

	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014		2014 vs. 2013	
(In millions)				%		%	
Contracted services	\$ 81	\$ 88	\$ 94	\$ (7)	(8.0)	(6)	(6.4)
Office supplies and services	44	45	45	(1)	(2.2)	—	—
Transportation	16	20	21	(4)	(20.0)	(1)	(4.8)
Rents	14	15	16	(1)	(6.7)	(1)	(6.3)
Other	39	49	40	(10)	(20.4)	9	22.5
Total	<u>\$ 194</u>	<u>\$ 217</u>	<u>\$ 216</u>	<u>\$ (23)</u>	<u>(10.6)</u>	<u>\$ 1</u>	<u>0.5</u>

In 2015, operating supplies and services decreased \$23 million, or 10.6%, primarily due to a:

- \$5 million decrease in condemnation and conservation costs primarily due to initiatives in 2014 incurred by our California subsidiary;
- \$3 million decrease in legal services;
- \$3 million incremental costs in 2014 associated with the Freedom Industries chemical spill in West Virginia;
- \$3 million adjustment attributable to the recognition of a regulatory asset for previously expensed business transformation costs as a result of the finalization of our California rate case; and
- \$3 million decrease in transportation costs primarily due to lower fuel prices.

In 2014, operating supplies and services increased \$1 million, or 0.5%, primarily due to a:

- \$9 million increase in other operating supplies and services primarily due to an increase in condemnation and conservation costs related to one-time initiatives in our California subsidiary, as well as inclusion in 2013 of insurance proceeds for the recovery of expenses related to Hurricanes Irene and Sandy; partially offset by a
- \$6 million decrease in contracted services as a result of completion of our business transformation project, which required the use of additional contracted services in 2013, partially offset by increases resulting from the Freedom Industries chemical spill in West Virginia mentioned above.

Market-Based Businesses

The following table summarizes certain financial information for our Market-Based Businesses:

(In millions)	For the Years Ended December 31,		
	2015	2014	2013
Operating revenues	\$ 434	\$ 355	\$ 303
Operation and maintenance	358	289	241
Operating expenses, net	370	300	252
Income from continuing operations	42	40	39

Operating revenues. In 2015, operating revenues increased \$79 million, or 22.3%, primarily due to a:

- \$41 million increase in our Military Services Group revenues primarily due to additional construction project activities and the addition of two military contracts, Hill Air Force Base and Picatinny Arsenal, in the second half of 2015;
- \$15 million increase in our Homeowner Services Group revenues primarily due to contract growth, mainly in New York City, and the expansion into other geographic areas; and
- \$26 million increase resulting from Keystone; partially offset by a
- \$3 million decrease in our Contract Operations Group revenues primarily due to attributable to the termination of certain municipal and industrial operations and maintenance contracts.

In 2014, operating revenues increased \$52 million, or 17.2%, primarily due to a:

- \$39 million increase in our Military Service Group revenues primarily resulting from an increase in construction project activities for our military contracts, which includes \$5 million in price redeterminations for several of our military contracts; and
- \$16 million increase in our Homeowners Services Group revenues primarily due to contract growth, mainly in New York City, as well as expansion into other geographic areas and price increases for certain existing customers; partially offset by a
- \$3 million decrease in our Contract Operations Group revenues primarily due to the termination of certain municipal and industrial operations and maintenance contracts.

Operation and maintenance. The following table provides information regarding components of operation and maintenance:

(In millions)	For the Years Ended December 31,			Increase (Decrease)		Increase (Decrease)	
	2015	2014	2013	2015 vs. 2014	%	2014 vs. 2013	%
Production costs	\$ 36	\$ 35	\$ 37	\$ 1	2.9%	\$ (2)	(5.4%)
Employee-related costs	76	62	60	14	22.6%	2	3.3%
Operating supplies and services	182	138	99	44	31.9%	39	39.4%
Maintenance materials and supplies	57	47	41	10	21.3%	6	14.6%
Other	7	7	4	—	—	3	75.0%
Total	<u>\$ 358</u>	<u>\$ 289</u>	<u>\$ 241</u>	<u>\$ 69</u>	<u>23.9%</u>	<u>\$ 48</u>	<u>19.9%</u>

In 2015, operation and maintenance increased \$69 million, or 23.9%, primarily due to a:

- \$30 million increase in our Military Services Group operating supplies and services primarily due to increased construction project activities and the addition of two military contracts; and

- \$24 million increase resulting from Keystone, including \$9 million in employee-related costs, \$14 million in operating supplies and services and \$1 million in maintenance, materials, and supplies;
- \$7 million increase in our Homeowner Services Group maintenance and supplies primarily due to higher repair costs incurred, which was attributable to the increase in the number of contracts.
- \$5 million increase in our Military Services Group and Homeowners Services Group employee-related costs, which was attributable to the addition of two military contracts and increase in headcount.

In 2014, operation and maintenance increased \$48 million, 19.9%, or primarily due to a:

- \$35 million increase in operating supplies and services related to our Military Services Group primarily due to increased construction project activities;
- \$4 million in loss contract reserves due to the resolution of certain outstanding issues and uncertainties; and
- \$6 million increase in maintenance materials and supplies primarily due to higher repair costs incurred by our Homeowners Services Group, which was attributable to a higher volume of contracts.

Liquidity and Capital Resources

We regularly evaluate and monitor our cash requirements for capital investments, acquisitions, operations, commitments, debt service and dividends. Our business is capital intensive, with a majority of this capital funded by cash flows from operations. When necessary, we also obtain funds from external sources, primarily in the debt markets and through short-term commercial paper borrowings. We also have access to equity capital markets, if needed. Our access to external financing on reasonable terms depends on our credit ratings and current business conditions, including that of the utility and water utility industries in general, as well as conditions in the debt or equity capital markets and the national and international economic and geopolitical arenas. If these business, market, financial and other conditions deteriorate to the extent that we no longer are able to access the capital markets on reasonable terms, we have access to an unsecured revolving credit facility with aggregate bank commitments of \$1.25 billion, with an expiration date of June 2020 (subject to extension by us for up to two one-year periods). We rely on this revolving credit facility and the capital markets to fulfill our short-term liquidity needs, to issue letters of credit and to support our commercial paper program. Disruptions in the credit markets may discourage lenders from extending the terms of such commitments or agreeing to new commitments. Market disruptions may also limit our ability to issue debt and equity securities in the capital markets. See “Credit Facility and Short-Term Debt” below for further discussion. In order to meet our short-term liquidity needs, we, through AWCC, our wholly owned financing subsidiary, issue commercial paper, which is supported by the revolving credit facility. AWCC had no outstanding borrowings and \$82 million of outstanding letters of credit under its credit facility as of December 31, 2015. As of December 31, 2015, AWCC had \$1.25 billion available under the credit facility that we could use to fulfill our short-term liquidity needs and to issue letters of credit, which supported our \$626 million outstanding commercial paper. We believe that our ability to access the capital markets, our revolving credit facility and our cash flows from operations will generate sufficient cash to fund our short-term requirements. We have no plans to issue equity under normal operating conditions with the limited exception of privately or investor-owned tuck-in acquisitions whose sellers require equity as necessary to complete the acquisition. We believe we have sufficient liquidity and ability to manage our expenditures should there be a disruption of the capital and credit markets. However, there can be no assurances 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.

In addition, our regulated subsidiaries receive advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable for limited periods, which vary according to state regulations, as new customers begin to receive service or other contractual obligations are fulfilled. Amounts which are no longer refundable

are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from the rate base. Generally, we depreciate contributed property and amortize contributions in aid of construction at the composite rate of the related property. Some of our subsidiaries do not depreciate contributed property, based on regulatory guidelines.

We use our capital resources, including cash, primarily to; (i) fund operating and capital requirements; (ii) pay interest and meet debt maturities; (iii) pay dividends; (iv) fund pension and postretirement welfare obligations; and (v) fund acquisitions. We invest a significant amount of cash on regulated capital projects where we expect to earn a long-term return on investment. Additionally, we operate in rate-regulated environments in which the amount of new investment recovery may be limited, and where such recovery takes place over an extended period of time, as our recovery is subject to regulatory lag. See Item 1—Business—Operating Segments—Regulated Businesses—Economic Regulation and Rate Making Process. We expect to fund future maturities of long-term debt through a combination of external debt and, to the extent available, cash flows from operations. Since we expect our capital investments over the next few years to be greater than or equal to our cash flows from operating activities, we have no plans to reduce debt significantly.

If necessary, the Company may delay certain capital investments or other funding requirements or pursue financing from other sources to preserve liquidity, if necessary. In this event, we believe we can rely upon cash flows from operations to meet our obligations and fund our minimum required capital investments for an extended period of time.

Cash Flows Provided by Operating Activities

Cash flows provided by operating activities primarily result from the sale of water and wastewater services and, due to the seasonality of demand, are generally greater during the third quarter of each fiscal year. Our future cash flows provided by operating activities will be affected by, among other things, economic utility regulation; infrastructure investment; inflation; compliance with environmental, health and safety standards; production costs; customer growth; declining customer usage of water; employee-related costs, including pension funding; weather and seasonality; and overall economic conditions.

Cash flows provided by operating activities have been a reliable, steady source of funding, sufficient to meet operating requirements, make our dividend payments and fund a portion of our capital expenditure requirements. We expect to seek access to debt capital markets to meet the balance of our capital expenditure requirements as needed. We also have access to equity capital markets, if needed. Operating cash flows can be negatively affected by changes in our rate regulated environments or changes in our customers' economic outlook and ability to pay for service in a timely manner. As such, our working capital needs are primarily limited to funding increases in customer accounts receivable and unbilled revenues mainly associated with revenue increases in our Regulated Businesses. We can provide no assurance that our customers' historical payment pattern will continue in the future. We address cash timing differences through the liquidity funding mechanisms discussed above.

The following table provides a summary of the major items affecting our cash flows provided by operating activities:

	For the Years Ended December 31,		
	2015	2014	2013
	(In millions)		
Net income	\$ 476	\$ 423	\$ 369
Add (less):			
Non-cash activities (a)	773	723	762
Changes in working capital (b)	(13)	3	(137)
Pension and postretirement benefit contributions	(57)	(52)	(98)
Net cash flows provided by operating activities	<u>\$ 1,179</u>	<u>\$ 1,097</u>	<u>\$ 896</u>

- (a) Includes depreciation and amortization, provision for deferred income taxes and amortization of investment tax credits, provision for losses on accounts receivable, (gain) loss on asset dispositions and purchases, pension and non-pension postretirement benefits, and other non-cash items. Details of each component can be found in the Consolidated Statements of Cash Flows.
- (b) Changes in working capital include changes to receivables and unbilled revenues, accounts payable and accrued liabilities, pension and non-pension postretirement benefit contributions, change in book overdraft and other current assets and liabilities.

In 2015, cash flows provided by operations increased \$82 million primarily due to higher net income compared to the same period in 2014.

In 2014, cash flows provided by operations increased \$201 million primarily due to an improvement in the cash collections of our Regulated Businesses' accounts receivable, some of which were unbilled at December 31, 2013. Cash collections in 2013 for our Regulated Businesses' accounts receivable were slower than historical payment patterns, mainly due to the implementation of our CIS system in May 2013. We implemented the CIS system in our remaining Regulated Businesses in October 2013 and experienced a similar slowdown in cash collections for these operating companies in 2014.

The Company expects to make pension and postretirement benefit contributions to the plan trusts of \$55 million in 2016, of which \$9 million was already made in 2016. In addition, we estimate that contributions will amount to \$61 million in 2017, \$79 million in 2018, \$93 million in 2019 and \$103 million in 2020. Actual amounts contributed could change materially from these estimates as a result of changes in assumptions and actual investment returns, among other factors.

Cash Flows Used in Investing Activities

Cash flows used in investing activities were as follows:

	For the Years Ended December 31,		
	2015	2014	2013
	(In millions)		
Net capital expenditures	\$(1,160)	\$ (956)	\$ (980)
Proceeds from sale of assets and securities	5	14	1
Acquisitions	(197)	(9)	(24)
Other investing activities, net (a)	(113)	(63)	(50)
Net cash flows used in investing activities	<u>\$(1,465)</u>	<u>\$(1,014)</u>	<u>\$(1,053)</u>

- (a) Includes removal costs from property, plant and equipment retirements, net and net funds released.

In 2015 and 2014, cash flows used in investing activities increased primarily due to an increase in our regulated capital expenditures, principally from incremental investments associated with the replacement and renewal of our transmission and distribution infrastructure.

Our infrastructure investment plan consists of both infrastructure renewal programs, where we replace infrastructure, as needed, and major capital investment projects, where we construct new water and wastewater treatment and delivery facilities to meet new customer growth and water quality regulations. Our projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors.

The following table provides a summary of our historical capital expenditures related to upgrading our infrastructure and systems:

	For the Years Ended December 31,		
	2015	2014	2013
	(In millions)		
Transmission and distribution	\$ 527	\$ 463	\$ 436
Treatment and pumping	136	97	89
Services, meter and fire hydrants	214	170	178
General structure and equipment	174	142	131
Business transformation project	—	8	60
Sources of supply	53	31	50
Wastewater	56	45	36
Total capital expenditures	\$ 1,160	\$ 956	\$ 980

In 2015, capital expenditures increased \$204 million, or 21.3%, primarily due to continued investment across all infrastructure categories, mainly replacement and renewal of transmission and distribution infrastructure.

In 2014, capital expenditures decreased \$24 million, or 2.5%, primarily due to the completion of Phase I and Phase II of our business transformation project in 2013, partially offset by increased infrastructure investment.

We also grow our business through acquisitions of water and wastewater systems, as well as other water-related services. These acquisitions are complementary to our existing business and support continued geographical diversification and growth of our operations. Generally, acquisitions are funded initially with short-term debt and later refinanced with the proceeds from long-term debt.

The following provides a summary of the acquisitions and dispositions affecting our cash flows from investing activities:

2015:

- Paid \$133 million for the acquisition of our ninety five percent interest in Water Solutions Holdings, LLC, the parent company of Keystone Clearwater Solutions, LLC; and
- Paid \$64 million for 14 water and wastewater systems representing approximately 24,000 customers
- Received \$5 million for the sale of assets and securities.

2014:

- Paid \$9 million for 13 water and wastewater systems representing approximately 4,500 customers.
- Received \$14 million for the sale of assets and securities.

2013:

- Paid approximately \$24 million for ten water and five wastewater systems, which added approximately 30,000 customers. The largest of these acquisitions was the acquisition of the stock of a wastewater system in Virginia with approximately 20,000 customers in November 2013.
- We received approximately \$1 million for the sale of assets and securities.

As previously noted, we expect to invest \$6.4 billion from 2016 through 2020. In 2016, we estimate that our total capital expenditures will be \$1.3 billion, with \$1.2 billion allocated to improving infrastructure in our Regulated Businesses segment and \$100 million for acquisitions and strategic capital investments.

We are currently considering a plan to construct a new corporate headquarters to consolidate our support services and certain of our employees in our Market-Based Businesses within a single location. We are

considering several locations within Camden, New Jersey for the new headquarters. The cost of construction, which would take several years to complete, is currently estimated to be up to \$165 million, depending on the location selected and exclusive of any tax incentives that the Company may receive.

Cash Flows from Financing Activities

Our financing activities, primarily focused on funding infrastructure construction expenditures, include the issuance of long-term and short-term debt, primarily through AWCC. In addition, new infrastructure may be funded with customer advances and contributions in aid of construction (net of refunds), which amounted to \$26 million for the years ended December 31, 2015 and 2014 and \$19 million for the year ended December 31, 2013. Based on the needs of our regulated subsidiaries and the Company, AWCC may borrow funds or issue its debt in the capital markets and then, through intercompany loans, provides those borrowings to the regulated subsidiaries and the Company. The regulated subsidiaries and the Company are obligated to pay their portion of the respective principal and interest to AWCC in the amount necessary to enable AWCC to meet its debt service obligations. Because the Company’s borrowings are not a source of capital for the regulated subsidiaries, the Company is not able to recover the interest charges on the Company’s debt through regulated water and wastewater rates. As of December 31, 2015, AWCC has made long-term fixed rate loans and commercial paper loans to our Regulated Businesses amounting to \$3.3 billion and \$284 million, respectively. Additionally, as of December 31, 2015, AWCC has made long-term fixed rate loans and commercial paper loans to the Company totaling \$1.2 billion and \$344 million to the Company, respectively.

On May 7, 2015, the Company and AWCC filed with the SEC a universal shelf registration statement that enables us to meet our capital needs through the offer and sale to the public from time to time of an unlimited amount of various types of securities, including American Water common stock, preferred stock and other equity securities, and AWCC debt types of securities, all subject to market conditions and demand, general economic conditions, and as applicable, rating status. The shelf registration will expire in May 2018. During 2015, 2014 and 2013, \$550 million, \$500 million and \$400 million, respectively, of debt securities were issued pursuant to this and predecessor registration statements.

The following long-term debt was issued in 2015:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount</u>
AWCC	Senior notes—fixed rate	3.40%-4.30%	2025-2045	\$ 550
Other American Water subsidiaries	Private activity bonds and government funded debt—fixed rate	1.00%-1.56%	2032	15
Total issuances				<u>\$ 565</u>

(a) On August 13, 2015, AWCC completed an offering of its senior fixed rate notes. Proceeds from this offering were used to lend funds to the Company and its regulated utilities, to refinance commercial paper borrowings and to finance redemptions of long-term debt.

In addition to the above issuances, we also assumed \$1 million of debt as a result of an acquisition in 2015, which has a fixed interest rate of 1.00% and matures in 2040.

The following long-term debt was retired through optional redemption or payment at maturity during 2015:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount (In millions)</u>
AWCC	Private activity bonds and government funded debt—fixed rate	1.79%-5.25%	2015-2031	\$ 36
AWCC	Senior notes—fixed rate	6.00%	2015	30
Other American Water subsidiaries (a) . . .	Private activity bonds and government funded debt—fixed rate	0.00%-5.40%	2015-2041	61
Other American Water subsidiaries	Mandatorily redeemable preferred stock	8.49%-9.18%	2031-2036	4
Other American Water subsidiaries	Capital lease payments			—
Total retirements and redemptions				<u>\$ 131</u>

(a) Includes \$2 million of non-cash redemptions resulting from the use of restricted funds.

The following long-term debt was issued in 2014:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount (In millions)</u>
AWCC (a)	Senior notes—fixed rate	3.40%-4.30%	2025-2042	\$ 500
Other subsidiaries (b) . . .	Private activity bonds and government funded debt—fixed rate	0.00%-5.00%	2031-2033	10
Total issuances				<u>\$ 510</u>

- (a) On August 14, 2014, AWCC completed an offering of its senior fixed rate notes. Proceeds from this offering were used to lend funds to the Company and its regulated utilities, to refinance commercial paper borrowings and to finance redemptions of long-term debt.
- (b) Proceeds from the above issuance were received in 2014 and have been utilized to fund certain specific projects. \$10.0 million of these proceeds are held in trust pending our certification that we have incurred qualifying capital expenditures. These issuances have been presented as non-cash on the Consolidated Statements of Cash Flows. Subsequent releases of all or a lesser portion of the funds by the trust are reflected as the release of restricted funds and are included in the investing activities in the Consolidated Statements of Cash Flows.

In addition to the above issuances, we also assumed \$2 million of debt as a result of acquisitions in 2014.

The following long-term debt was retired through optional redemption or payment at maturity during 2014:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount (In millions)</u>
American Water Capital Corp.	Private activity bonds and government funded debt—fixed rate	6.00%-6.75%	2018-2032	\$ 101
American Water Capital Corp.	Senior notes—fixed rate	6.00%	2039	59
Other American Water subsidiaries (a)	Private activity bonds and government funded debt—fixed rate	0.00%-5.25%	2014-2041	79
Other American Water subsidiaries	Mandatorily redeemable preferred stock	8.49%-9.18%	2031-2036	2
Other American Water subsidiaries	Capital lease payments			0
Total retirements and redemptions				<u>\$ 241</u>

(a) Includes \$1.0 million of non-cash redemptions resulting from the use of restricted funds.

The following long-term debt was issued in 2013:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount (In millions)</u>
AWCC (a)	Senior notes—fixed rate	3.85%	2024	\$ 400
AWCC (b)	Private activity bonds and government funded debt—fixed rate	2.30%-2.90%	2021-2030	8
Other subsidiaries (c)	Private activity bonds and government funded debt—fixed rate	1.59%-2.41%	2031-2033	3
Total issuances				<u>\$ 411</u>

(a) On November 20, 2013, AWCC completed an offering of its 3.85% senior fixed rate notes. Proceeds from the offering were used to refinance long-term debt and to repay commercial paper borrowings.

(b) Proceeds from these issuances were received in the fourth quarter of 2013 and have been utilized to fund certain specific projects. \$7 million of these proceeds are held in trust pending our certification that we have incurred qualifying capital expenditures. These issuances have been presented as non-cash on the Consolidated Statements of Cash Flows. Subsequent releases of all or a lesser portion of the funds by the trust are reflected as the release of restricted funds and are included in the investing activities in the Consolidated Statements of Cash Flows.

(c) Proceeds from these issuances were received from the Pennsylvania Infrastructure Investment Authority and have been used to fund specified projects.

In addition to the above issuances, we also assumed \$13 million of debt as a result of acquisitions in 2013, most of which is associated with the Dale Service Corporation stock acquisition in the fourth quarter of 2013.

The following long-term debt was retired through optional redemption or payment at maturity during 2013:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount (In millions)</u>
AWCC (a)	Senior notes—fixed rate	5.39%-10.00%	2013-2017	\$ 476
Other subsidiaries (b)	Private activity bonds and government funded debt—fixed rate	0.00%-5.50%	2013-2041	18
Other subsidiaries	Mortgage bonds—fixed rate	6.59%	2013	2
Other subsidiaries	Mandatorily redeemable preferred stock	8.49%-9.18%	2031-2036	2
Other subsidiaries	Capital leases & other			0
Total retirements and redemptions				\$ 498

- (a) On October 8, 2013, we announced the purchase and retirement through a tender offer of \$226 million in aggregate outstanding principal amount of our 6.08% Senior Notes due 2017. On October 8, 2013, we paid \$272 million to effect the tender, which, in addition to the principal, included a repurchase premium of \$39 million and accrued interest of \$7 million. Also, in October 2013 and related to the tender, we recorded transaction fees of \$1 million and a write-off of \$1 million for unamortized debt issuance costs. The redemption was originally financed through commercial paper borrowing.
- (b) Includes a \$4 million of non-cash redemptions resulting from the use of restricted funds.

On November 1, 2013, we issued notices of redemption for \$75 million and \$75 million of outstanding Senior Notes with an original maturity date of 2038 and interest rates of 8.25% and 10.0%, respectively. These notes were retired on December 1, 2013.

Also on December 21, 2013, an additional \$101 million in Senior Notes with an interest rate of 5.39% matured.

From time to time and as market conditions warrant, we may engage in long-term debt retirements via tender offers, open market repurchases or other viable alternatives to strengthen our balance sheets.

In February 2015, our Board of Directors authorized an anti-dilutive common stock repurchase program to mitigate the effect of shares issued through our dividend reinvestment, employee stock purchase and executive compensation activities. The program allows the Company to purchase up to 10 million shares of its outstanding common stock over an unrestricted period of time in the open market or through privately negotiated transactions. The program is conducted in accordance with Rule 10b-18 of the Exchange Act, and to facilitate the repurchases, the Company has also entered into a Rule 10b5-1 share repurchase plan with a third-party broker, which allows us to repurchase shares at times when we may otherwise be prevented from doing so under insider trading laws or because of self-imposed trading blackout periods. Subject to applicable regulations, the Company may elect to amend or cancel this repurchase program or the share repurchase parameters at its discretion. As of December 31, 2015, we have repurchased an aggregate of approximately 2.3 million shares of common stock under this program.

Credit Facility and Short-Term Debt

In June 2015, AWCC amended and restated the outstanding credit agreement, dated as of October 29, 2012, associated with the \$1.25 billion aggregate commitment in unsecured revolving credit facility, to extend the expiration date of the facility from October 2018 to June 2020 and to allow AWCC to request to extend further the term of the credit facility for up to two one-year periods. An extension request must satisfy certain conditions and receive approval of the lenders, as set forth in the agreement. Interest rates on advances under the facility are based on a credit spread to the Eurodollar rate or base rate with the credit spread based AWCC's Moody's Investors Service, which we refer to as Moody's, or Standard & Poor's Ratings Services ratings, which we refer to as S&P, credit rating. At current ratings that spread would be 0.90%. The facility is used principally to support AWCC's commercial paper program and to provide up to \$150 million in letters of credit. Indebtedness under

the facility is considered “debt” for purposes of a support agreement between American Water and AWCC, which serves as a functional equivalent of a guarantee by American Water of AWCC’s payment obligations under the credit facility.

Also, the Company acquired an additional revolving line of credit as part of its Keystone acquisition. The total commitment under this credit facility was \$16 million of which \$2 million was outstanding as of December 31, 2015.

The following table summarizes information regarding the Company’s aggregate credit facility commitments, letter of credit sub-limits and available funds under those revolving credit facilities, as well as outstanding amounts of commercial paper and outstanding borrowings under the respective facilities as of December 31, 2015 and 2014:

	<u>Credit Facility Commitment</u>	<u>Available Credit Facility Capacity</u>	<u>Letter of Credit Sublimit</u>	<u>Available Letter of Credit Capacity</u>	<u>Outstanding Commercial Paper (Net of Discount)</u>	<u>Credit Line Borrowing</u>
	(In millions)					
December 31, 2015	\$ 1,266	\$ 1,182	\$ 150	\$ 68	\$ 626	\$ 2
December 31, 2014	\$ 1,250	\$ 1,212	\$ 150	\$ 112	\$ 450	\$ —

The weighted-average interest rate on AWCC short-term borrowings for the years ended December 31, 2015 and 2014 was approximately 0.49% and 0.31%, respectively. Interest accrues on the Keystone revolving line of credit daily at a rate per annum equal to 2.75% above the greater of the one month or one day LIBOR.

Capital Structure

The following table indicates the percentage of our capitalization represented by the components of our capital structure as of December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Total common stockholders’ equity	43.5%	45.2%	44.6%
Long-term debt and redeemable preferred stock at redemption value	50.6%	50.1%	49.3%
Short-term debt and current portion of long-term debt	5.9%	4.7%	6.1%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The changes in the capital structure between periods were mainly attributable to changes in outstanding commercial paper balances.

Debt Covenants

Our debt agreements contain financial and non-financial covenants. To the extent that we are not in compliance with these covenants such an event may create an event of default under the debt agreement and we or our subsidiaries may be restricted in our ability to pay dividends, issue new debt or access our revolving credit facility. For two of our smaller operating companies, we have informed our counterparties that we will provide only unaudited financial information at the subsidiary level, which resulted in technical non-compliance with certain of their reporting requirements under debt agreements with respect to \$8 million of outstanding debt. We do not believe this event will materially impact us. Our long-term debt indentures contain a number of covenants that, among other things, limit the Company from issuing debt secured by the Company’s assets, subject to certain exceptions. Our failure to comply with any of these covenants could accelerate repayment obligations.

Certain long-term notes and the revolving credit facility require us to maintain a ratio of consolidated debt to consolidated capitalization (as defined in the relevant documents) of not more than 0.70 to 1.00. On December 31, 2015, our ratio was 0.56 to 1.00 and therefore we were in compliance with the covenant.

Security Ratings

Our access to the capital markets, including the commercial paper market, and respective financing costs in those markets, may be directly affected by our securities ratings. We primarily access the debt capital markets, including the commercial paper market, through AWCC. However, we have also issued debt through our regulated subsidiaries, primarily in the form of tax exempt securities or borrowings under state revolving funds, to lower our overall cost of debt.

On May 7, 2015, Standard and Poor's ("S&P") raised our corporate credit rating on AWCC and American Water from A- to A and our commercial paper rating from A-2 to A-1 on American water and AWCC. S&P also confirmed its stable rating outlook. On August 7, 2015, Moody's upgraded the long-term ratings for American Water and AWCC from Baa1 to A3. At the same time, Moody's also affirmed AWCC's commercial paper rating at P2. Moody's rating outlook for American Water and AWCC remains as stable.

Our long-term and short-term credit ratings as of December 31, 2015 are as follows:

<u>Securities</u>	<u>Moody's Investors Service</u>	<u>Standard & Poor's Ratings Service</u>
Senior unsecured debt	A3	A
Commercial paper	P2	A-1

A security rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time by the assigning rating agency, and each rating should be evaluated independently of any other rating. Security ratings are highly dependent upon our ability to generate cash flows in an amount sufficient to service our debt and meet our investment plans. We can provide no assurances that our ability to generate cash flows is sufficient to maintain our existing ratings. None of our borrowings are subject to default or prepayment as a result of the downgrading of these security ratings, although such a downgrading could increase fees and interest charges under our credit facility.

As part of the normal course of business, we routinely enter into contracts for the purchase and sale of water, energy, chemicals and other services. These contracts either contain express provisions or otherwise permit us and our counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if we are downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance, which could include a demand that we provide collateral to secure our obligations. We do not expect to post any collateral which will have a material adverse impact on the Company's results of operations, financial position or cash flows.

Dividends

Our Board of Directors authorizes the payment of dividends. The payment of dividends is subject to (sufficient liquidity, dividends from subsidiaries, etc.). The Company's dividend rate on its common stock is determined by the Board of Directors on a quarterly basis and takes into consideration, among other factors, current and possible future developments that may affect the Company's income and cash flows. Historically, dividends have been paid quarterly to holders of record approximately 15 days prior to the distribution date. Since the dividends on our common stock are not cumulative, only declared dividends are paid.

During 2015, 2014 and 2013, we paid \$239 million, \$216 million and \$150 million in cash dividends, respectively. For 2015, we paid a cash dividend of \$0.34 per share on December 1, September 1, June 1 and \$0.31 per share on March 2. In 2014, we paid a cash dividend of \$0.31 per share on December 1, September 2, June 2 and \$0.28 on March 3. In 2013, we paid a cash dividend of \$0.28 per share on December 2, September 3 and June 3.

On December 11, 2015, our Board of Directors declared a quarterly cash dividend payment of \$0.34 per share payable on March 1, 2016 to shareholders of record as of February 8, 2016.

Regulatory Restrictions

The issuance by the Company or AWCC of long-term debt or equity securities does not require authorization of any state PUC if no guarantee or pledge of the regulated subsidiaries is utilized. However, state PUC authorization is required to issue long-term debt at most of our regulated subsidiaries. Our regulated subsidiaries normally obtain the required approvals on a periodic basis to cover their anticipated financing needs for a period of time or in connection with a specific financing.

Under applicable law, our subsidiaries can pay dividends only from retained, undistributed or current earnings. A significant loss recorded at a subsidiary may limit the dividends that the subsidiary can distribute to us.

Insurance Coverage

We carry various property, casualty and financial insurance policies with limits, deductibles and exclusions that we believe are consistent with industry standards. However, insurance coverage may not be adequate or available to cover unanticipated losses or claims. Additionally, annual policy renewals can be impacted by claims experience which in turn can impact coverage terms and conditions on a going forward basis. We are self-insured to the extent that losses are within the policy deductible or exceed the amount of insurance maintained. Such losses could have a material adverse effect on our short-term and long-term financial condition and our results of operations and cash flows.

Contractual Obligations and Commitments

We enter into contractual obligations with third parties in the ordinary course of business. Information related to our contractual obligations as of December 31, 2015 is summarized in the table below:

<u>Contractual Obligation</u>	<u>Total</u>	<u>1 Year or Less</u>	<u>2-3 Years</u>	<u>4-5 Years</u>	<u>More Than 5 Years</u>
	(In millions)				
Long-term debt obligations (a)	\$ 5,895	\$ 52	\$ 1,027	\$ 184	\$ 4,632
Interest on long-term debt (b)	4,369	319	594	498	2,958
Operating lease obligations (c)	128	13	23	18	74
Purchase water obligations (d)	610	51	89	87	383
Other purchase obligations (e)	140	140	—	—	—
Postretirement benefit plans' obligations (f)	98	22	40	36	—
Pension plan obligations (f)	292	33	99	160	—
Preferred stocks with mandatory redemption requirements	13	2	3	3	5
Interest on preferred stock with mandatory redemption requirements	7	1	2	1	3
Other obligations (g)	2,346	979	847	97	423
Total	\$13,898	\$ 1,612	\$ 2,724	\$ 1,084	\$ 8,478

Note: The above table reflects only financial obligations and commitments. Therefore, performance obligations associated with our Market-Based Businesses are not included in the above amounts. Also, uncertain tax positions of \$233 million are not reflected in this table as we cannot predict when open tax years will close with completed examinations. See Note 13—Income Taxes in the Notes to the Consolidated Financial Statements.

(a) Represents sinking fund obligations and debt maturities.

- (b) Represents expected interest payments on outstanding long-term debt. Amounts reported may differ from actual due to future financing of debt.
- (c) Represents future minimum payments under non-cancelable operating leases, primarily for the lease of motor vehicles, buildings, land and other equipment including water facilities and systems constructed by partners under the Public-Private Partnerships described below.
- (d) Represents future payments under water purchase agreements for minimum quantities of water.
- (e) Represents the open purchase orders as of December 31, 2015, for goods and services purchased in the ordinary course of business.
- (f) Represents contributions expected to be made to pension and postretirement benefit plans for the years 2016 through 2020.
- (g) Includes an estimate of advances for construction to be refunded, capital expenditures estimated to be required under legal and binding contractual obligations, contracts entered into for energy purchases, a liability associated with a conservation agreement and service agreements.

Public-Private Partnerships

WVAWC has entered into a series of agreements with various public entities, which we refer to as the Partners, to establish certain joint ventures, commonly referred to as “public-private partnerships.” Under the public-private partnerships, WVAWC constructed utility plant, financed by WVAWC, and the Partners constructed utility plant (connected to WVAWC’s property), financed by the Partners. WVAWC agreed to transfer and convey some of its real and personal property to the Partners in exchange for an equal principal amount of Industrial Development Bonds, commonly referred to as IDBs, issued by the Partners under a state Industrial Development Bond and Commercial Development Act. WVAWC leased back the total facilities, including portions funded by both WVAWC and the Partners, under leases for a period of 40 years.

The leases have payments that approximate the payments required by the terms of the IDBs. These payments are considered “PILOT payments” which represent payments in lieu of taxes and approximate what WVAWC otherwise would pay as property taxes on the properties. We have presented the transaction on a net basis in the consolidated financial statements. The carrying value of the transferred facilities, which is presented in property, plant and equipment in the Consolidated Balance Sheets, was approximately \$156 million as of December 31, 2015.

Performance Obligations

We have entered into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. These military services agreements expire between 2051 and 2065 and have remaining performance commitments as measured by estimated remaining contract revenues of \$2.8 billion as of December 31, 2015. The operations and maintenance agreements with municipalities and other customers expire between 2015 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$795 million as of December 31, 2015. Some of the Company’s long-term contracts to operate and maintain a municipality’s, federal government’s or other party’s water or wastewater treatment and delivery facilities include responsibility for certain major maintenance for some of the facilities, in exchange for an annual fee.

Critical Accounting Policies and Estimates

The application of critical accounting policies is particularly important to our financial condition and results of operations and provides a framework for management to make significant estimates, assumptions and other judgments. Although our management believes that these estimates, assumptions and other judgments are appropriate, they relate to matters that are inherently uncertain. Accordingly, changes in the estimates, assumptions and other judgments applied to these accounting policies could have a significant impact on our financial condition and results of operations as reflected in our consolidated financial statements.

Our financial condition, results of operations and cash flows are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. Management believes that the areas described below require significant judgment in the application of accounting policy or in making estimates and assumptions in matters that are inherently uncertain and that may change in subsequent periods. Our management

has reviewed these critical accounting policies, and the estimates and assumptions regarding them, with our audit committee. In addition, our management has also reviewed the following disclosures regarding the application of these critical accounting policies with the audit committee.

Regulatory Accounting

Our regulated utility subsidiaries are subject to regulation by state PUCs and the local governments of the states in which they operate. As such, we follow the authoritative accounting principles required for rate regulated entities, which requires us to reflect the effects of rate regulation in our financial statements. Use of the authoritative guidance is applicable to utility operations that meet the following criteria: (i) third-party regulation of rates; (ii) cost-based rates; and (iii) a reasonable assumption that rates will be set to recover the estimated costs of providing service plus a return on net investment, or rate base. As of December 31, 2015, we concluded that the operations of our regulated subsidiaries met the criteria.

Due to timing and other differences in the collection of revenue, these accounting principles allow a cost that would otherwise be charged as an expense by an unregulated entity to be capitalized as a regulatory asset if it is probable that such cost is recoverable through future rates; conversely, the principles allow creation of a regulatory liability for amounts collected in rates to recover costs expected to be incurred in the future or amounts collected in excess of costs incurred and are refundable to customers. Regulators may also impose certain fines or penalties.

As of December 31, 2015, we have recorded \$1.3 billion of net regulatory assets and \$402 million of regulatory liabilities within our consolidated financial statements. See Note 6—Regulatory Assets and Liabilities in the Notes to Consolidated Financial Statements for further information regarding the significant regulatory assets and liabilities.

For each regulatory jurisdiction where we conduct business, we assess at the end of each reporting period, or earlier, if appropriate, whether the regulatory assets and liabilities continue to meet the criteria for probable future recovery or settlement. This assessment includes consideration of factors such as changes in applicable regulatory environments, recent rate orders on recovery of a specific or similar incurred cost to other regulated entities in the same jurisdiction, the status of any pending or potential legislation that could impact the ability to recover costs through regulated rates. If subsequent events indicate that the regulatory assets or liabilities no longer meet the criteria for probable future recovery or settlement, our statement of operations and financial position could be materially affected. In addition, if we conclude in a future period that a separable portion of the business no longer meets the criteria, we are required to eliminate the financial statement effects of regulation for that part of the business, which would include the elimination of any or all regulatory assets and liabilities that had been recorded in the consolidated financial statements. Failure to meet the criteria of the authoritative guidance could materially impact our consolidated financial statements.

Goodwill

The Company has recorded \$1.3 billion and \$1.2 billion of goodwill at December 31, 2015 and 2014. The Company's annual impairment test is performed as of November 30 of each year, in conjunction with the timing of the completion of the Company's annual business plan. The Company also undertakes interim reviews when the Company determines that a triggering event that would more likely than not reduce the fair value of a reporting unit below its carrying value has occurred.

Entities assessing goodwill for impairment have the option of first performing a qualitative assessment to determine whether a quantitative assessment is necessary. In performing a qualitative assessment, the Company assess, among other things, macroeconomic conditions, industry and market considerations, overall financial performance, cost factors and entity specific events. If an entity determines, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not greater than the carrying amount, no further testing

is required. If the entity bypasses the qualitative assessment or performs the qualitative assessment, but determines that it is more likely than not that its fair value is less than its carrying amount, a quantitative two-step, fair value-based test is performed.

The first step compares the estimated fair value of the reporting unit to its respective net carrying values, including goodwill, on the measurement date. If the estimated fair value of any reporting unit is less than such reporting unit's carrying value, then the second step is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation accounting guidance in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount for the reporting unit, an impairment loss is recorded as a reduction to goodwill and a charge to operating expense. Application of the goodwill impairment test requires significant management judgment, including the identification of reporting units and determining the fair value of the reporting unit. Management estimates fair value using a combination of a discounted cash flow analysis and market multiples analysis. Significant assumptions used in these fair value analyses include, but are not limited to, discount and growth rates and projected terminal values.

Excluding goodwill acquired in 2015 related to the Keystone acquisition, the Company determined that no qualitative factors were present that would indicate the estimated fair values of its reporting units were less than the respective carrying values. As such, the Company determined that the two-step goodwill impairment test was not necessary at November 30, 2015. Further, no triggering events occurred which required an impairment evaluation between the annual testing dates.

The Company recorded goodwill of \$91 million as part of the Keystone acquisition. The Keystone business is an operating segment comprised of one reporting unit to which all of the goodwill arising from the acquisition was assigned. A step one test was completed for the Keystone goodwill. We used an income approach valuation technique which estimates the discounted future cash flows of operations. The discounted cash flow analysis relies on a single scenario reflecting the best estimate of projected cash flows. Significant assumptions were used in estimating the fair value, including the discount rate, growth rate and terminal value. The estimated fair value of the Keystone reporting unit exceeded its carrying value by less than 3%, and as such the Company does not believe the goodwill is impaired. If a further decline in the fair value were to occur, the Keystone reporting unit would be at risk of failing step one of the goodwill impairment test.

No impairment charge was recorded for goodwill for the years ended December 31, 2015, 2014 or 2013.

There can be no assurances that the Company will not be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the Company's performance. These market events could include a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities and reporting unit companies, the lack of an increase in the Company's market price consistent with its peer companies, decreases in control premiums or continued downward pressure on commodity prices. 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. In regards to the Keystone goodwill, adverse developments in market conditions, including prolonged depression of natural gas prices or other factors that negatively impact our forecast operating results, cash flows or key assumptions in the future could result in an impairment charge of a portion or all of the goodwill balance.

Impairment of Long-Lived Assets

Long-lived assets include land, buildings, equipment and long-term investments. Long-lived assets, other than investments and land, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such

circumstances would include items such as a significant decrease in the market value of a long-lived asset, a significant adverse change in the manner in which the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, we estimate the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the assets, and compare that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value. The key variables that must be estimated include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties since they are forecasting future events. A variation in the assumptions used could lead to a different conclusion regarding the realizability of an asset and, thus, could have a significant effect on the consolidated financial statements.

The long-lived assets of the regulated utility subsidiaries are grouped on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which we invest, as well as volatility inherent in the external markets. In assessing potential impairment for these investments, we consider these factors. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value.

Revenue Recognition

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are delivered to customers and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the meter reading associated with the latest customer bill to the end of the accounting period. Unbilled utility revenues as of December 31, 2015 and 2014 were \$267 million and \$221 million, respectively. Increases in volumes delivered to the utilities' customers and rate mix due to changes in usage patterns in customer classes in the period could be significant to the calculation of unbilled revenue. Changes in the timing of meter reading schedules and the number and type of customers scheduled for each meter reading date would also have an effect on the estimated unbilled revenue.

Revenue from Market-Based Businesses is recognized as services are rendered. Revenues from certain construction projects are recognized over the contract term based on the costs incurred to date during the period compared to the total estimated costs over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities on the balance sheet until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Accounting for Income Taxes

Significant management judgment is required in determining the provision for income taxes, primarily due to the uncertainty related to tax positions taken, as well as deferred tax assets and liabilities, valuation allowances and the utilization of net operating loss carryforwards.

In accordance with applicable authoritative guidance, we account for uncertain income tax positions using a benefit recognition model with a two-step approach, including a more-likely-than-not recognition threshold and a measurement approach based on the largest amount of tax benefit that is greater than 50% likely of being realized

upon ultimate settlement. If it is not more-likely-than-not that the benefit of the tax position will be sustained on its technical merits, no benefit is recorded. Uncertain tax positions that relate only to timing of when an item is included on a tax return are considered to have met the recognition threshold. Management evaluates each position based solely on the technical merits and facts and circumstances of the position, assuming the position will be examined by a taxing authority having full knowledge of all relevant information. Significant judgment is required to determine whether the recognition threshold has been met and, if so, the appropriate amount of unrecognized tax benefit to be recorded in the consolidated financial statements.

We evaluate the probability of realizing deferred tax assets quarterly by reviewing a forecast of future taxable income and our intent and ability to implement tax planning strategies, if necessary, to realize deferred tax assets. We also assess our ability to utilize tax attributes, including those in the form of carryforwards, for which the benefits have already been reflected in the financial statements. We record valuation allowances for deferred tax assets when we conclude it is more-likely-than-not such benefit will not be realized in future periods.

Actual income taxes could vary from estimated amounts due to the future impacts of various items, including changes in income tax laws, our forecasted financial condition and results of operations, failure to successfully implement tax planning strategies, recovery of taxes through the regulatory process for our Regulated Businesses, as well as results of audits and examinations of filed tax returns by taxing authorities. While we believe the resulting tax balances as of December 31, 2015 and 2014 are appropriately accounted for in accordance with the applicable authoritative guidance, the ultimate outcome of tax matters could result in favorable or unfavorable adjustments to our consolidated financial statements and such adjustments could be material. See Note 13—Income Taxes in the Notes to Consolidated Financial Statements for additional information regarding income taxes.

Accounting for Pension and Postretirement Benefits

We maintain noncontributory defined benefit pension plans covering eligible employees of our regulated utility and shared service operations. Benefits under the plans are based on the employee's years of service and compensation. The pension plans were closed for most employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan. We also maintain other postretirement benefit plans, which provide varying levels of medical and life insurance for eligible retirees. These retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002. The Company also has several unfunded noncontributory supplemental non-qualified pension plans that provide additional retirement benefits to certain employees. The Company does not participate in a multiemployer plan. See Note 13 in the Notes to Consolidated Financial Statements for further information regarding the accounting for the defined benefit pension plans and postretirement benefit plans. The Company's pension and postretirement benefit costs are developed from actuarial valuations. Inherent in these valuations are key assumptions provided by the Company to its actuaries, including the discount rate and expected long-term rate of return on plan assets. Material changes in the Company's pension and postretirement benefit costs may occur in the future due to changes in these assumptions as well as fluctuations in plan assets. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes. The primary assumptions are:

- **Discount Rate**—The discount rate is used in calculating the present value of benefits, which are based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due;

- Expected Return on Plan Assets (“EROA”)—Management projects the future return on plan assets considering prior performance, but primarily based upon the plans’ mix of assets and expectations for the long-term returns on those asset classes. These projected returns reduce the net benefit costs we record currently;
- Rate of Compensation Increase—Management projects employees’ pay increases, which are used to project employees’ pension benefits at retirement;
- Health Care Cost Trend Rate—Management projects the expected increases in the cost of health care; and
- Mortality—In the determination of year end 2014 projected benefit obligations, Management adopted a new table based on the Society of Actuaries RP 2014 mortality table including a generational BB-2D projection scale. The adoption resulted in a significant increase to pension and other postretirement benefit plans’ projected benefit obligations.

The discount rate assumption, which is determined for the pension and postretirement benefit plans independently, is subject to change each year, consistent with changes in applicable high-quality, long-term corporate bond indices. We use an approach that approximates the process of settlement of obligations tailored to the plans’ expected cash flows by matching the plans’ cash flows to the coupons and expected maturity values of individually selected bonds. The yield curve was developed for a portfolio containing the majority of United States-issued AA-graded non-callable (or callable with make-whole provisions) corporate bonds. For each plan, the discount rate was developed as the level equivalent rate that would yield the same present value as using spot rates aligned with the projected benefit payments. The discount rate for determining pension benefit obligations was 4.66%, 4.24% and 5.12% at December 31, 2015, 2014 and 2013, respectively. The discount rate for determining other post-retirement benefit obligations was 4.67%, 4.24% and 5.10% at December 31, 2015, 2014 and 2013, respectively.

In selecting an expected return on plan assets, we considered tax implications, past performance and economic forecasts for the types of investments held by the plans. The long-term EROA assumption used in calculating pension cost was 6.91% for 2015, 6.91% for 2014, and 7.49% for 2013. The weighted average EROA assumption used in calculating other postretirement benefit costs was 4.92% for 2015, 5.87% for 2014 and 6.99% for 2013.

The asset allocations for the Company’s U.S. pension plan by asset category were as follows:

<u>Asset Category</u>	<u>Target Allocation</u>	<u>Percentage of Plan Assets as of December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Equity securities	52%	50%	51%
Fixed income	40%	41%	41%
Real Estate	6%	7%	6%
Real estate investment trusts (“REITs”)	2%	2%	2%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The investment policy guidelines of the pension plan require that the fixed income portfolio has an overall weighted average credit rating of AA or better by Standard & Poor’s and the minimum credit quality for fixed income securities must be BBB- or better. Up to 20% of the portfolio may be invested in collateralized mortgage obligations backed by the United States Government.

The Company's other postretirement benefit plans are partially funded. The asset allocations for the Company's other postretirement benefit plans by asset category were as follows:

<u>Asset Category</u>	<u>Target Allocation</u>	<u>Percentage of Plan Assets as of December 31,</u>	
	<u>2016</u>	<u>2015</u>	<u>2014</u>
Equity securities	32%	32%	30%
Fixed income	68%	68%	70%
REITs	—	—	—%
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

The Company's investment policy, and related target asset allocation, is evaluated periodically through asset liability studies. The studies consider projected cash flows of maturity liabilities, projected asset class return risk, and correlation and risk tolerance.

The pension and postretirement welfare plan trusts investments include debt and equity securities held either directly or through commingled funds. The trustee for the Company's defined benefit pension and postretirement welfare plans uses independent valuation firms to calculate the fair value of plan assets. Additionally, the Company independently verifies the assets values. Approximately 45.6% of the assets are valued using the quoted market price for the assets in an active market at the measurement date, while 54.4% of the assets are valued using other inputs.

In selecting a rate of compensation increase, we consider past experience in light of movements in inflation rates. Our rate of compensation increase was 3.10% for 2015, 3.12% for 2014 and 3.15% for 2013.

In selecting health care cost trend rates, we consider past performance and forecasts of increases in health care costs. Our health care cost trend rate used to calculate the periodic cost was 6.75% in 2015 gradually declining to 5.00% in 2021 and thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

<u>Change in Actuarial Assumption</u>	<u>Impact on Other Postretirement Benefit Obligation as of December 31, 2015</u>	<u>Impact on 2015 Total Service and Interest Cost Components</u>
	(In millions)	
Increase assumed health care cost trend by 1%	\$ 99	\$ 8
Decrease assumed health care cost trend by 1%	\$ (81)	\$ (6)

We will use a discount rate and EROA of 4.66% and 7.02%, respectively, for estimating our 2016 pension costs. Additionally, we will use a discount rate and EROA of 4.67% and 5.20%, respectively, for estimating our 2016 other postretirement benefit costs. A decrease in the discount rate or the EROA would increase our pension expense. Our 2015 and 2014 pension and postretirement costs, including such expenses charged to our discontinued operations, were \$61 million and \$24 million, respectively. The Company expects to make pension and postretirement benefit contributions to the plan trusts of \$55 million, \$61 million, \$79 million, \$93 million and \$103 million in 2016, 2017, 2018, 2019 and 2020, respectively. Actual amounts contributed could change significantly from these estimates. The assumptions are reviewed annually and at any interim re-measurement of the plan obligations. The impact of assumption changes is reflected in the recorded pension and postretirement benefit amounts as they occur, or over a period of time if allowed under applicable accounting standards. As these assumptions change from period to period, recorded pension and postretirement benefit amounts and funding requirements could also change.

Accounting for Contingencies

We record loss contingencies when management determines that the outcome of future events is probable of occurring and when the amount of the loss can be reasonably estimated. The determination of a loss contingency is based on management judgment and estimates about the likely outcome of the matter, which may include an analysis of different scenarios. Liabilities are recorded or adjusted when events or circumstances cause these judgments or estimates to change. In assessing whether a loss is reasonably possible, management considers many factors, which include, but are not limited to: the nature of the litigation, claim or assessment, available information, opinions or views of legal counsel and other advisors, and the experience gained from similar cases or situations. We provide disclosures for material contingencies when management deems there is a reasonable possibility that a loss or an additional loss may be incurred. We provide estimates of reasonably possible losses when such estimates may be reasonably determined, either as a single amount or within a reasonable range.

Actual amounts realized upon settlement of contingencies may be different than amounts recorded and disclosed and could have a significant impact on the liabilities, revenue and expenses recorded on the consolidated financial statements. For a discussion of contingencies, see Note 15—Commitments and Contingencies in the Notes to Consolidated Financial Statements.

New Accounting Standards

See Note 2—Significant Accounting Policies in the Notes to Consolidated Financial Statements for a description of recent accounting standards.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk associated with changes in commodity prices, equity prices and interest rates. We are exposed to risks from changes in interest rates as a result of our issuance of variable and fixed rate debt and commercial paper. We manage our interest rate exposure by limiting our variable rate exposure and by monitoring the effects of market changes in interest rates. We also have the ability to enter into financial derivative instruments, which could include instruments such as, but not limited to, interest rate swaps, forward starting swaps, swaptions and U.S. Treasury lock agreements to manage and mitigate interest rate risk exposure. As of December 31, 2015, a hypothetical increase of interest rates by 1% associated with our short-term borrowings would result in a \$6 million decrease in our pre-tax earnings.

In July 2010, we entered into an interest rate swap agreement with a notional amount of \$100 million. This agreement effectively converted the interest on \$100 million of outstanding 6.085% fixed rate debt maturing 2017 to a variable rate of six-month LIBOR plus 3.422%. We entered into this interest rate swap to mitigate interest cost at the parent company relating to debt that was incurred by our prior owners and was not used in any manner to finance the cash needs of our subsidiaries. The interest rate swap reduced interest expense by \$2 million for the years ended December 31, 2015 and 2014. As the swap interest rates are fixed through April 2016, a hypothetical 1% increase in the interest rates associated with the interest swap agreement would result in a \$1 million decrease on our pre-tax earnings for the year ended December 31, 2015. This calculation holds all other variables constant and assumes only the discussed changes in interest rates.

Our risks associated with price increases for chemicals, electricity and other commodities are reduced through contractual arrangements and the expected ability to recover price increases through rates. Non-performance by these commodity suppliers could have a material adverse impact on our results of operations, financial position and cash flows.

The market price of our common stock may experience fluctuations, which may be unrelated to our operating performance. In particular, our stock price may be affected by general market movements as well as developments specifically related to the water and wastewater industry. These could include, among other things, interest rate movements, quarterly variations or changes in financial estimates by securities analysts and governmental or regulatory actions. This volatility may make it difficult for us to access the capital markets in

the future through additional offerings of our common stock, regardless of our financial performance, and such difficulty may preclude us from being able to take advantage of certain business opportunities or meet business obligations.

We are exposed to credit risk through our water, wastewater and other water-related services provided by our Regulated Businesses and Market-Based Businesses. Our Regulated Businesses serve residential, commercial, industrial and other customers while our Market-Based Businesses engage in business activities with developers, government entities and other customers. Our primary credit risk is exposure to customer default on contractual obligations and the associated loss that may be incurred due to the non-payment of customer accounts receivable balances. Our credit risk is managed through established credit and collection policies which are in compliance with applicable regulatory requirements and involve monitoring of customer exposure and the use of credit risk mitigation measures such as letters of credit or prepayment arrangements. Our credit portfolio is diversified with no significant customer or industry concentrations. In addition, our Regulated Businesses are generally able to recover all prudently incurred costs including uncollectible customer accounts receivable expenses and collection costs through rates.

The Company's retirement trust assets are exposed to the market prices of debt and equity securities. Changes to the retirement trust asset value can impact the Company's pension and other benefits expense, funded status and future minimum funding requirements. Our risk is reduced through our ability to recover pension and other benefit costs through rates. In addition, pension and other benefits liabilities decrease as fixed income asset values decrease (fixed income yields rise) since the rate at which we discount pension and other retirement trust asset future obligations is highly correlated to fixed income yields.

We are also exposed to a potential national economic recession or further deterioration in local economic conditions in the markets in which we operate. The credit quality of our customer accounts receivable is dependent on the economy and the ability of our customers to manage through unfavorable economic cycles and other market changes. In addition, as a result of the downturn in the economy and heightened sensitivity of the impact of additional rate increases on certain customers, there can be no assurances that regulators will grant sufficient rate authorizations. Therefore our ability to fully recover operating expense, recover our investment and provide an appropriate return on invested capital made in our Regulated Businesses may be adversely impacted.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
American Water Works Company, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of comprehensive income, of cash flows, and of changes in stockholders' equity present fairly, in all material respects, the financial position of American Water Works Company, Inc. and Subsidiary Companies at December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
February 24, 2016

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets

(In millions, except share and per share data)

	<u>December 31,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
ASSETS		
Property, plant and equipment	\$ 18,504	\$ 17,269
Accumulated depreciation	<u>(4,571)</u>	<u>(4,240)</u>
Property, plant and equipment, net	<u>13,933</u>	<u>13,029</u>
Current assets:		
Cash and cash equivalents	45	23
Restricted funds	21	14
Accounts receivable, net	255	232
Unbilled revenues	267	221
Materials and supplies	38	37
Other	<u>31</u>	<u>48</u>
Total current assets	<u>657</u>	<u>575</u>
Regulatory and other long-term assets:		
Regulatory assets	1,271	1,153
Goodwill	1,302	1,208
Other	<u>78</u>	<u>73</u>
Total regulatory and other long-term assets	<u>2,651</u>	<u>2,434</u>
TOTAL ASSETS	<u>\$ 17,241</u>	<u>\$ 16,038</u>

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets

(In millions, except share and per share data)

	<u>December 31, 2015</u>	<u>December 31, 2014</u>
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock (\$0.01 par value, 500,000,000 shares authorized, 180,907,483 and 179,461,606 shares issued as of December 31, 2015 and 2014, respectively)	\$ 2	\$ 2
Paid-in-capital	6,351	6,302
Accumulated deficit	(1,073)	(1,296)
Accumulated other comprehensive loss	(88)	(82)
Treasury stock, at cost (2,625,112 and 260,243 shares as of December 31, 2015 and 2014, respectively)	(143)	(11)
Total common stockholders' equity	<u>5,049</u>	<u>4,915</u>
Long-term debt		
Long-term debt	5,862	5,427
Redeemable preferred stock at redemption value	12	15
Total capitalization	<u>10,923</u>	<u>10,357</u>
Current liabilities:		
Short-term debt	628	450
Current portion of long-term debt	54	61
Accounts payable	126	100
Accrued liabilities	493	395
Taxes accrued	26	25
Interest accrued	62	57
Other	144	153
Total current liabilities	<u>1,533</u>	<u>1,241</u>
Regulatory and other long-term liabilities:		
Advances for construction	349	368
Deferred income taxes, net	2,310	2,034
Deferred investment tax credits	24	25
Regulatory liabilities	402	392
Accrued pension	342	316
Accrued postretirement benefit	169	193
Other	68	37
Total regulatory and other long-term liabilities	<u>3,664</u>	<u>3,365</u>
Contributions in aid of construction	1,121	1,075
Commitments and contingencies (See Note 15)	—	—
TOTAL CAPITALIZATION AND LIABILITIES	<u>\$ 17,241</u>	<u>\$ 16,038</u>

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Operations

(In millions, except per share data)

	For the Years Ended December 31,		
	2015	2014	2013
Operating revenues	\$ 3,159	\$ 3,011	\$ 2,879
Operating expenses:			
Operation and maintenance	1,404	1,350	1,289
Depreciation and amortization	440	424	407
General taxes	243	236	234
(Gain) loss on asset dispositions and purchases	(3)	(2)	1
Total operating expenses, net	2,084	2,008	1,931
Operating income	1,075	1,003	948
Other income (expenses):			
Interest, net	(308)	(299)	(308)
Loss on extinguishment of debt	—	—	(41)
Other, net	15	6	9
Total other income (expenses)	(293)	(293)	(340)
Income from continuing operations before income taxes	782	710	608
Provision for income taxes	306	280	237
Income from continuing operations	476	430	371
Loss from discontinued operations, net of tax	—	(7)	(2)
Net income attributable to common stockholders	\$ 476	\$ 423	\$ 369
Basic earnings per share: (a)			
Income from continuing operations	\$ 2.66	\$ 2.40	\$ 2.08
Loss from discontinued operations, net of tax	\$ —	\$ (0.04)	\$ (0.01)
Net income attributable to common stockholders	\$ 2.66	\$ 2.36	\$ 2.08
Diluted earnings per share: (a)			
Income from continuing operations	\$ 2.64	\$ 2.39	\$ 2.07
Loss from discontinued operations, net of tax	\$ —	\$ (0.04)	\$ (0.01)
Net income attributable to common stockholders	\$ 2.64	\$ 2.35	\$ 2.06
Weighted average common shares outstanding			
Basic	179	179	178
Diluted	180	180	179
Dividends declared per common share	\$ 1.36	\$ 1.24	\$ 1.12

(a) Amounts may not sum due to rounding.

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies
Consolidated Statements of Comprehensive Income
(In millions)

	For the Years Ended December 31,		
	2015	2014	2013
Net income attributable to common stockholders	\$ 476	\$ 423	\$ 369
Other comprehensive (loss) income, net of tax:			
Change in employee benefit plan funded status, net of tax of \$(6), \$(29) and \$47 in 2015, 2014 and 2013, respectively	(10)	(46)	73
Pension amortized to periodic benefit cost:			
Actuarial loss, net of tax of \$3 and \$6 in 2015 and 2013, respectively ...	5	—	9
Foreign currency translation adjustment	(1)	—	(1)
Unrealized loss on cash flow hedge, net of tax of \$(1)	—	(1)	—
Other comprehensive (loss) income	(6)	(47)	81
Comprehensive income attributable to common stockholders	\$ 470	\$ 376	\$ 450

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Cash Flows

(In millions)

	For the Years Ended December 31,		
	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	\$ 476	\$ 423	\$ 369
Adjustments to reconcile to net cash flows provided by operating activities:			
Depreciation and amortization	440	424	407
Deferred income taxes and amortization of investment tax credits	296	254	250
Provision for losses on accounts receivable	32	37	27
(Gain) loss on asset dispositions and purchases	(3)	(2)	1
Pension and non-pension postretirement benefits	61	24	78
Other non-cash, net	(53)	(14)	(1)
Changes in assets and liabilities:			
Receivables and unbilled revenues	(84)	(62)	(79)
Pension and non-pension postretirement benefit contributions	(57)	(52)	(98)
Accounts payable and accrued liabilities	80	27	15
Other current assets and liabilities, net	(9)	38	(73)
Net cash provided by operating activities	<u>1,179</u>	<u>1,097</u>	<u>896</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(1,160)	(956)	(980)
Acquisitions	(197)	(9)	(24)
Proceeds from sale of assets and securities	5	14	1
Removal costs from property, plant and equipment retirements, net	(107)	(78)	(65)
Net funds (restricted) released	(6)	15	15
Net cash used in investing activities	<u>(1,465)</u>	<u>(1,014)</u>	<u>(1,053)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	565	501	404
Repayments of long-term debt	(130)	(240)	(496)
Proceeds from short-term borrowings with maturities greater than three months	60	35	221
Repayments of short-term borrowings with maturities greater than three months	(60)	(256)	—
Net short-term borrowings with maturities less than three months	180	41	139
Proceeds from issuances of employee stock plans and DRIP	39	21	26
Advances and contributions for construction, net of refunds of \$23, \$21 and \$23 in 2015, 2014 and 2013, respectively	26	26	19
Debt issuance costs	(7)	(5)	(4)
Dividends paid	(239)	(216)	(149)
Anti-dilutive share repurchases	(126)	—	—
Tax benefit realized from equity compensation	—	6	—
Net cash provided by (used in) financing activities	<u>308</u>	<u>(87)</u>	<u>160</u>
Net increase (decrease) in cash and cash equivalents	22	(4)	3
Cash and cash equivalents at beginning of period	23	27	24
Cash and cash equivalents at end of period	<u>\$ 45</u>	<u>\$ 23</u>	<u>\$ 27</u>
Cash paid during the year for:			
Interest, net of capitalized amount	\$ 309	\$ 301	\$ 318
Income taxes, net of refunds of \$1 and \$4 in 2015 and 2014, respectively	\$ 12	\$ 16	\$ 8
Non-cash investing activity:			
Capital expenditures acquired on account but unpaid as of year end	\$ 224	\$ 186	\$ 129

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies
Consolidated Statements of Changes in Stockholders' Equity
(In millions)

	Common Stock		Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock		Preferred Stock of Subsidiary Companies Without Mandatory Redemption Requirements	Total Stockholders' Equity
	Shares	Par Value				Shares	At Cost		
Balance as of December 31, 2012 . . .	177.0	\$ 2	\$ 6,223	\$ (1,665)	\$ (116)	—	\$ —	1	\$ 4,445
Net income	—	—	—	369	—	—	—	—	369
Direct stock reinvestment and purchase plan	0.1	—	2	—	—	—	—	—	2
Employee stock purchase plan . . .	0.1	—	5	—	—	—	—	—	5
Stock-based compensation activity	1.2	—	32	(1)	—	(0.1)	(5)	—	26
Subsidiary preferred stock redemption	—	—	—	—	—	—	—	(1)	(1)
Other comprehensive income, net of tax of \$53	—	—	—	—	81	—	—	—	81
Dividends	—	—	—	(199)	—	—	—	—	(199)
Balance as of December 31, 2013 . . .	178.4	\$ 2	\$ 6,262	\$ (1,496)	\$ (35)	(0.1)	\$ (5)	—	\$ 4,728
Net income	—	—	—	423	—	—	—	—	423
Direct stock reinvestment and purchase plan	0.1	—	2	—	—	—	—	—	2
Employee stock purchase plan . . .	0.1	—	5	—	—	—	—	—	5
Stock-based compensation activity	0.9	—	33	(1)	—	(0.1)	(6)	—	26
Other comprehensive loss, net of tax of \$(30)	—	—	—	—	(47)	—	—	—	(47)
Dividends	—	—	—	(222)	—	—	—	—	(222)
Balance as of December 31, 2014 . . .	179.5	\$ 2	\$ 6,302	\$ (1,296)	\$ (82)	(0.2)	\$ (11)	—	\$ 4,915
Cumulative effect of change in accounting principle	—	—	—	(8)	—	—	—	—	(8)
Net income attributable to common stockholders	—	—	—	476	—	—	—	—	476
Direct stock reinvestment and purchase plan	0.1	—	4	—	—	—	—	—	4
Employee stock purchase plan . . .	0.1	—	5	—	—	—	—	—	5
Stock-based compensation activity	1.2	—	40	(1)	—	(0.1)	(6)	—	33
Repurchases of common stock . . .	—	—	—	—	—	(2.3)	(126)	—	(126)
Other comprehensive income, net of tax of \$(3)	—	—	—	—	(6)	—	—	—	(6)
Dividends	—	—	—	(244)	—	—	—	—	(244)
Balance as of December 31, 2015 . . .	180.9	\$ 2	\$ 6,351	\$ (1,073)	\$ (88)	(2.6)	\$ (143)	—	\$ 5,049

The accompanying notes are an integral part of these consolidated financial statements.

American Water Works Company, Inc. and Subsidiary Companies

Notes to Consolidated Financial Statements

(Unless otherwise noted, in millions, except per share data)

Note 1: Organization and Operation

American Water Works Company, Inc. (the “Company” or “American Water”) is the holding company for regulated and market-based subsidiaries throughout the United States of America and Ontario, Canada. The Regulated Businesses provide water and wastewater services as public utilities in 16 states in the United States. The Market-Based Businesses is comprised of four non-reportable operating segments including Military Services Group, which conducts operation and maintenance (“O&M”) of water and wastewater systems for military bases; Contract Operations Group, which conducts operation and maintenance of water and wastewater facilities for municipalities and the food and beverage industry; Homeowner Services Group, which primarily provides water and sewer line protection plans for homeowners; and Keystone Operations, which provides water services for natural gas exploration and production companies.

Note 2: Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of American Water and all of its subsidiaries in which a controlling interest is maintained after the elimination of intercompany accounts and transactions. Intercompany balances and transactions between subsidiaries have been eliminated. The Company uses the equity method to report its investments in joint ventures in which the Company holds up to a 50% voting interest and cannot exercise control over the operations and policies of the investments. Under the equity method, the Company records its interests as an investment and its percentage share of the investee’s earnings as earnings or losses.

In July 2015, the Company acquired a ninety-five percent interest in Water Solutions Holdings, LLC, including its wholly-owned subsidiary, Keystone Clearwater Solutions, LLC (collectively referred to as “Keystone”). The outside stockholders’ interest, which is redeemable at the option of the minority owners, is recognized as redeemable noncontrolling interest. The redeemable noncontrolling interest amounted to \$7 as of December 31, 2015 and is included in other long-term liabilities in the accompanying Consolidated Balance Sheets. The net loss attributable to the noncontrolling interest was not significant. The Company has entered into an agreement, whereby it has the option to acquire from the minority owners, and the minority owners have the option to sell to the Company, the remaining five percent interest at fair value upon the occurrence of certain triggering events or at defined dates of December 31, 2016 and December 31, 2018.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The Company considers its critical accounting estimates to include: the application of regulatory accounting principles and the related determination and estimates of regulatory assets and liabilities; estimates used in impairment testing of goodwill and other long-lived assets, including regulatory assets; revenue recognition; accounting for income taxes; benefit plan assumptions; and contingent liabilities. The Company’s critical accounting estimates that are particularly sensitive to change in the near term are amounts reported for regulatory assets and liabilities, benefit plans assumptions, contingency-related obligations and goodwill.

Regulation

The Company's regulated utilities are subject to economic regulation by the public utility commissions and the local governments of the states in which they operate (the "PUCs"). These PUCs generally authorize revenue at levels intended to recover the estimated costs of providing service, plus a return on net investments, or rate base. Regulators may also impose certain penalties or grant certain incentives. Due to timing and other differences in the collection of utility revenue, an incurred cost that would otherwise be charged to expense by a non-regulated entity is to be deferred as a regulatory asset if it is probable that the cost is recoverable in future rates. Conversely, GAAP requires recording of a regulatory liability for amounts collected in rates to recover costs expected to be incurred in the future or amounts collected in excess of costs incurred and refundable to customers. See Note 6—Regulatory Assets and Liabilities.

Property, Plant and Equipment

Property, plant and equipment consist primarily of utility plant. Additions to utility plant and replacements of retirement units of property are capitalized. Costs include material, direct labor and such indirect items as engineering and supervision, payroll taxes and benefits, transportation and an allowance for funds used during construction ("AFUDC"). The cost of repairs, maintenance, including planned major maintenance activities, and minor replacements is charged to maintenance expense as incurred.

The costs incurred to acquire and internally develop computer software for internal use are capitalized as a unit of property. The carrying value of these costs amounted to \$311 and \$320 as of December 31, 2015 and 2014, respectively.

When units of property are replaced, retired or abandoned, the recorded value is credited to the asset account and charged to accumulated depreciation. To the extent the Company recovers cost of removal or other retirement costs through rates after the retirement costs are incurred, a regulatory asset is recorded. In some cases, the Company recovers retirement costs through rates during the life of the associated asset and before the costs are incurred. These amounts result in a regulatory liability being reported based on the amounts previously recovered through customer rates, until the costs to retire those assets are incurred.

The cost of property, plant and equipment is depreciated using the straight-line average remaining life method. The Company's regulated utility subsidiaries record depreciation in conformity with amounts approved by state regulators after regulatory review of information the Company submits to support its estimates of the assets' remaining useful lives.

Nonutility property consists primarily of buildings and equipment utilized by the Company for internal operations. This property is stated at cost, net of accumulated depreciation calculated using the straight-line method over the useful lives of the assets.

Cash and Cash Equivalents

Substantially all cash is invested in interest-bearing accounts. All highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents.

Restricted Funds

Restricted funds primarily represent proceeds from financings for the construction and capital improvement of facilities and deposits for future services under operation and maintenance projects. The proceeds from these financings are held in escrow until the designated expenditures are incurred. Classification of restricted funds in the Consolidated Balance Sheets as either current or long-term is based upon the intended use of the funds.

Accounts Receivable and Unbilled Revenues

Accounts receivable include regulated utility customer accounts receivable, which represent amounts billed to water and wastewater customers on a cycle basis. Credit is extended based on the guidelines of the applicable PUCs and collateral is generally not required. Also included are market-based trade accounts receivable and nonutility customer receivables of the regulated subsidiaries. Unbilled revenues are accrued when service has been provided but has not been billed to customers.

Allowance for Uncollectible Accounts

Allowances for uncollectible accounts are maintained for estimated probable losses resulting from the Company's inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due. A number of factors are considered in determining the allowance for uncollectible accounts, including the length of time receivables are past due and previous loss history. The Company generally writes off accounts when they become uncollectible or are over a certain number of days outstanding. See Note 5—Allowance for Uncollectible Accounts.

Materials and Supplies

Materials and supplies are stated at the lower of cost or net realizable value. Cost is determined using the average cost method.

Goodwill

Goodwill represents the excess of the purchase price paid over the estimated fair value of the assets acquired and liabilities assumed in the acquisition of a business. Goodwill is not amortized, but is tested for impairment at least annually or on an interim basis if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Goodwill is primarily associated with the acquisitions of E'town Corporation in 2001, American Water in 2003 and Keystone in 2015 (the "Acquisitions") and has been assigned to reporting units based on the fair values at the date of the Acquisitions. The reporting units in the Regulated Businesses segment are aggregated into a single reporting unit. The Market-Based Businesses is comprised of four non-reportable operating segments. The Company's annual impairment test is performed as of November 30 of each year, in conjunction with the completion of the Company's annual business plan. The Company assesses qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If based on qualitative factors, the fair value of the reporting unit is more likely than not greater than the carrying amount, no further testing is required. If the Company bypasses the qualitative assessment or performs the qualitative assessment, but determines that it is more likely than not that its fair value is less than its carrying amount, a quantitative two-step, fair value-based test is performed.

The first step compares the estimated fair value of the reporting unit to its respective net carrying value, including goodwill, on the measurement date. If the estimated fair value of any reporting unit is less than such reporting unit's carrying value, then the second step is performed to measure the amount of the impairment loss (if any) for such reporting unit.

The second step requires an allocation of fair value to the individual assets and liabilities using purchase price allocation accounting guidance in order to determine the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount for the reporting unit, an impairment loss is recorded as a reduction to goodwill and a charge to operating expense. Application of the goodwill impairment test requires management judgment, including the identification of reporting units and determining the fair value of the reporting unit. Management estimates fair value using a combination of a discounted cash flow analysis and market multiples analysis. Significant assumptions used in these fair value analyses include discount and growth rates and projected terminal values.

The Company believes the assumptions and other considerations used to value goodwill to be appropriate. However, if experience differs from the assumptions and considerations used in its analysis, the resulting change could have a material adverse impact on the consolidated financial statements.

Long-Lived Assets

Long-lived assets include land, buildings, equipment and long-term investments. Long-lived assets, other than investments and land, are depreciated over their estimated useful lives, and are reviewed for impairment whenever changes in circumstances indicate the carrying value of the asset may not be recoverable. Such circumstances would include items such as a significant decrease in the market value of a long-lived asset, a significant adverse change in the manner the asset is being used or planned to be used or in its physical condition, or a history of operating or cash flow losses associated with the use of the asset. In addition, changes in the expected useful life of these long-lived assets may also be an impairment indicator. When such events or changes occur, the Company estimates the fair value of the asset from future cash flows expected to result from the use and, if applicable, the eventual disposition of the asset and compares that to the carrying value of the asset. If the carrying value is greater than the fair value, an impairment loss is recorded.

The Company believes the assumptions and other considerations used to evaluate the carrying value of long-lived assets are appropriate. However, if actual experience differs from the assumptions and considerations used in its estimates, the resulting change could have a material adverse impact on the consolidated financial statements.

The key variables to determine fair value include assumptions regarding sales volume, rates, operating costs, labor and other benefit costs, capital additions, assumed discount rates and other economic factors. These variables require significant management judgment and include inherent uncertainties, since they are forecasting future events. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value.

The long-lived assets of the regulated utility subsidiaries are tested on a separate entity basis for impairment testing as they are integrated state-wide operations that do not have the option to curtail service and generally have uniform tariffs. A regulatory asset is charged to earnings if and when future recovery in rates of that asset is no longer probable.

The Company holds other investments including investments in privately held companies and investments in joint ventures accounted for using the equity method. The Company's investments in privately held companies and joint ventures are classified as other long-term assets in the accompanying Consolidated Balance Sheets.

The fair values of long-term investments are dependent on the financial performance and solvency of the entities in which the Company invests, as well as volatility inherent in the external markets. If such assets are considered impaired, an impairment loss is recognized equal to the amount by which the asset's carrying value exceeds its fair value.

Advances for Construction and Contributions in Aid of Construction

Regulated utility subsidiaries may receive advances for construction and contributions in aid of construction from customers, home builders and real estate developers to fund construction necessary to extend service to new areas.

Advances are refundable for limited periods of time as new customers begin to receive service or other contractual obligations are fulfilled. Included in other current liabilities as of December 31, 2015 and 2014 in the accompanying Consolidated Balance Sheets are estimated refunds of \$19 and \$18, respectively. Those amounts represent expected refunds during the next 12-month period.

Advances that are no longer refundable are reclassified to contributions. Contributions are permanent collections of plant assets or cash for a particular construction project. For ratemaking purposes, the amount of such contributions generally serves as a rate base reduction since the contributions represent non-investor supplied funds.

Generally, the Company depreciates utility plant funded by contributions and amortizes its contributions balance as a reduction to depreciation expense, producing a result which is functionally equivalent to reducing the original cost of the utility plant for the contributions. In accordance with applicable regulatory guidelines, some of the Company's utility subsidiaries do not amortize contributions, and any contribution received remains on the balance sheet indefinitely. Amortization of contributions in aid of construction was \$26, \$24 and \$22 for the years ended December 31, 2015, 2014 and 2013, respectively.

Recognition of Revenues

Revenues of the regulated utility subsidiaries are recognized as water and wastewater services are provided, and include amounts billed to customers on a cycle basis and unbilled amounts based on estimated usage from the date of the meter reading associated with the latest customer bill to the end of the accounting period.

The Company has agreements with the U.S. Department of Defense to operate and maintain water and wastewater systems at various military bases pursuant to 50-year contracts ("military agreements"). These contracts also include construction components that are accounted for separately from the O&M components. Nine of the military agreements are subject to periodic price redetermination adjustments and modifications for changes in circumstance. The remaining three agreements are subject to annual price adjustments under a mechanism similar to price redeterminations. Additionally, the Company has agreements ranging in length from two to 40 years with municipalities and businesses in various industries to operate and maintain water and wastewater systems ("O&M agreements"). Revenues from operations and management services are recognized as services are provided. See Note 15—Commitments and Contingencies.

Revenues from construction projects are recognized over the contract term based on the costs incurred to date during the period compared to the total estimated costs over the entire contract. Losses on contracts are recognized during the period in which the loss first becomes probable and estimable. Revenues recognized during the period in excess of billings on construction contracts are recorded as unbilled revenue. Billings in excess of revenues recognized on construction contracts are recorded as other current liabilities until the recognition criteria are met. Changes in contract performance and related estimated contract profitability may result in revisions to costs and revenues and are recognized in the period in which revisions are determined.

Income Taxes

American Water and its subsidiaries participate in a consolidated federal income tax return for U.S. tax purposes. Members of the consolidated group are charged with the amount of federal income tax expense determined as if they filed separate returns.

Certain income and expense items are accounted for in different time periods for financial reporting than for income tax reporting purposes. The Company provides deferred income taxes on the difference between the tax basis of assets and liabilities and the amounts at which they are carried in the financial statements. These deferred income taxes are based on the enacted tax rates expected to be in effect when these temporary differences are projected to reverse. In addition, the regulated utility subsidiaries recognize regulatory assets and liabilities for the effect on revenues expected to be realized as the tax effects of temporary differences, previously flowed through to customers, reverse.

Investment tax credits have been deferred by the regulated utility subsidiaries and are being amortized to income over the average estimated service lives of the related assets.

The Company recognizes accrued interest and penalties related to tax positions as a component of income tax expense and accounts for sales tax collected from customers and remitted to taxing authorities on a net basis.

Allowance for Funds Used During Construction

AFUDC is a non-cash credit to income with a corresponding charge to utility plant that represents the cost of borrowed funds or a return on equity funds devoted to plant under construction. The regulated utility subsidiaries record AFUDC to the extent permitted by the PUCs. The portion of AFUDC attributable to borrowed funds is shown as a reduction of interest, net in the accompanying Consolidated Statements of Operations. Any portion of AFUDC attributable to equity funds would be included in other income (expenses) in the accompanying Consolidated Statements of Operations. AFUDC is summarized in the following table for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Allowance for other funds used during construction	\$13	\$9	\$13
Allowance for borrowed funds used during construction	8	6	6

Environmental Costs

The Company’s water and wastewater operations are subject to U.S. federal, state, local and foreign requirements relating to environmental protection, and as such, the Company periodically becomes subject to environmental claims in the normal course of business. Environmental expenditures that relate to current operations or provide a future benefit are expensed or capitalized as appropriate. Remediation costs that relate to an existing condition caused by past operations are accrued, on an undiscounted basis, when it is probable that these costs will be incurred and can be reasonably estimated. Remediation costs accrued amounted to \$1 and \$2 as of December 31, 2015 and 2014, respectively. The accrual relates entirely to a conservation agreement entered into by a subsidiary of the Company with the National Oceanic and Atmospheric Administration (“NOAA”) requiring the Company to, among other provisions, implement certain measures to protect the steelhead trout and its habitat in the Carmel River watershed in the State of California. The Company has agreed to pay \$1 annually from 2010 to 2016. The Company’s inception-to-date costs related to the NOAA agreement were recorded in regulatory assets in the accompanying Consolidated Balance Sheets as of December 31, 2015 and 2014 and are expected to be fully recovered from customers in future rates.

Derivative Financial Instruments

The Company uses derivative financial instruments for purposes of hedging exposures to fluctuations in interest rates. These derivative contracts are entered into for periods consistent with the related underlying exposures and do not constitute positions independent of those exposures. The Company does not enter into derivative contracts for speculative purposes and does not use leveraged instruments.

All derivatives are recognized on the balance sheet at fair value. On the date the derivative contract is entered into, the Company may designate the derivative as a hedge of the fair value of a recognized asset or liability (fair-value hedge) or a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash-flow hedge).

Changes in the fair value of a fair-value hedge, along with the gain or loss on the underlying hedged item, are recorded in current-period earnings. The effective portion of gains and losses on cash-flow hedges are recorded in other comprehensive income, until earnings are affected by the variability of cash flows. Any ineffective portion of designated hedges is recognized in current-period earnings.

Cash flows from derivative contracts are included in net cash provided by operating activities in the accompanying Consolidated Statements of Cash Flows.

New Accounting Standards

The following recently issued accounting standards have been adopted by the Company as of December 31, 2015:

Standard	Description	Date of Adoption	Application	Effect on the Consolidated Financial Statements (or Other Significant Matters)
Service Concession Arrangements	Clarified that an operating entity should not account for a services concession arrangement with a public-sector grantor as a lease if: (1) the grantor controls or has the ability to modify or approve the services the operating entity must provide, to whom it must provide them, and at what price; and (2) the grantor controls any residual interest in the infrastructure at the end of the arrangement. In addition, the infrastructure used in a service concession arrangement would not be recognized as property, plant and equipment of the operating entity.	January 1, 2015	Modified retrospective basis	The Company reduced nonutility property and other long-term assets for infrastructure related to service concession arrangements and recognized a cumulative effect adjustment of \$8 net of tax, to the opening balance of accumulated deficit at January 1, 2015.
Reporting Discontinued Operations	Amended the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Now, a discontinued operation is defined as a component or group of components that is disposed of or is classified as held for sale and represents a strategic shift that has or will have a major effect on an entity's operations and financial results. In addition, the update no longer precludes presentation as a discontinued operation if there are operations and cash flows of the component that have not been eliminated from the reporting entity's ongoing operations or if there is significant continuing involvement with a component after its disposal.	January 1, 2015	Prospective basis	The adoption of this standard did not impact the Company's results of operations, financial position or cash flows.
Presentation of Debt Issuance Costs	Updated guidance on the imputation of interest and simplified the presentation of debt issuance costs. The updated guidance requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of the related liability. Such treatment is consistent with the current presentation of debt discounts or premiums.	October 1, 2015	Retrospective basis	The December 31, 2014 Consolidated Balance Sheet was revised, which resulted in decreases of \$7 to other assets and long-term debt, respectively. Unamortized debt issuance costs of \$7 were included in long-term debt as of December 31, 2015.
Presentation of Deferred Income Taxes	Simplified the presentation of deferred income taxes and requires that deferred income tax assets and liabilities be classified as noncurrent in the balance sheet.	October 1, 2015	Retrospective basis	The December 31, 2014 Consolidated Balance Sheet was revised, which resulted in decreases of \$87 to the current deferred income tax asset and long-term deferred income tax liability.

The following recently issued accounting standards have not yet been adopted by the Company as of December 31, 2015:

<u>Standard</u>	<u>Description</u>	<u>Effective Date</u>	<u>Application</u>	<u>Effect on the Consolidated Financial Statements (or Other Significant Matters)</u>
Revenue from Contracts with Customers	Provided new revenue recognition guidance that will replace most existing revenue recognition guidance in GAAP, including industry-specific guidance. Upon adoption, a company will recognize revenue for the transfer of goods or services to customers equal to the amount that it expects to be entitled to receive for those goods or services. The guidance also requires additional disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments.	January 1, 2018	The Company is currently evaluating the alternative methods available and has not yet selected a transition method.	The Company is currently evaluating the effect on the financial statements and related disclosures.
Accounting for Fees Paid in a Cloud Computing Arrangement	Clarified guidance on how customers should account for fees paid in a cloud computing arrangement. Under the new guidance, if a cloud computing arrangement contains a software license, the customer would account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the cloud computing arrangement does not include a software license, the customer would account for the arrangement as a service contract.	January 1, 2016	Prospective basis	The effect on the financial statements upon adoption will be dependent on the software license arrangements entered into by the Company subsequent adoption.

Reclassifications

Certain reclassifications have been made to prior periods in the accompanying consolidated financial statements and notes to conform to the current presentation

Note 3: Acquisitions and Divestitures

Acquisitions

During 2015, the Company closed on fourteen acquisitions of various regulated water and wastewater systems for a total aggregate purchase price of \$64. Assets acquired, principally utility plant, totaled \$90. Liabilities assumed totaled \$26, including \$10 of contributions in aid of construction, and assumed debt of \$1. The Company recorded additional goodwill of \$3 associated with four of its acquisitions, which is reported in its Regulated Businesses segment and is expected to be fully deductible for tax purposes. The Company also recognized a bargain purchase gain of \$3 associated with five of its acquisitions, of which \$1 was deferred as a regulatory liability.

The Company also closed on the Keystone acquisition, which is included as part of the Market-Based Businesses, for a total purchase price of \$133, net of cash received. The fair value of identifiable assets acquired and liabilities assumed was \$56 and \$7, respectively, and principally included the acquisition of nonutility property of \$25, accounts receivable and unbilled revenues of \$18 and intangible assets of \$12. The purchase price allocation, which is based on the estimated fair value of net assets acquired, resulted in the Company recording redeemable noncontrolling interest of \$7 and additional goodwill of \$91. Goodwill is expected to be fully deductible for tax purposes. The pro forma impact of this acquisition would not have been material to the Company's results of operations for the years ended December 31, 2015 and 2014 respectively.

During 2014, the Company closed on thirteen acquisitions of various regulated water and wastewater systems for a total aggregate purchase price of \$9. Assets acquired, principally plant, totaled \$17. Liabilities assumed totaled \$8, including \$5 of contributions in aid of construction and assumed debt of \$2.

During 2013, the Company closed on fifteen acquisitions of various regulated water and wastewater systems for a total aggregate net purchase price of \$24. Assets acquired, primarily utility plant, totaled \$67. Liabilities assumed totaled \$43, including \$26 of contributions in aid of construction and assumed debt of \$13. Included in these totals was the Company's November 14, 2013 acquisition of all of the capital stock of Dale Service Corporation ("Dale"), a regulated wastewater utility company, for a total cash purchase price of \$5 (net of cash acquired of \$7), plus assumed liabilities. The Dale acquisition was accounted for as a business combination; accordingly, operating results from November 14, 2013 were included in the Company's results of operations. The purchase price was allocated to the net tangible and intangible assets based upon their estimated fair values at the date of acquisition. The Company's regulatory practice was followed whereby property, plant and equipment (rate base) was considered fair value for business combination purposes. Similarly, regulatory assets and liabilities acquired were recorded at book value and are subject to regulatory approval where applicable. The acquired debt was valued in a manner consistent with the Company's Level 3 debt. See Note 17—Fair Value of Financial Instruments. Non-cash assets acquired in the Dale acquisition, primarily utility plant, totaled \$41; liabilities assumed totaled \$36, including debt assumed of \$13 and contributions of \$19.

Divestitures

In November 2014, the Company completed the sale of Terratec, previously included in the Market-Based Businesses. After post-close adjustments, net proceeds from the sale totaled \$1, and the Company recorded a pretax loss on sale of \$1.

The following table summarizes the operating results of discontinued operations presented in the accompanying Consolidated Statements of Operations for the years ended December 31:

	<u>2014</u>	<u>2013</u>
Operating revenues	\$ 13	\$ 23
Total operating expenses, net	<u>19</u>	<u>26</u>
Loss from discontinued operations before income taxes	(6)	(3)
Provision (benefit) for income taxes	<u>1</u>	<u>(1)</u>
Loss from discontinued operations, net of tax	<u>\$ (7)</u>	<u>\$ (2)</u>

The provision for income taxes of discontinued operations includes the recognition of tax expense related to the difference between the tax basis and book basis of assets upon the sales of Terratec that resulted in taxable gains, since an election was made under Section 338(h)(10) of the Internal Revenue Code to treat the sales as asset sales.

There were no assets or liabilities of discontinued operations in the accompanying Consolidated Balance Sheets as of December 31, 2015 and 2014.

Note 4: Property, Plant and Equipment

The following table summarizes the major classes of property, plant and equipment by category as of December 31:

	<u>2015</u>	<u>2014</u>	<u>Range of Remaining Useful Lives</u>	<u>Weighted Average Useful Life</u>
Utility plant:				
Land and other non-depreciable assets	\$ 141	\$ 137		
Sources of supply	705	681	12 to 127 Years	51 Years
Treatment and pumping facilities	3,070	2,969	3 to 101 Years	39 Years
Transmission and distribution facilities	8,516	7,963	9 to 156 Years	83 Years
Services, meters and fire hydrants	3,250	3,062	8 to 93 Years	35 Years
General structures and equipment	1,227	1,096	1 to 154 Years	39 Years
Waste treatment, pumping and disposal	313	281	2 to 115 Years	46 Years
Waste collection	473	399	5 to 109 Years	56 Years
Construction work in progress	<u>404</u>	<u>303</u>		
Total utility plant	18,099	16,891		
Nonutility property	<u>405</u>	<u>378</u>	3 to 50 years	6 Years
Total property, plant and equipment	<u>\$18,504</u>	<u>\$17,269</u>		

Property, plant and equipment depreciation expense amounted to \$405, \$392, and \$374 for the years ended December 31, 2015, 2014 and 2013, respectively and was included in depreciation and amortization expense in the accompanying Consolidated Statements of Operations. The provision for depreciation expressed as a percentage of the aggregate average depreciable asset balances was 3.13% for the year ended December 31, 2015 and 3.20% for years December 31, 2014 and 2013.

Note 5: Allowance for Uncollectible Accounts

The following table summarizes the changes in the Company’s allowances for uncollectible accounts for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Balance as of January 1	\$ (35)	\$ (34)	\$ (27)
Amounts charged to expense	(32)	(37)	(27)
Amounts written off	38	43	24
Recoveries of amounts written off	<u>(10)</u>	<u>(7)</u>	<u>(4)</u>
Balance as of December 31	<u>\$ (39)</u>	<u>\$ (35)</u>	<u>\$ (34)</u>

Note 6: Regulatory Assets and Liabilities

Regulatory Assets

The regulatory assets represent costs that are probable of recovery from customers in future rates. The majority of the regulatory assets earn a return. The following table summarizes the composition of regulatory assets as of December 31:

	<u>2015</u>	<u>2014</u>
Deferred pension expense	\$ 269	\$ 263
Income taxes recoverable through rates	236	229
Removal costs recoverable through rates	225	163
Deferred other postretirement benefit expense	90	107
San Clemente Dam project costs	95	72
Regulatory balancing accounts	88	60
Debt expense	68	71
Purchase premium recoverable through rates	60	60
Deferred tank painting costs	37	37
Other	103	91
Total Regulatory Assets	<u>\$ 1,271</u>	<u>\$ 1,153</u>

The Company's deferred pension expense includes a portion of the underfunded status that is probable of recovery through rates in future periods of \$258 and \$248 as of December 31, 2015 and 2014, respectively. The remaining portion is the pension expense in excess of the amount contributed to the pension plans which is deferred by certain subsidiaries and will be recovered in future service rates as contributions are made to the pension plan.

The Company has recorded a regulatory asset for the additional revenues expected to be realized when the tax effects of temporary differences previously flowed through to customers reverse. These temporary differences are primarily related to the difference between book and tax depreciation on property placed in service before the adoption by the regulatory authorities of full normalization for rate making purposes. Full normalization requires no flow through of tax benefits to customers. The regulatory asset for income taxes recoverable through rates is net of the reduction expected in future revenues as deferred taxes previously provided, attributable to the difference between the state and federal income tax rates under prior law and the current statutory rates, reverse over the average remaining service lives of the related assets.

Removal costs recoverable through rates represent costs incurred for removal of property, plant and equipment or other retirement costs.

The Company's deferred other postretirement benefit expense includes a portion of the underfunded status that is probable of recovery through rates in future periods of \$87 and \$107 as of December 31, 2015 and 2014, respectively. The remaining portion is postretirement benefit expense in excess of the amount recovered in rates through 1997 has been deferred by certain subsidiaries. These costs are recognized in the rates charged for water service and will be recovered as authorized by the Company's regulatory authorities.

San Clemente Dam project costs represent costs incurred and deferred by the Company's California subsidiary pursuant to its efforts to investigate alternatives to strengthen or remove the dam due to potential earthquake and flood safety concerns. In June 2012, the California Public Utility Commission ("CPUC") issued a decision authorizing implementation of a project to reroute the Carmel River and remove the San Clemente Dam. The project includes the Company's California subsidiary, the California State Conservancy and the National Marine Fisheries Services. Under the order's terms, the CPUC has authorized recovery of \$24 for pre-construction costs, \$3 for interim dam safety measures and environmental costs and \$49 for construction costs.

The authorized costs of \$76 are to be recovered via a surcharge over a twenty-year period beginning October 2012. Surcharges collected as of December 31, 2015 and 2014 were \$4 and \$5, respectively. In addition to the authorized costs, the Company expects to incur additional costs totaling \$34, which will be recovered from contributions made by the California State Coastal Conservancy. Contributions collected as of December 31, 2015 and 2014 were \$8 and \$5, respectively.

Regulatory balancing accounts accumulate differences between revenues recognized and authorized revenue requirements until they are collected from customers or are refunded. Regulatory balancing accounts include low income programs and purchased power and water accounts.

Debt expense is amortized over the lives of the respective issues. Call premiums on the redemption of long-term debt, as well as unamortized debt expense, are deferred and amortized to the extent they will be recovered through future service rates.

Purchase premium recoverable through rates is primarily the recovery of the acquisition premiums related to an asset acquisition by the Company's California subsidiary during 2002, and acquisitions in 2007 by the Company's New Jersey subsidiary. As authorized for recovery by the California and New Jersey PUCs, these costs are being amortized to depreciation and amortization in the Consolidated Statements of Operations through November 2048.

Tank painting costs are generally deferred and amortized to operations and maintenance expense in the Consolidated Statements of Operations on a straight-line basis over periods ranging from five to fifteen years, as authorized by the regulatory authorities in their determination of rates charged for service.

Other regulatory assets include certain deferred business transformation costs, construction costs for treatment facilities, property tax stabilization, employee-related costs, business services project expenses, coastal water project costs, rate case expenditures and environmental remediation costs among others. These costs are deferred because the amounts are being recovered in rates or are probable of recovery through rates in future periods.

Regulatory Liabilities

The regulatory liabilities generally represent probable future reductions in revenues associated with amounts that are to be credited or refunded to customers through the rate-making process. The following table summarizes the composition of regulatory liabilities as of December 31:

	<u>2015</u>	<u>2014</u>
Removal costs recovered through rates	\$ 311	\$ 301
Pension and other postretirement benefit balancing accounts	59	54
Other	<u>32</u>	<u>37</u>
Total Regulatory Liabilities	<u>\$ 402</u>	<u>\$ 392</u>

Removal costs recovered through rates are estimated costs to retire assets at the end of their expected useful life that are recovered through customer rates over the life of the associated assets. In December 2008, the Company's subsidiary in New Jersey, at the direction of the New Jersey PUC, began to depreciate \$48 of the total balance into depreciation and amortization expense in the Consolidated Statements of Operations via straight line amortization through November 2048.

Pension and other postretirement benefit balancing accounts represent the difference between costs incurred and costs authorized by the PUC's that are expected to be refunded to customers.

Other regulatory liabilities include legal settlement proceeds, deferred gains and various regulatory balancing accounts.

Note 7: Goodwill and Other Intangible Assets

Goodwill

The following table summarizes changes in the carrying amount of goodwill for the years ended December 31, 2015 and 2014:

	Regulated Businesses		Market-Based Businesses		Consolidated		
	Cost	Accumulated Impairment	Cost	Accumulated Impairment	Cost	Accumulated Impairment	Total Net
	Balance as of January 1, 2014	\$3,412	\$ (2,332)	\$236	\$ (108)	\$3,648	\$ (2,440)
Goodwill from acquisitions	3	—	91	—	94	—	94
Balance as of December 31, 2015	<u>\$3,415</u>	<u>\$ (2,332)</u>	<u>\$327</u>	<u>\$ (108)</u>	<u>\$3,742</u>	<u>\$ (2,440)</u>	<u>\$1,302</u>

The Company recorded goodwill of \$91 as part of the Keystone acquisition. The Keystone business is an operating segment comprised of one reporting unit to which all of the goodwill arising from the acquisition was assigned and which is included in the Market-Based Business information. The Company also acquired aggregate goodwill of \$3 associated with four of its acquisitions in its Regulated Businesses segment.

Excluding goodwill acquired in 2015 related to the Keystone acquisition, the Company determined that no qualitative factors were present that would indicate the estimated fair values of its reporting units were less than the respective carrying values. As such, the Company determined that the two-step goodwill impairment test was not necessary at November 30, 2015 or 2014.

A step one test was completed for the Keystone goodwill. We used an income approach valuation technique which estimates the discounted future cash flows of operations. The discounted cash flow analysis relies on a single scenario reflecting best estimate projected cash flows. Significant assumptions were used in estimating the fair value, including the discount rate, growth rate and terminal value. The estimated fair value of the Keystone reporting unit exceeded its carrying value by less than 3% and as such the Company does not believe the goodwill is impaired. If a further decline in the fair value were to occur the Keystone reporting unit could be at risk of failing step one of the goodwill impairment test.

There can be no assurances that the Company will not be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to the performance of the Company's reporting units. These market events could include a decline over a period of time of the Company's stock price, a decline over a period of time in valuation multiples of comparable water utilities and reporting unit companies, the lack of an increase in the Company's market price consistent with its peer companies, decreases in control premiums or continued downward pressure on commodity prices. 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. In regards to the Keystone goodwill, adverse developments in market conditions, including prolonged depression of natural gas prices or other factors that negatively impact our forecast operating results, cash flows or key assumptions in the future could result in an impairment charge of a portion or all of the goodwill balance.

Other Intangible Assets

Included in other long-term assets as of December 31, 2015, is a \$12 customer relationship intangible resulting from the Keystone acquisition. This intangible is being amortized on a straight-line basis over a period of eight years.

Note 8: Stockholders' Equity

Common Stock

Under the dividend reinvestment and direct stock purchase plan (the "DRIP"), stockholders may reinvest cash dividends and purchase additional Company common stock, up to certain limits, through the plan administrator without commission fees. Shares purchased by participants through the DRIP may be newly-issued shares, treasury shares, or at the Company's election, shares purchased by the plan administrator in the open market or in privately negotiated transactions. Purchases generally will be made and credited to DRIP accounts once each week. As of December 31, 2015, there were approximately 4.5 shares available for future issuance under the DRIP.

Antidilutive Stock Repurchase Program

In February 2015, the Company's Board of Directors authorized an anti-dilutive common stock repurchase program to mitigate the dilutive effect of shares issued through the Company's dividend reinvestment, employee stock purchase and executive compensation activities. This program allows the Company to purchase up to 10 shares of its outstanding common stock over an unrestricted period of time in the open market or through privately negotiated transactions in order to minimize dilution.

The shares repurchased are held as treasury shares, at cost, until cancelled or reissued at the discretion of the Company's management. As of December 31, 2015, the Company purchased 2.3 shares of common stock in the open market at an aggregate cost of \$126 under this program.

Accumulated Other Comprehensive Loss

The following table presents changes in accumulated other comprehensive loss by component, net of tax, for the years ended December 31, 2015 and 2014:

	Defined Benefit Plans				Loss on Cash Flow Hedge	Accumulated Other Comprehensive Loss
	Employee Benefit Plan Funded Status	Amortization of Prior Service Cost	Amortization of Actuarial Loss	Foreign Currency Translation		
Beginning balance as of January 1, 2014	\$ (70)	\$ 1	\$ 31	\$ 3	\$ —	\$ (35)
Other comprehensive loss (income)	(46)	—	—	—	(1)	(47)
Ending balance as of December 31, 2014	<u>\$ (116)</u>	<u>\$ 1</u>	<u>\$ 31</u>	<u>\$ 3</u>	<u>\$ (1)</u>	<u>\$ (82)</u>
Other comprehensive loss (income)	(10)	—	5	(1)	—	(6)
Ending balance as of December 31, 2015	<u>\$ (126)</u>	<u>\$ 1</u>	<u>\$ 36</u>	<u>\$ 2</u>	<u>\$ (1)</u>	<u>\$ (88)</u>

The Company does not reclassify the amortization of defined benefit pension cost components from accumulated other comprehensive loss directly to net income in its entirety, as a portion of these costs have been capitalized as a regulatory asset. These accumulated other comprehensive loss components are included in the computation of net periodic pension cost. See Note 14—Employee Benefits.

The amortization of the loss on cash flow hedge is reclassified to net income during the period incurred and is included in interest, net in the accompanying Consolidated Statements of Operations.

Note 9: Stock Based Compensation

The Company has granted stock option and restricted stock unit (“RSUs”) awards to non-employee directors, officers and other key employees of the Company pursuant to the terms of its 2007 Omnibus Equity Compensation Plan (the “2007 Plan”). The total aggregate number of shares of common stock that may be issued under the 2007 Plan is 15.5. As of December 31, 2015, 8.4 shares were available for grant under the 2007 Plan. Shares issued under the 2007 Plan may be authorized-but-unissued shares of Company stock or reacquired shares of Company stock, including shares purchased by the Company on the open market.

The Company recognizes compensation expense for stock awards over the vesting period of the award. The following table presents stock-based compensation expense recorded in operation and maintenance expense in the accompanying Consolidated Statements of Operations for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Stock options	\$ 2	\$ 2	\$ 3
RSUs	8	10	9
ESPP	<u>1</u>	<u>1</u>	<u>1</u>
Stock-based compensation	11	13	13
Income tax benefit	<u>(4)</u>	<u>(5)</u>	<u>(5)</u>
Stock-based compensation expense, net of tax	<u>\$ 7</u>	<u>\$ 8</u>	<u>\$ 8</u>

There were no significant stock-based compensation costs capitalized during the years ended December 31, 2015, 2014 and 2013.

The cost of services received from employees in exchange for the issuance of stock options and restricted stock awards is measured based on the grant date fair value of the awards issued. The value of stock options and RSUs awards at the date of the grant is amortized through expense over the three-year service period. All awards granted in 2015, 2014 and 2013 are classified as equity.

The Company receives a tax deduction based on the intrinsic value of the award at the exercise date for stock options and the distribution date for RSUs. For each award, throughout the requisite service period, the Company recognizes the tax benefits, which have been included in deferred income tax assets, related to compensation costs. The tax deductions in excess of the benefits recorded throughout the requisite service period are recorded to common stockholders’ equity or the statement of operations and are presented in the financing section of the Consolidated Statements of Cash Flows.

The Company stratified its grant populations and used historic employee turnover rates to estimate employee forfeitures. The estimated rate is compared to the actual forfeitures at the end of the reporting period and adjusted as necessary.

Stock Options

In 2015, 2014 and 2013, the Company granted non-qualified stock options to certain employees under the 2007 Plan. The stock options vest ratably over the three-year service period beginning on January 1 of the year of the grant. These awards have no performance vesting conditions and the grant date fair value is amortized through expense over the requisite service period using the straight-line method and is included in operations and maintenance expense in the accompanying Consolidated Statements of Operations.

The following table summarizes the weighted-average assumptions used in the Black-Scholes option-pricing model for grants and the resulting weighted-average grant date fair value per share of stock options granted for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Dividend yield	2.35%	2.55%	2.52%
Expected volatility	17.64%	17.75%	23.50%
Risk-free interest rate	1.48%	1.06%	0.70%
Expected life (years)	4.4	3.6	4.3
Exercise price	\$52.75	\$44.29	\$39.60
Grant date fair value per share	\$ 6.21	\$ 4.57	\$ 5.78

The Company utilized the “simplified method” to determine the expected stock option life due to insufficient historical experience to estimate the exercise patterns of the stock options granted. The Company began granting stock options at the time of its initial public offering in April 2008. Expected volatility is based on a weighted average of historic volatilities of traded common stock of peer companies (regulated water companies) over the expected term of the stock options and historic volatilities of the Company’s common stock during the period it has been publicly traded. The dividend yield is based on the Company’s expected dividend payments and the stock price on the date of grant. The risk-free interest rate is the market yield on U.S. Treasury strips with maturities similar to the expected term of the stock options. The exercise price of the stock options is equal to the fair market value of the underlying stock on the date of option grant. Stock options vest over periods ranging from one to three years and have a maximum term of seven years from the effective date of the grant.

As of December 31, 2015, \$2 of total unrecognized compensation cost related to nonvested stock options is expected to be recognized over the remaining weighted-average period of 1.6 years. The total grant date fair value of stock options vested was \$3 for the years ended December 31, 2015 and 2014 and \$4 for the year ended December 31, 2013.

The table below summarizes stock option activity for the year ended December 31, 2015:

	<u>Shares (in thousands)</u>	<u>Weighted- Average Exercise Price (per share)</u>	<u>Weighted- Average Remaining Life (years)</u>	<u>Aggregate Intrinsic Value</u>
Options outstanding as January 1, 2015	1,910	\$ 33.47	3.9	\$ 38
Granted	301	52.75		
Forfeited or expired	(51)	44.36		
Exercised	(973)	31.26		
Options outstanding as of December 31, 2015	<u>1,187</u>	<u>\$ 39.70</u>	<u>3.9</u>	<u>\$ 24</u>
Exercisable as of December 31, 2015	<u>666</u>	<u>\$ 32.92</u>	<u>2.6</u>	<u>\$ 18</u>

The following table summarizes additional information regarding stock options exercised during the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Intrinsic value	\$ 22	\$ 13	\$ 15
Exercise proceeds	30	15	20
Income tax benefit	7	4	4

RSUs

During 2012, the Company granted selected employees an aggregate of 139 thousand RSUs with internal performance measures and, separately, certain market thresholds. These awards vested in January 2015. The terms of the grants specified that to the extent certain performance goals, comprised of internal measures and, separately, market thresholds were achieved, the RSUs would vest; if performance goals were surpassed, up to 175% of the target awards would be distributed; and if performance goals were not met, the awards would be forfeited. In January 2015, an additional 93 thousand RSUs were granted and distributed because performance thresholds were exceeded.

In 2015, 2014 and 2013, the Company granted RSUs, both with and without performance conditions, to certain employees under the 2007 Plan. The RSUs without performance conditions vest ratably over the three-year service period beginning January 1 of the year of the grant and the RSUs with performance conditions vest ratably over the three-year performance period beginning January 1 of the year of the grant (the "Performance Period"). Distribution of the performance shares is contingent upon the achievement of internal performance measures and, separately, certain market thresholds over the Performance Period.

During 2015, 2014 and 2013, the Company granted RSUs to non-employee directors under the 2007 Plan. The RSUs vested on the date of grant; however, distribution of the shares will be made within 30 days of the earlier of: (i) 15 months after grant date, subject to any deferral election by the director; or (ii) the participant's separation from service. Because these RSUs vested on the grant date, the total grant date fair value was recorded in operation and maintenance expense included in the expense table above on the grant date.

RSUs generally vest over periods ranging from one to three years. RSUs granted with service-only conditions and those with internal performance measures are valued at the market value of the closing price of the Company's common stock on the date of grant. RSUs granted with market conditions are valued using a Monte Carlo model. Expected volatility is based on historical volatilities of traded common stock of the Company and comparative companies using daily stock prices over the past three years. The expected term is three years and the risk-free interest rate is based on the three-year U.S. Treasury rate in effect as of the measurement date. The following table presents the weighted-average assumptions used in the Monte Carlo simulation and the weighted-average grant date fair values of RSUs granted for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Expected volatility	14.93%	17.78%	19.37%
Risk-free interest rate	1.07%	0.75%	0.40%
Expected life (years)	3.0	3.0	3.0
Grant date fair value per share	\$62.10	\$45.45	\$40.13

The grant date fair value of restricted stock awards that vest ratably and have market and/or performance and service conditions are amortized through expense over the requisite service period using the graded-vesting method. RSUs that have no performance conditions are amortized through expense over the requisite service period using the straight-line method and are included in operations expense in the accompanying Consolidated Statements of Operations. As of December 31, 2015, \$4 of total unrecognized compensation cost related to the nonvested restricted stock units is expected to be recognized over the weighted-average remaining life of 1.4 years. The total grant date fair value of RSUs vested was \$12, \$11 and \$9 for the years ended December 31, 2015, 2014 and 2013.

The table below summarizes restricted stock unit activity for the year ended December 31, 2015:

	<u>Shares (in thousands)</u>	<u>Weighted-Average Grant Date Fair Value (per share)</u>
Non-vested total as of January 1, 2015	516	\$ 41.46
Granted	156	55.67
Performance share adjustment	93	38.11
Vested	(304)	39.46
Forfeited	<u>(25)</u>	45.84
Non-vested total as of December 31, 2015	<u>436</u>	<u>\$ 46.97</u>

The following table summarizes additional information regarding RSUs distributed during the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Intrinsic value	\$ 17	\$ 16	\$ 14
Income tax benefit	2	2	2

If dividends are paid with respect to shares of the Company's common stock before the RSUs are distributed, the Company credits a liability for the value of the dividends that would have been paid if the RSUs were shares of Company common stock. When the RSUs are distributed, the Company pays the participant a lump sum cash payment equal to the value of the dividend equivalents accrued. The Company accrued dividend equivalents totaling \$1 to accumulated deficit in the accompanying Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2015, 2014 and 2013, respectively.

Employee Stock Purchase Plan

Under the Nonqualified Employee Stock Purchase Plan ("ESPP"), employees can use payroll deductions to acquire Company stock at the lesser of 90% of the fair market value of common stock at either the beginning or the end of a three-month purchase period. As of December 31, 2015, there were 1.2 shares of common stock reserved for issuance under the ESPP. The Company's ESPP is considered compensatory. During the years ended December 31, 2015, 2014 and 2013, the Company issued 98, 102 and 111 thousand shares, respectively, under the ESPP.

Note 10: Long-Term Debt

The Company obtains long-term debt primarily to fund capital expenditures of the regulated subsidiaries and refinance debt of the parent company. The following table summarizes the components of long-term as of December 31:

	<u>Rate</u>	<u>Weighted Average Rate</u>	<u>Maturity</u>	<u>2015</u>	<u>2014</u>
Long-term debt of American Water Capital Corp. (a)					
Senior notes—fixed rate	3.40%-8.27%	5.23%	2016-2045	\$4,273	\$3,753
Private activity bonds and government funded debt—fixed rate	1.79%-6.25%	5.41%	2021-2040	195	231
Long-term debt of other American Water subsidiaries					
Private activity bonds and government funded debt—fixed rate (b)	0.00%-6.20%	4.70%	2016-2041	790	795
Mortgage bonds—fixed rate	4.29%-9.71%	7.41%	2017-2039	637	677
Mandatorily redeemable preferred stock	8.47%-9.75%	8.61%	2019-2036	13	17
Capital lease obligations	12.23%	12.23%	2026	1	1
Long-term debt				5,909	5,474
Unamortized debt premium, net (c)				23	31
Unamortized debt issuance costs				(7)	(6)
Interest rate swap fair value adjustment				3	4
Total long-term debt				\$5,928	\$5,503

- (a) This indebtedness is considered “debt” for purposes of a support agreement between American Water and American Water Capital Corp. (“AWCC”), which serves as a functional equivalent of a guarantee by AWCC’s payment obligations under such indebtedness.
- (b) Includes \$8 and \$10 of variable rate debt with variable-to-fixed interest rate swaps ranging between 4.65% and 3.93%, as of December 31, 2015 and 2014, respectively. This debt was assumed via an acquisition in 2013.
- (c) Primarily fair value adjustments previously recognized in acquisition purchase accounting.

All mortgage bonds and \$716 of the private activity bonds and government funded debt held by the subsidiaries were collateralized by utility plant as of December 31, 2015.

Long-term debt indentures contain a number of covenants that, among other things, limit, subject to certain exceptions, the Company from issuing debt secured by the Company’s assets. Certain long term notes require the Company to maintain a ratio of consolidated total indebtedness to consolidated total capitalization of not more than 0.70 to 1.00. The ratio as of December 31, 2015 was 0.56 to 1.00. In addition, the Company has \$985 of notes which include the right to redeem the notes at par in whole or in part from time to time subject to certain restrictions.

The future sinking fund payments and maturities were as follows:

<u>Year</u>	<u>Amount</u>
2016	\$ 54
2017	573
2018	457
2019	166
2020	22
Thereafter	4,637

The following long-term debt was issued in 2015:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount</u>
AWCC	Senior notes—fixed rate	3.40%-4.30%	2025-2045	\$ 550
Other American Water subsidiaries	Private activity bonds and government funded debt—fixed rate	1.00%-1.56%	2032	15
Total issuances				<u>\$ 565</u>

The Company also assumed debt of \$1 as a result of an acquisition during 2015, which has a fixed interest rate of 1.00% and matures in 2040. The Company incurred debt issuance costs of \$5 related to the above issuances.

The following long-term debt was retired through optional redemption or payment at maturity during 2015:

<u>Company</u>	<u>Type</u>	<u>Rate</u>	<u>Maturity</u>	<u>Amount</u>
AWCC	Private activity bonds and government funded debt—fixed rate	1.79%-5.25%	2015-2031	\$ 36
AWCC	Senior notes—fixed rate	6.00%	2015	30
Other American Water subsidiaries (a)	Private activity bonds and government funded debt—fixed rate	0.00%-5.40%	2015-2041	61
Other American Water subsidiaries	Mandatorily redeemable preferred stock	8.49%-9.18%	2031-2036	4
Total retirements and redemptions				<u>\$ 131</u>

(a) Includes \$2 of non-cash defeasance via the use of restricted funds.

Interest, net includes interest income of approximately \$13, \$11 and \$12 in 2015, 2014 and 2013, respectively.

One of the principal market risks to which the Company is exposed is changes in interest rates. In order to manage the exposure, the Company follows risk management policies and procedures, including the use of derivative contracts such as swaps. The Company reduces exposure to interest rates by managing commercial paper and debt maturities. The Company does not enter into derivative contracts for speculative purposes and does not use leveraged instruments. The derivative contracts entered into are for periods consistent with the related underlying exposures. The Company is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. The Company minimizes the counterparty credit risk on these transactions by dealing only with leading, credit-worthy financial institutions having long-term credit ratings of “A” or better.

The Company has an interest-rate swap to hedge \$100 of its 6.085% fixed-rate debt maturing 2017. The Company pays variable interest of six-month LIBOR plus 3.422%. The swap is accounted for as a fair-value hedge and matures with the fixed-rate debt in 2017. The following table provides a summary of the derivative and fixed rate debt fair value balances recorded by the Company as of December 31, 2015 and 2014, and the line items in the Consolidated Balance Sheets in which such amounts are recorded:

<u>Balance Sheet Classification</u>	<u>2015</u>	<u>2014</u>
Regulatory and other long-term assets		
Other	\$ 2	\$ 4
Long-term debt		
Long-term debt	2	4

For derivative instruments that are designated and qualify as fair-value hedges, the gain or loss on the hedge instrument as well as the offsetting gain or loss on the hedged item attributable to the hedged risk are recognized in current net income. The Company includes the gain or loss on the derivative instrument and the offsetting gain or loss on the hedged item in interest expense for the years ended December 31 were as follows:

<u>Income Statement Classification</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Interest, net			
Loss on swap	\$ (1)	\$ (1)	\$ (3)
Gain on borrowing	1	1	3

Note 11: Short-Term Debt

Short-term debt consists of commercial paper and credit facility borrowings totaling \$628 and \$450 as of December 31, 2015 and 2014, respectively. As of December 31, 2015 there were no borrowings outstanding with maturities greater than three months.

AWCC has a revolving credit facility with \$1,250 in aggregate total commitments from a diversified group of financial institutions. The agreement includes a \$150 sublimit for letters of credit and a \$100 sublimit for swing loans. On June 30, 2015, AWCC and its lenders extended the termination date of revolving credit facility from October 2018 to June 2020. The amended and restated agreement also allows AWCC to request to further extend the term of the credit facility for up to two one-year periods. Interest on borrowings are based on a LIBOR-based rate, plus an applicable margin. The Company incurred \$2 of issuance costs in connection with the extended terms of the credit facility, which will be amortized over the remaining extended life and is included in interest, net in the accompanying Consolidated Statements of Operations.

Also, the Company acquired an additional revolving credit facility as part of its Keystone acquisition. The total commitment under this credit facility was \$16, of which \$14 was available as of December 31, 2015. Interest accrues each day at a rate per annum equal to 2.75% above the greater of the one month or one day LIBOR.

The following table summarizes the Company's aggregate credit facility commitments, letter of credit sublimit under our revolving credit facility and commercial paper limit, as well as the available capacity for each as of:

	<u>Credit Facility Commitment</u>	<u>Available Credit Facility Capacity</u>	<u>Letter of Credit Sublimit (a)</u>	<u>Available Letter of Credit Capacity</u>	<u>Commercial Paper Limit</u>	<u>Available Commercial Paper Capacity</u>
December 31, 2015	\$ 1,266	\$ 1,182	\$ 150	\$ 68	\$ 1,000	\$ 374
December 31, 2014	1,250	1,212	150	112	1,000	550

- (a) Letters of credit are non-debt instruments maintained to provide credit support for certain transactions as requested by third parties. The Company had \$82 and \$38 of outstanding letters of credit as of December 31, 2015 and 2014, respectively, all of which were issued under the revolving credit facility noted above.

The following table summarizes the short-term borrowing activity for AWCC for the years ended December 31:

	<u>2015</u>	<u>2014</u>
Average borrowings	\$ 553	\$ 549
Maximum borrowings outstanding	871	745
Weighted average interest rates, computed on daily basis	0.49%	0.31%
Weighted average interest rates, as of December 31	0.66%	0.42%

The credit facility requires the Company to maintain a ratio of consolidated debt to consolidated capitalization of not more than 0.70 to 1.00. The ratio as of December 31, 2015 was 0.56 to 1.00.

None of the Company's borrowings are subject to default or prepayment as a result of a downgrading of securities, although such a downgrading could increase fees and interest charges under the Company's credit facility.

As part of the normal course of business, the Company routinely enters contracts for the purchase and sale of water, energy, fuels and other services. These contracts either contain express provisions or otherwise permit the Company and its counterparties to demand adequate assurance of future performance when there are reasonable grounds for doing so. In accordance with the contracts and applicable contract law, if the Company is downgraded by a credit rating agency, especially if such downgrade is to a level below investment grade, it is possible that a counterparty would attempt to rely on such a downgrade as a basis for making a demand for adequate assurance of future performance. Depending on the Company's net position with the counterparty, the demand could be for the posting of collateral. In the absence of expressly agreed provisions that specify the collateral that must be provided, the obligation to supply the collateral requested will be a function of the facts and circumstances of the Company's situation at the time of the demand. If the Company can reasonably claim that it is willing and financially able to perform its obligations, it may be possible that no collateral would need to be posted or that only an amount equal to two or three months of future payments should be sufficient. The Company does not expect to post any collateral which will have a material adverse impact on the Company's results of operations, financial position or cash flows.

Note 12: General Taxes

The following table summarizes the components of general tax expense from continuing operations for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Gross receipts and franchise	\$ 99	\$ 96	\$ 96
Property and capital stock	98	96	94
Payroll	31	31	31
Other general	15	13	13
Total general taxes	<u>\$ 243</u>	<u>\$ 236</u>	<u>\$ 234</u>

Note 13: Income Taxes

The following table summarizes the components of income tax expense from continuing operations for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Current income taxes			
State	\$ 10	\$ 11	\$ 7
Federal	—	15	(20)
Total current income taxes	<u>\$ 10</u>	<u>\$ 26</u>	<u>\$ (13)</u>
Deferred income taxes			
State	\$ 32	\$ 31	\$ 27
Federal	265	224	225
Amortization of deferred investment tax credits	(1)	(1)	(2)
Total deferred income taxes	<u>296</u>	<u>254</u>	<u>250</u>
Provision for income taxes	<u>\$ 306</u>	<u>\$ 280</u>	<u>\$ 237</u>

The following is a reconciliation between the statutory federal income tax rate and the Company's effective tax rate for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Income tax at statutory rate	35.0%	35.0%	35.0%
Increases (decreases) resulting from:			
State taxes, net of federal taxes	3.6	3.8	3.6
Flow through differences	0.5	0.4	0.5
Amortization of deferred investment tax credits	(0.1)	(0.1)	(0.3)
Subsidiary preferred dividends	—	0.1	0.2
Other, net	<u>0.1</u>	<u>0.2</u>	<u>—</u>
Provision for income taxes	<u>39.1%</u>	<u>39.4%</u>	<u>39.0%</u>

The following table provides the components of the net deferred tax liability from continuing operations as of December 31:

	<u>2015</u>	<u>2014</u>
Deferred tax assets		
Advances and contributions	\$ 513	\$ 502
Other postretirement benefits	76	105
Tax losses and credits	173	197
Pension benefits	105	125
Unamortized debt discount, net	20	20
Other	<u>12</u>	<u>42</u>
Total deferred tax assets	<u>899</u>	<u>991</u>
Valuation allowance	<u>(8)</u>	<u>(10)</u>
Total deferred tax assets, net of allowance	<u>\$ 891</u>	<u>\$ 981</u>
Deferred tax liabilities		
Property, plant and equipment, principally due to depreciation differences	\$ 2,913	\$ 2,677
Income taxes recoverable through rates	76	76
Deferred other postretirement benefits	35	65
Deferred pension benefits	104	121
Other	<u>73</u>	<u>76</u>
Total deferred tax liabilities	<u>3,201</u>	<u>3,015</u>
Total deferred tax liabilities, net of deferred tax assets	<u>\$ (2,310)</u>	<u>\$ (2,034)</u>

As of December 31, 2015 and 2014, the Company recognized federal net operating loss ("NOL") carryforwards of \$1,080 and \$1,005, respectively. The 2015 NOL carryforward includes \$37 of windfall tax benefits on stock-based compensation that will not be recorded to equity until the benefit is realized. The Company believes the federal NOL carryforwards are more likely than not to be recovered and require no valuation allowance. The Company's federal NOL carryforwards will begin to expire in 2028.

As of December 31, 2015 and 2014, the Company had state NOLs of \$534 and \$543, respectively, a portion of which are offset by a valuation allowance because the Company does not believe these NOLs are more likely than not to be realized. The state NOL carryforwards will begin to expire in 2016 through 2034.

As of December 31, 2015 and 2014, the Company had Canadian NOL carryforwards of \$2 and \$6, respectively. The majority of these carryforwards are offset by a valuation allowance because the Company does

not believe these NOLs are more likely than not to be realized. The Canadian NOL carryforwards will expire between 2026 through 2034.

The Company had capital loss carryforwards for federal income tax purposes of \$4 as of December 31, 2015 and 2014. The Company has recognized a full valuation allowance for the capital loss carryforwards because the Company does not believe these losses are more likely than not to be recovered.

The Company files income tax returns in the United States federal jurisdiction and various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local or non-U.S. income tax examinations by tax authorities for years before 2010. For U.S. federal, tax year 2011 is also closed. The Company has state income tax examinations in progress and does not expect material adjustments to result.

The Patient Protection and Affordable Care Act (the “PPACA”) became law on March 23, 2010, and the Health Care and Education Reconciliation Act of 2010 became law on March 30, 2010, which makes various amendments to certain aspects of the PPACA (together, the “Acts”). The PPACA effectively changes the tax treatment of federal subsidies paid to sponsors of retiree health benefit plans that provide a benefit that is at least actuarially equivalent to the benefits under Medicare Part D. The Acts effectively make the subsidy payments taxable in tax years beginning after December 31, 2012 and as a result, the Company followed its original accounting for the underfunded status of the other postretirement benefits for the Medicare Part D adjustment and recorded a reduction in deferred tax assets and an increase in its regulatory assets amounting to \$6 as of December 31, 2015 and 2014.

In connection with the filing of our consolidated 2014 tax return in September 2015, we deducted bonus depreciation, of which approximately \$89 of deferred tax liabilities is related to the Regulated Businesses segment.

The following table summarizes the changes in the Company’s gross liability, excluding interest and penalties, for unrecognized tax benefits:

Balance as of January 1, 2014	\$178
Increases in current period tax positions	54
Decreases in prior period measurement of tax positions	(37)
Balance as of December 31, 2014	\$195
Increases in current period tax positions	39
Decreases in prior period measurement of tax positions	(1)
Balance as of December 31, 2015	<u>\$233</u>

The increase in 2015 current period tax positions related primarily to the Company’s change in tax accounting method filed in 2008 for repair and maintenance costs on its utility plant. The Company does not anticipate material changes to its unrecognized tax benefits within the next year. If the Company sustains all of its positions as of December 31, 2015 and 2014, an unrecognized tax benefit of \$9, excluding interest and penalties, would impact the Company’s effective tax rate. The Company had an insignificant amount of interest and penalties related to its tax positions as of December 31, 2015 and 2014.

The following table summarizes the changes in the Company’s valuation allowance:

Balance as of January 1, 2013	\$19
Decreases in current period tax positions	(6)
Balance as of December 31, 2013	\$13
Decreases in current period tax positions	(3)
Balance as of December 31, 2014	\$10
Decreases in current period tax positions	(2)
Balance as of December 31, 2015	<u>\$ 8</u>

Note 14: Employee Benefits

Pension and Other Postretirement Benefits

The Company maintains noncontributory defined benefit pension plans covering eligible employees of its regulated utility and shared services operations. Benefits under the plans are based on the employee's years of service and compensation. The pension plans have been closed for all new employees. The pension plans were closed for most employees hired on or after January 1, 2006. Union employees hired on or after January 1, 2001 had their accrued benefit frozen and will be able to receive this benefit as a lump sum upon termination or retirement. Union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006 are provided with a 5.25% of base pay defined contribution plan. The Company does not participate in a multiemployer plan.

The Company's pension funding practice is to contribute at least the greater of the minimum amount required by the Employee Retirement Income Security Act of 1974 or the normal cost. Further, the Company will consider additional contributions if needed to avoid "at risk" status and benefit restrictions under the Pension Protection Act of 2006. The Company may also consider increased contributions, based on other financial requirements and the plans' funded position. Pension plan assets are invested in a number of actively managed and commingled funds including equities, fixed income securities, guaranteed interest contracts with insurance companies, real estate funds and real estate investment trusts ("REITs").

Pension expense in excess of the amount contributed to the pension plans is deferred by certain regulated subsidiaries pending future recovery in rates charged for utility services as contributions are made to the plans. See Note 6—Regulatory Assets and Liabilities.

The Company also has unfunded noncontributory supplemental non-qualified pension plans that provide additional retirement benefits to certain employees.

The Company maintains other postretirement benefit plans providing varying levels of medical and life insurance to eligible retirees. The retiree welfare plans are closed for union employees hired on or after January 1, 2006. The plans had previously closed for non-union employees hired on or after January 1, 2002.

The Company's policy is to fund other postretirement benefit costs up to the amount recoverable through rates. Assets of the plans are invested in a number of actively managed and commingled funds including equities and fixed income securities.

The obligations of the pension and postretirement benefit plans are dominated by obligations for active employees. Because the timing of expected benefit payments is so far in the future, the investment strategy is to allocate a significant percentage of assets to equities, which the Company believes will provide the highest return over the long-term period. The fixed income assets are invested in intermediate and long duration debt securities and may be invested in fixed income instruments, such as futures and options, in order to better match the duration of the plan liability.

The Company periodically conducts asset liability studies to ensure the investment strategies are aligned with the profile of the plans' obligations.

None of the Company's securities are included in pension or other postretirement benefit plan assets.

The Company uses fair value for all classes of assets in the calculation of market-related value of plan assets.

The investment policy guidelines of the pension plan require that the fixed income portfolio has an overall weighted-average credit rating of A or better by Standard & Poor's.

The investment policies' objectives are focused on reducing the volatility of the plans' funding status over a long term horizon.

The fair values and asset allocations of pension plan assets as of December 31, 2015 and 2014, respectively, by asset category were as follows:

<u>Asset Category</u>	<u>Target Allocation 2016</u>	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Percentage of Plan Assets as of December 31, 2015</u>
Cash	—	\$ 5	\$ 5	\$ —	\$ —	—
Equity Securities:						
U.S. large cap	24%	318	318	—	—	23%
U.S. small cap	8%	115	115	—	—	8%
International	20%	260	—	260	—	19%
Fixed Income Securities:	40%					41%
U.S. Treasury and government bonds ...	—	120	95	25	—	—
Corporate bonds	—	375	—	375	—	—
Mortgage-backed securities	—	9	—	9	—	—
Long duration bond fund	—	7	7	—	—	—
Guarantee annuity contracts	—	49	—	8	41	—
Real Estate	6%	95	—	—	95	7%
REITs	2%	23	—	23	—	2%
Total	100%	\$1,376	\$ 540	\$ 700	\$ 136	100%

<u>Asset Category</u>	<u>Target Allocation 2015</u>	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Percentage of Plan Assets as of December 31, 2014</u>
Cash	—	\$ 8	\$ 8	\$ —	\$ —	—
Equity Securities:						
U.S. large cap	24%	342	342	—	—	24%
U.S. small cap	8%	117	117	—	—	8%
International	20%	274	—	274	—	19%
Fixed Income Securities:	40%					41%
U.S. Treasury and government bonds	—	140	121	19	—	—
Corporate bonds	—	377	—	377	—	—
Mortgage-backed securities	—	4	—	4	—	—
Long duration bond fund	—	7	7	—	—	—
Guarantee annuity contracts	—	51	—	9	42	—
Real Estate	6%	85	—	—	85	6%
REITs	2%	23	—	23	—	2%
Total	100%	\$1,428	\$ 595	\$ 706	\$ 127	100%

The following tables present a reconciliation of the beginning and ending balances of the fair value measurements using significant unobservable inputs (Level 3) for 2015 and 2014, respectively:

	<u>Level 3</u>
Balance as of January 1, 2015	\$ 127
Actual return on assets	12
Purchases, issuances and settlements, net	<u>(3)</u>
Balance as of December 31, 2015	<u>\$ 136</u>
	<u>Level 3</u>
Balance as of January 1, 2014	\$ 44
Actual return on assets	7
Purchases, issuances and settlements, net	<u>76</u>
Balance as of December 31, 2014	<u>\$ 127</u>

The Company’s other postretirement benefit plans are partially funded and the assets are held under various trusts. The investments and risk mitigation strategies for the plans are tailored specifically for each trust. In setting new strategic asset mixes, consideration is given to the likelihood that the selected asset allocation will effectively fund the projected plan liabilities and the risk tolerance of the Company. The Company periodically updates the long-term, strategic asset allocations and uses various analytics to determine the optimal asset allocation. Considerations include plan liability characteristics, liquidity characteristics, funding requirements, expected rates of return and the distribution of returns.

In June 2012, the Company implemented a de-risking strategy for the medical bargaining trust within the plan to minimize volatility. As part of the de-risking strategy, the Company revised the asset allocations to increase the matching characteristics of assets relative to liabilities. The initial de-risking asset allocation for the plan was 60% return-generating assets and 40% liability-driven assets. The investment strategies and policies for the plan reflect a balance of liability driven and return-generating considerations. The objective of minimizing the volatility of assets relative to liabilities is addressed primarily through asset—liability matching, asset diversification and hedging. The fixed income target asset allocation matches the bond-like and long-dated nature of the postretirement liabilities. Assets are broadly diversified within asset classes to achieve risk-adjusted returns that in total lower asset volatility relative to the liabilities. The Company assesses the investment strategy regularly to ensure actual allocations are in line with target allocations as appropriate. Strategies to address the goal of ensuring sufficient assets to pay benefits include target allocations to a broad array of asset classes and, within asset classes strategies are employed to provide adequate returns, diversification and liquidity.

The assets of the Company’s other trusts, within the other postretirement benefit plans, have been primarily invested in equities and fixed income funds. The assets under the various other postretirement benefit trusts are invested differently based on the assets and liabilities of each trust. The obligations of the other postretirement benefit plans are dominated by obligations for the medical bargaining trust. Thirty-nine percent and four percent of the total postretirement plan benefit obligations are related to the medical non-bargaining and life insurance trusts, respectively. Because expected benefit payments related to the benefit obligations are so far into the future, and the size of the medical non-bargaining and life insurance trusts’ obligations are large compared to each trusts’ assets, the investment strategy is to allocate a significant portion of the assets’ investment to equities, which the Company believes will provide the highest long-term return and improve the funding ratio.

The Company engages third party investment managers for all invested assets. Managers are not permitted to invest outside of the asset class (e.g. fixed income, equity, alternatives) or strategy for which they have been appointed. Investment management agreements and recurring performance and attribution analysis are used as tools to ensure investment managers invest solely within the investment strategy they have been provided. Futures and options may be used to adjust portfolio duration to align with a plan’s targeted investment policy.

In order to minimize asset volatility relative to the liabilities, a portion of plan assets is allocated to fixed income investments that are exposed to interest rate risk. Increases in interest rates generally will result in a decline in the value of fixed income assets while reducing the present value of the liabilities. Conversely, rate decreases will increase fixed income assets, partially offsetting the related increase in the liabilities. Within equities, risk is mitigated by constructing a portfolio that is broadly diversified by geography, market capitalization, manager mandate size, investment style and process.

Actual allocations to each asset class vary from target allocations due to periodic investment strategy updates, market value fluctuations, the length of time it takes to fully implement investment allocation, and the timing of benefit payments and contributions. The asset allocation is rebalanced on a quarterly basis, if necessary.

The fair values and asset allocations of postretirement benefit plan assets as of December 31, 2015 and 2014, respectively, by asset category, were as follows:

<u>Asset Category</u>	<u>Target Allocation 2016</u>	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Percentage of Plan Assets as of December 31, 2015</u>
Bargain VEBA:						
Equity Securities:						
U.S. large cap	9%	\$ 32	\$ 32	\$ —	\$ —	9%
International	11%	38	38	—	—	10%
Fixed Income Securities:	80%					81%
U.S. Treasury and government bonds	—	118	118	—	—	—
Corporate bonds	—	184	—	184	—	—
Long duration bond fund ...	—	3	3	—	—	—
Future and option contracts (a)	—	1	1	—	—	—
Total Bargain VEBA	100%	\$376	\$ 192	\$ 184	\$ —	100%
Non-bargain VEBA:						
Cash						
	—	\$ 2	\$ 2	\$ —	\$ —	—
Equity Securities:						
U.S. large cap	21%	24	24	—	—	21%
U.S. small cap	21%	26	26	—	—	22%
International	28%	33	33	—	—	28%
Fixed Income Securities:	30%					29%
Core fixed income bond fund	—	33	33	—	—	—
Total Non-bargain VEBA	100%	\$118	\$ 118	\$ —	\$ —	100%
Life VEBA:						
Equity Securities:						
U.S. large cap	70%	\$ 4	\$ 4	\$ —	\$ —	68%
Fixed Income Securities:	30%					32%
Core fixed income bond fund	—	2	2	—	—	—
Total Life VEBA	100%	\$ 6	\$ 6	\$ —	\$ —	100%
Total	100%	\$500	\$ 316	\$ 184	\$ —	100%

(a) Includes cash for margin requirements.

<u>Asset Category</u>	<u>Target Allocation 2015</u>	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	<u>Percentage of Plan Assets as of December 31, 2014</u>
Bargain VEBA:						
Equity Securities:						
U.S. large cap	9%	\$ 34	\$ 34	\$ —	\$ —	9%
International	11%	41	41	—	—	10%
Fixed Income Securities:	80%					81%
U.S. Treasury and government bonds . . .	—	155	155	—	—	—
Corporate bonds	—	168	—	168	—	—
Long duration bond fund	—	3	3	—	—	—
Future and option contracts (a)	—	1	1	—	—	—
Total Bargain VEBA	<u>100%</u>	<u>\$402</u>	<u>\$ 234</u>	<u>\$ 168</u>	<u>\$ —</u>	<u>100%</u>
Non-bargain VEBA:						
Cash	—	\$ 1	\$ 1	\$ —	\$ —	—
Equity Securities:						
U.S. large cap	21%	22	22	—	—	21%
U.S. small cap	21%	21	21	—	—	21%
International	28%	28	28	—	—	28%
Fixed Income Securities:	30%					30%
Core fixed income bond fund	—	31	31	—	—	—
Total Non-bargain VEBA . . .	<u>100%</u>	<u>\$103</u>	<u>\$ 103</u>	<u>\$ —</u>	<u>\$ —</u>	<u>100%</u>
Life VEBA:						
Equity Securities:						
U.S. large cap	70%	\$ 5	\$ 5	\$ —	\$ —	67%
Fixed Income Securities:	30%					33%
Core fixed income bond fund	—	2	2	—	—	—
Total Life VEBA	<u>100%</u>	<u>\$ 7</u>	<u>\$ 7</u>	<u>\$ —</u>	<u>\$ —</u>	<u>100%</u>
Total	<u>100%</u>	<u>\$512</u>	<u>\$ 344</u>	<u>\$ 168</u>	<u>\$ —</u>	<u>100%</u>

(a) Includes cash for margin requirements.

Valuation Techniques Used to Determine Fair Value

Cash—Cash and investments with maturities of three months or less when purchased, including certain short-term fixed-income securities, are considered cash and are included in the recurring fair value measurements hierarchy as Level 1.

Equity securities—For equity securities, the trustees obtain prices from pricing services, whose prices are obtained from direct feeds from market exchanges, that the Company is able to independently corroborate. Equity securities are valued based on quoted prices in active markets and categorized as Level 1. Certain equities, such as international securities held in the pension plan are invested in commingled funds. These funds are valued to reflect the plan fund's interest in the fund based on the reported year-end net asset value. Since net asset value is not directly observable or not available on a nationally recognized securities exchange for the commingled funds, they are categorized as Level 2.

Fixed-income securities—The majority of U.S. Treasury securities and government bonds have been categorized as Level 1 because they trade in highly-liquid and transparent markets that the Company can corroborate. The fair values of corporate bonds, mortgage backed securities, certain government bonds and a guaranteed annuity contract are based on evaluated prices that reflect observable market information, such as actual trade information of similar securities, and have been categorized as Level 2 because the valuations are calculated using models which utilize actively traded market data that the Company can corroborate. Certain other guaranteed annuity contracts are categorized as Level 3 because the investments are not publicly quoted. The fund administrator values the fund using the net asset value per fund share, derived from the quoted prices in active markets of the underlying securities. Since these valuation inputs are not highly observable, these contracts have been categorized as Level 3. Exchange-traded future and option positions are reported in accordance with changes in daily variation margins that are settled daily. Exchange-traded options and futures, for which market quotations are readily available, are valued at the last reported sale price or official closing price on the primary market or exchange on which they are traded and are classified as Level 1.

Real estate fund—Real estate fund is valued using the net asset value based on valuation models of underlying securities which generally include significant unobservable inputs that cannot be corroborated using verifiable observable market data. Real estate fund is categorized as Level 3 as the fund uses significant unobservable inputs for fair value measurement.

REITs—REITs are invested in commingled funds. Commingled funds are valued to reflect the plan fund's interest in the fund based on the reported year-end net asset value. Since the net asset value is not directly observable for the commingled funds, they are categorized as Level 2.

The following table provides a rollforward of the changes in the benefit obligation and plan assets for the most recent two years for all plans combined:

	Pension Benefits		Other Benefits	
	2015	2014	2015	2014
Change in benefit obligation				
Benefit obligation as of January 1,	\$ 1,746	\$ 1,494	\$ 703	\$ 562
Service cost	37	32	14	11
Interest cost	74	76	30	29
Plan participants' contributions	—	—	2	2
Actuarial (gain) loss	(76)	256	(58)	123
Gross benefits paid	(61)	(112)	(26)	(26)
Federal subsidy	—	—	2	2
Benefit obligation as of December 31,	<u>\$ 1,720</u>	<u>\$ 1,746</u>	<u>\$ 667</u>	<u>\$ 703</u>
Change in plan assets				
Fair value of plan assets as of January 1,	\$ 1,428	\$ 1,384	\$ 512	\$ 475
Actual return on plan assets	(21)	116	(15)	49
Employer contributions	30	40	27	12
Plan participants' contributions	—	—	2	2
Benefits paid	(61)	(112)	(26)	(26)
Fair value of plan assets as of December 31,	<u>\$ 1,376</u>	<u>\$ 1,428</u>	<u>\$ 500</u>	<u>\$ 512</u>
Funded status as of December 31,	\$ (344)	\$ (318)	\$ (167)	\$ (191)
Amounts recognized in the balance sheet consist of:				
Noncurrent asset	\$ —	\$ —	\$ 2	\$ 1
Current liability	(2)	(2)	—	—
Noncurrent liability	(342)	(316)	(169)	(192)
Net amount recognized	<u>\$ (344)</u>	<u>\$ (318)</u>	<u>\$ (167)</u>	<u>\$ (191)</u>

Benefits paid in 2014 include \$56 from a one-time lump sum window offering to retired vested participants.

The following table provides the components of the Company's accumulated other comprehensive income and regulatory assets that have not been recognized as components of periodic benefit costs as of December 31:

	Pension Benefits		Other Benefits	
	2015	2014	2015	2014
Net actuarial loss	\$ 397	\$ 379	\$ 97	\$ 119
Prior service cost (credit)	3	4	(10)	(12)
Net amount recognized	\$ 400	\$ 383	\$ 87	\$ 107
Regulatory assets	\$ 258	\$ 248	\$ 87	\$ 107
Accumulated other comprehensive income	142	135	—	—
Total	\$ 400	\$ 383	\$ 87	\$ 107

As of December 31, 2015 and 2014, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets for pension plans with a projected obligation in excess of plan assets were as follows:

	Projected Benefit Obligation Exceeds the Fair Value of Plans' Assets	
	2015	2014
Projected benefit obligation	\$ 1,721	\$ 1,746
Fair value of plan assets	1,376	1,428

	Accumulated Benefit Obligation Exceeds the Fair Value of Plans' Assets	
	2015	2014
Accumulated benefit obligation	\$ 1,584	\$ 1,616
Fair value of plan assets	1,376	1,428

The accumulated postretirement benefit obligation exceeds plan assets for all of the Company's other postretirement benefit plans.

In August 2006, the Pension Protection Act ("PPA") was signed into law in the U.S. The PPA replaces the funding requirements for defined benefit pension plans by requiring that defined benefit plans contribute to 100% of the current liability funding target over seven years. Defined benefit plans with a funding status of less than 80% of the current liability are defined as being "at risk" and additional funding requirements and benefit restrictions may apply. The PPA was effective for the 2008 plan year with short-term phase-in provisions for both the funding target and at-risk determination. The Company's qualified defined benefit plan is currently funded above the at-risk threshold, and therefore the Company expects that the plans will not be subject to the "at risk" funding requirements of the PPA. The Company is proactively monitoring the plan's funded status and projected contributions under the law to appropriately manage the potential impact on cash requirements.

Minimum funding requirements for the qualified defined benefit pension plan are determined by government regulations and not by accounting pronouncements. The Company plans to contribute amounts at least equal to the greater of the minimum required contributions or the normal cost in 2016 to the qualified pension plans. The Company plans to contribute to its 2016 other postretirement benefit cost for rate-making purposes.

Information about the expected cash flows for the pension and postretirement benefit plans is as follows:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
2016 expected employer contributions		
To plan trusts	\$ 33	\$ 22
To plan participants	2	—

The Company made 2016 contributions to fund pension benefits and other benefits of \$9 and \$6, respectively, through February 2016.

The following table reflects the net benefits expected to be paid from the plan assets or the Company's assets:

	<u>Pension Benefits</u>	<u>Other Benefits</u>	
	<u>Expected Benefit Payments</u>	<u>Expected Benefit Payments</u>	<u>Expected Federal Subsidy Payments</u>
2016	\$ 65	\$ 28	\$ 2
2017	70	30	2
2018	76	32	2
2019	82	35	3
2020	89	37	3
2021-2025	525	212	18

Because the above amounts are net benefits, plan participants' contributions have been excluded from the expected benefits.

Accounting for pensions and other postretirement benefits requires an extensive use of assumptions about the discount rate, expected return on plan assets, the rate of future compensation increases received by the Company's employees, mortality, turnover and medical costs. Each assumption is reviewed annually. The assumptions are selected to represent the average expected experience over time and may differ in any one year from actual experience due to changes in capital markets and the overall economy. These differences will impact the amount of pension and other postretirement benefit expense that the Company recognizes.

The significant assumptions related to the Company's pension and other postretirement benefit plans were as follows:

	Pension Benefits			Other Benefits		
	2015	2014	2013	2015	2014	2013
Weighted-average assumptions used to determine December 31 benefit obligations						
Discount rate	4.66%	4.24%	5.12%	4.67%	4.24%	5.10%
Rate of compensation increase	3.10%	3.12%	3.15%	N/A	N/A	N/A
Medical trend	N/A	N/A	N/A	graded from 6.50% in 2015 to 5.00% in 2021+	graded from 6.75% in 2014 to 5.00% in 2021+	graded from 7.00% in 2013 to 5.00% in 2019+
Weighted-average assumptions used to determine net periodic cost						
Discount rate	4.24%	5.12%	4.17%	4.24%	5.10%	4.16%
Expected return on plan assets	6.91%	6.91%	7.49%	4.92%	5.87%	6.99%
Rate of compensation increase	3.12%	3.15%	3.19%	N/A	N/A	N/A
Medical trend	N/A	N/A	N/A	graded from 6.75% in 2015 to 5.00% in 2021+	graded from 7.00% in 2014 to 5.00% in 2019+	graded from 7.25% in 2013 to 5.00% in 2019+

N/A—Assumption is not applicable.

The discount rate assumption was determined for the pension and postretirement benefit plans independently. At year-end 2011, the Company began using an approach that approximates the process of settlement of obligations tailored to the plans' expected cash flows by matching the plans' cash flows to the coupons and expected maturity values of individually selected bonds. The yield curve was developed for a universe containing the majority of U.S.-issued AA-graded corporate bonds, all of which were non callable (or callable with make-whole provisions). Historically, for each plan, the discount rate was developed as the level equivalent rate that would produce the same present value as that using spot rates aligned with the projected benefit payments.

The expected long-term rate of return on plan assets is based on historical and projected rates of return, prior to administrative and investment management fees, for current and planned asset classes in the plans' investment portfolios. Assumed projected rates of return for each of the plans' projected asset classes were selected after analyzing historical experience and future expectations of the returns and volatility of the various asset classes. Based on the target asset allocation for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to the benchmark returns and for the effect of expenses paid from plan assets. The Company's pension expense increases as the expected return on assets decreases. The Company used an expected return on plan assets of 7.02% and 5.20% to estimate its 2016 pension and other postretirement benefit costs, respectively.

In the determination of year end 2014 projected benefit plan obligations, the Company adopted a new table based on the Society of Actuaries RP 2014 mortality table including a generational BB-2D projection scale. The adoption resulted in a significant increase to pension and other postretirement benefit plans' projected benefit obligations. In 2015 a new RP 2015 mortality table was issued. All of the experience upon which the table is based was considered by the Company in selecting its 2014 assumptions.

Assumed health care cost trend rates have a significant effect on the amounts reported for the other postretirement benefit plans. The health care cost trend rate is based on historical rates and expected market conditions. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	<u>One-Percentage-Point Increase</u>	<u>One-Percentage-Point Decrease</u>
Effect on total of service and interest cost components	\$ 8	\$ (6)
Effect on other postretirement benefit obligation	\$ 99	\$ (81)

The following table provides the components of net periodic benefit costs for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Components of net periodic pension benefit cost			
Service cost	\$ 37	\$ 32	\$ 37
Interest cost	74	76	68
Expected return on plan assets	(97)	(95)	(88)
Amortization of:			
Prior service cost (credit)	1	1	1
Actuarial (gain) loss	25	—	37
Net periodic pension benefit cost	<u>\$ 40</u>	<u>\$ 14</u>	<u>\$ 55</u>
Other changes in plan assets and benefit obligations recognized in other comprehensive income			
Amortization of prior service credit (cost)	\$ —	\$ —	\$ —
Current year actuarial (gain) loss	10	46	(73)
Amortization of actuarial gain (loss)	(5)	—	(9)
Total recognized in other comprehensive income	<u>\$ 5</u>	<u>\$ 46</u>	<u>\$ (82)</u>
Total recognized in net periodic benefit cost and comprehensive income	<u>\$ 45</u>	<u>\$ 60</u>	<u>\$ (27)</u>
Components of net periodic other postretirement benefit cost			
Service cost	\$ 14	\$ 11	\$ 15
Interest cost	30	29	29
Expected return on plan assets	(26)	(28)	(30)
Amortization of:			
Prior service cost (credit)	(2)	(2)	(2)
Actuarial (gain) loss	5	—	11
Net periodic other postretirement benefit cost	<u>\$ 21</u>	<u>\$ 10</u>	<u>\$ 23</u>

The Company's policy is to recognize curtailments when the total expected future service of plan participants is reduced by greater than 10% due to an event that results in terminations and/or retirements.

Cumulative gains and losses that are in excess of 10% of the greater of either the projected benefit obligation or the fair value of plan assets are amortized over the expected average remaining future service of the current active membership for the plans.

The estimated amounts that will be amortized from accumulated other comprehensive income and regulatory assets into net periodic benefit cost in 2016 are as follows:

	<u>Pension Benefits</u>	<u>Other Benefits</u>
Actuarial (gain) loss	\$ 27	\$ 3
Prior service cost (credit)	1	(2)
Total	<u>\$ 28</u>	<u>\$ 1</u>

Savings Plans for Employees

The Company maintains 401(k) savings plans that allow employees to save for retirement on a tax-deferred basis. Employees can make contributions that are invested at their direction in one or more funds. The Company makes matching contributions based on a percentage of an employee's contribution, subject to certain limitations. Due to the Company's discontinuing new entrants into the defined benefit pension plan, on January 1, 2006 the Company began providing an additional 5.25% of base pay defined contribution benefit for union employees hired on or after January 1, 2001 and non-union employees hired on or after January 1, 2006. Plan expenses totaled \$9, \$8 and \$8 for 2015, 2014 and 2013, respectively. All of the Company's contributions are invested in one or more funds at the direction of the employees.

Note 15: Commitments and Contingencies

Commitments

Commitments have been made in connection with certain construction programs. The estimated capital expenditures required under legal and binding contractual obligations amounted to \$238 as of December 31, 2015.

The Company's regulated subsidiaries maintain agreements with other water purveyors for the purchase of water to supplement their water supply. The future annual commitments related to minimum quantities of purchased water having non-cancelable terms are as follows:

<u>Year</u>	<u>Amount</u>
2016	\$ 51
2017	45
2018	44
2019	43
2020	44
Thereafter	383

The Company enters into agreements for the provision of services to water and wastewater facilities for the United States military, municipalities and other customers. The Company's military agreements expire between 2051 and 2065 and have remaining performance commitments as measured by estimated remaining contract revenue of \$2,784 as of December 31, 2015. The military agreements are subject to customary termination provisions held by the U.S. Federal Government prior to the agreed upon contract expiration. The Company's O&M agreements with municipalities and other customers expire between 2016 and 2048 and have remaining performance commitments as measured by estimated remaining contract revenue of \$795 as of December 31, 2015. Some of the Company's long-term contracts to operate and maintain a municipality's, federal government's or other party's water or wastewater treatment and delivery facilities include responsibility for certain maintenance for some of those facilities, in exchange for an annual fee. Unless specifically required to perform certain maintenance activities, the maintenance costs are recognized when the maintenance is performed.

Contingencies

The Company is routinely involved in legal actions incident to the normal conduct of its business. As of December 31, 2015, the Company has accrued approximately \$5 of probable loss contingencies and has estimated that the maximum amount of losses associated with reasonably possible loss contingencies that can be reasonably estimated is \$36. For certain matters, claims and actions, the Company is unable to estimate possible losses. The Company believes that damages or settlements, if any, recovered by plaintiffs in such matters, claims or actions, other than as described in this Note 15, will not have a material adverse effect on the Company.

West Virginia Elk River Freedom Industries Chemical Spill

On January 9, 2014, a chemical storage tank owned by Freedom Industries, Inc. leaked two substances, 4-methylcyclohexane methanol, or MCHM, and PPH/DiPPH, 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”), 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 for all of its approximately 93,000 customer accounts in parts of nine West Virginia counties served by the Charleston treatment plant. 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 the 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 were at non-detectable levels remained in place. In addition, based on saved samples taken on or before January 18, 2014, PPH/DiPPH was no longer detected in the water supply 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 were 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 continued to work with laboratories to test down to below 2 ppb of MCHM and announced on March 3, 2014, that it had cleared the system to below this level.

To date, there are 68 pending cases against WVAWC with respect to this matter in the United States District Court for the Southern District of West Virginia or West Virginia Circuit Courts in Kanawha, Boone and Putnam counties. Fifty-three of the state court cases naming WVAWC, and one case naming both WVAWC and American Water Works Service Company, Inc. (“AWWSC,” and together with WVAWC and the Company, the “American Water Defendants”) were removed to the United States District Court for the Southern District of West Virginia. On December 17, 2015, the federal district court entered orders remanding 52 of the previously removed cases back to the West Virginia Circuit Courts for further proceedings (two of the previously removed cases had been dismissed in the interim). Following that order, seven additional cases were filed against WVAWC in West Virginia Circuit Courts in Kanawha and Putnam counties with respect to this matter. On January 28, 2016, all of the state court cases were referred to West Virginia’s Mass Litigation Panel for further proceedings.

Four of the cases pending before the federal district court were consolidated for purposes of discovery, and an amended consolidated class action complaint for those cases (the “Federal action”) was filed on December 9,

2014 by several plaintiffs who allegedly suffered economic losses, loss of use of property and tap water or other specified adverse consequences as a result of the Freedom Industries spill, on behalf of a purported class of all persons and businesses supplied with, using, or exposed to water contaminated with Crude MCHM and provided by WVAWC in Logan, Clay, Lincoln, Roane, Jackson, Boone, Putnam, and Kanawha Counties and the Culloden area of Cabell County, West Virginia as of January 9, 2014. The amended consolidated complaint names several individuals and corporate entities as defendants, including the American Water Defendants. The plaintiffs seek unspecified damages for alleged business or economic losses; unspecified damages or a mechanism for recovery to address a variety of alleged costs, loss of use of property, personal injury and other consequences allegedly suffered by purported class members; punitive damages and certain additional relief, including the establishment of a medical monitoring program to protect the purported class members from an alleged increased risk of contracting serious latent disease.

On April 9, 2015, the court in the Federal action denied a motion to dismiss all claims against the Company for lack of personal jurisdiction. A separate motion to dismiss filed by AWWSC and WVAWC (and joined by the Company) asserting various legal defenses in the Federal action was resolved by the court on June 3, 2015. The court dismissed three causes of action but denied the motion to dismiss with respect to the remaining causes of actions and allowed the plaintiffs to continue to pursue the various claims for damages alleged in their amended consolidated complaint.

On July 6, 2015, the plaintiffs filed a motion seeking certification of a class defined to include persons who resided in dwellings served by WVAWC's Kanawha Valley Treatment Plant ("KVTP") on January 9, 2014, persons who owned businesses served by the KVTP on January 9, 2014, and hourly employees who worked for such businesses. The plaintiffs sought a class-wide determination of liability against the American Water Defendants, among others, and of damages to the three groups of plaintiffs as a result of the "Do Not Use" order issued after the Freedom Industries spill.

A court-directed mediation was held at the end of September 2015 with the assistance of private mediators. Representatives of the American Water Defendants, Eastman Chemical, the Federal action plaintiffs, and the plaintiffs in the 53 state court cases as to which removal to Federal court had been sought, as well as insurance carriers for certain of the defendants, participated in the mediation. No resolution was reached and no further mediation discussions have been scheduled to date.

On October 8, 2015, the court in the Federal action granted in part and denied in part the plaintiffs' class certification motion. The court certified a class addressing the alleged fault of Eastman Chemical for tort claims and the alleged fault of the American Water Defendants for tort and breach of contract claims, as well as the comparative fault of Freedom Industries. However, the court granted the joint motion by defendants to exclude certain expert testimony, disallowing the testimony of plaintiffs' economic damages experts, and denied class certification as to any damages, including punitive damages. Thus, determination or quantification of damages, if any, would be made in subsequent proceedings on an individual basis.

On December 17, 2015, the court in the Federal action entered a scheduling order that provides for the trial on class issues to begin in July 2016. During the first week of January 2016, three additional cases were filed against one or more of the American Water Defendants, as well as others, in the U.S. District Court for the Southern District of West Virginia with respect to this matter.

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 the Public Service Commission of West Virginia (the "PSC"). As a result of the U.S. Attorney's Office investigation, Freedom Industries and six former Freedom Industries employees (three of whom also were former owners of Freedom Industries), pled guilty to violations of the federal Clean Water Act.

On May 21, 2014, the PSC issued an Order initiating a General Investigation into certain matters relating to WVAWC's response to the Freedom Industries spill. Three parties have intervened in the proceeding, including

the Consumer Advocate Division of the PSC and two attorney-sponsored groups, including one sponsored by some of the plaintiffs' counsel involved in the civil litigation described above. WVAWC has filed testimony regarding its response to the spill and is subject to discovery from PSC staff and the intervenors as part of the General Investigation. Several disputes have arisen between the WVAWC and the intervenors regarding, among other things, the scope of the discovery and the maintenance of confidentiality with regard to certain WVAWC emergency planning documents. In addition, the intervenors and PSC staff filed expert testimony in support of their assertions that WVAWC did not act reasonably with respect to the Freedom Industries spill, and WVAWC has asserted that some of the testimony is outside the scope of the PSC proceeding. The PSC has deferred setting a revised procedural schedule and has not set a final hearing date on the matter.

The Company believes that the causes of action and other claims asserted against the American Water Defendants in the proceedings described above are without merit and continues to vigorously defend itself in these proceedings. Given the current stage of these proceedings, the Company cannot reasonably estimate the amount of any reasonably possible losses or a range of such losses related to these proceedings.

Note 16: Earnings per Common Share

The following is a reconciliation of the numerator and denominator for basic and diluted earnings per share (“EPS”) calculations for the years ended December 31:

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Numerator			
Income from continuing operations	\$ 476	\$ 430	\$ 371
Loss from discontinued operations, net of tax	<u>—</u>	<u>(7)</u>	<u>(2)</u>
Net income available to common stockholders	<u>\$ 476</u>	<u>\$ 423</u>	<u>\$ 369</u>
Denominator			
Weighted average common shares outstanding—Basic	179	179	178
Effect of dilutive common stock equivalents	<u>1</u>	<u>1</u>	<u>1</u>
Weighted average common shares outstanding—Diluted	<u>180</u>	<u>180</u>	<u>179</u>

The effect of dilutive common stock equivalents is related to the RSUs and stock options granted under the 2007 Plan, and shares purchased under the ESPP. Less than one million share-based awards were excluded from the computation of diluted EPS for the years ended December 31, 2015, 2014 and 2013 because their effect would have been anti-dilutive under the treasury stock method.

Note 17: Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Current assets and current liabilities—The carrying amounts reported in the Consolidated Balance Sheets for current assets and current liabilities, including revolving credit debt, due to the short-term maturities and variable interest rates, approximate their fair values.

Preferred stock with mandatory redemption requirements and long-term debt—The fair values of preferred stock with mandatory redemption requirements and long-term debt are categorized within the fair value hierarchy based on the inputs that are used to value each instrument. The fair value of long-term debt classified as Level 1 is calculated using quoted prices in active markets. Level 2 instruments are valued using observable inputs and Level 3 instruments are valued using observable and unobservable inputs. The fair values of instruments classified as Level 2 and 3 are determined by a valuation model that is based on a conventional discounted cash flow methodology and utilizes assumptions of current market rates. As a majority of the Company’s debts do not

trade in active markets, the Company calculated a base yield curve using a risk-free rate (a U.S. Treasury securities yield curve) plus a credit spread that is based on the following two factors: an average of the Company's own publicly-traded debt securities and the current market rates for U.S. Utility A debt securities. The Company used these yield curve assumptions to derive a base yield for the Level 2 and Level 3 securities. Additionally, the Company adjusted the base yield for specific features of the debt securities including call features, coupon tax treatment and collateral for the Level 3 instruments.

The carrying amounts, including fair value adjustments previously recognized in acquisition purchase accounting and a fair value adjustment related to the Company's interest rate swap fair value hedge (which is classified as Level 2 in the fair value hierarchy), and fair values of the financial instruments were as follows:

	Carrying Amount	December 31, 2015			
		Level 1	Level 2	Level 3	Total
Preferred stock with mandatory redemption requirements	\$ 13	\$ —	\$ —	\$ 18	\$ 18
Long-term debt (excluding capital lease obligations) . . .	5,914	3,397	1,419	1,941	6,757

	Carrying Amount	December 31, 2014			
		Level 1	Level 2	Level 3	Total
Preferred stock with mandatory redemption requirements	\$ 17	\$ —	\$ —	\$ 22	\$ 22
Long-term debt (excluding capital lease obligations) . . .	5,485	2,874	1,475	2,055	6,404

Fair Value Measurements

To increase consistency and comparability in fair value measurements, GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels as follows:

- Level 1—quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access as of the reporting date. Financial assets and liabilities utilizing Level 1 inputs include active exchange-traded equity securities, exchange-based derivatives, mutual funds and money market funds.
- Level 2—inputs other than quoted prices included within Level 1 that are directly observable for the asset or liability or indirectly observable through corroboration with observable market data. Financial assets and liabilities utilizing Level 2 inputs include fixed income securities, non-exchange-based derivatives, commingled investment funds not subject to purchase and sale restrictions and fair-value hedges.
- Level 3—unobservable inputs, such as internally-developed pricing models for the asset or liability due to little or no market activity for the asset or liability. Financial assets and liabilities utilizing Level 3 inputs include infrequently-traded non-exchange-based derivatives and commingled investment funds subject to purchase and sale restrictions.

Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level within the fair value hierarchy as of December 31, 2015 and 2014, respectively:

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Restricted funds	\$ 27	\$ —	\$ —	\$ 27
Rabbi trust investments	12			12
Deposits	1	—	—	1
Mark-to-market derivative asset	—	2	—	2
Other investments	4	—	—	4
Total assets	44	2	—	46
Liabilities				
Deferred compensation obligation	11	—	—	11
Mark-to-market derivative liability	—	1	—	1
Total liabilities	11	1	—	12
Total net assets	\$ 33	\$ 1	\$ —	\$ 34
	December 31, 2014			
	Level 1	Level 2	Level 3	Total
Assets				
Restricted funds	\$ 23	\$ —	\$ —	\$ 23
Rabbi trust investments	—	12	—	12
Deposits	4	—	—	4
Mark-to-market derivative asset	—	4	—	4
Other investments	22	—	—	22
Total assets	49	16	—	65
Liabilities				
Deferred compensation obligation	—	12	—	12
Mark-to-market derivative liability	—	1	—	1
Total liabilities	—	13	—	13
Total net assets	\$ 49	\$ 3	\$ —	\$ 52

Restricted funds—The Company’s restricted funds primarily represent proceeds received from financings for the construction and capital improvement of facilities and from customers for future services under operations and maintenance projects. The proceeds of these financings are held in escrow until the designated expenditures are incurred. Long-term restricted funds of \$6 and \$9 were included in other long-term assets as of December 31, 2015 and 2014, respectively.

Rabbi trust investments—The Company’s rabbi trust investments consist of equity and index funds from which supplemental executive retirement plan benefits and deferred compensation obligations can be paid. The Company includes these assets in other long-term assets.

Deposits—Deposits include escrow funds and certain other deposits held in trust. The Company includes cash deposits in other current assets.

Deferred compensation obligations—The Company’s deferred compensation plans allow participants to defer certain cash compensation into notional investment accounts. The Company includes such plans in other

long-term liabilities. The value of the Company’s deferred compensation obligations is based on the market value of the participants’ notional investment accounts. The notional investments are comprised primarily of mutual funds, which are based on observable market prices.

Mark-to-market derivative asset and liability—The Company utilizes fixed-to-floating interest-rate swaps, typically designated as fair-value hedges, to achieve a targeted level of variable-rate debt as a percentage of total debt. The Company also employs derivative financial instruments in the form of variable-to-fixed interest rate swaps, classified as economic hedges, in order to fix the interest cost on some of its variable-rate debt. The Company uses a calculation of future cash inflows and estimated future outflows, which are discounted, to determine the current fair value. Additional inputs to the present value calculation include the contract terms, counterparty credit risk, interest rates and market volatility.

Other investments—Other investments primarily represent money market funds used for active employee benefits. The Company includes other investments in other current assets.

Note 18: Leases

The Company has entered into operating leases involving certain facilities and equipment. Rental expenses under operating leases were \$21 for 2015, \$22 for 2014 and \$23 for 2013. The operating leases for facilities will expire over the next 25 years and the operating leases for equipment will expire over the next five years. Certain operating leases have renewal options ranging from one to five years.

The minimum annual future rental commitment under operating leases that have initial or remaining non-cancelable lease terms over the next five years and thereafter are as follows:

<u>Year</u>	<u>Amount</u>
2016	\$ 13
2017	12
2018	11
2019	10
2020	8
Thereafter	74

The Company has a series of agreements with various public entities (the “Partners”) to establish certain joint ventures, commonly referred to as “public-private partnerships.” Under the public-private partnerships, the Company constructed utility plant, financed by the Company and the Partners constructed utility plant (connected to the Company’s property), financed by the Partners. The Company agreed to transfer and convey some of its real and personal property to the Partners in exchange for an equal principal amount of Industrial Development Bonds (“IDBs”), issued by the Partners under a state Industrial Development Bond and Commercial Development Act. The Company leased back the total facilities, including portions funded by both the Company and the Partners, under leases for a period of 40 years.

The leases related to the portion of the facilities funded by the Company have required payments from the Company to the Partners that approximate the payments required by the terms of the IDBs from the Partners to the Company (as the holder of the IDBs). As the ownership of the portion of the facilities constructed by the Company will revert back to the Company at the end of the lease, the Company has recorded these as capital leases. The lease obligation and the receivable for the principal amount of the IDBs are presented by the Company on a net basis. The gross cost of the facilities funded by the Company recognized as a capital lease asset was \$156 and \$157 as of December 31, 2015 and 2014, respectively, which is presented in property, plant and equipment in the accompanying Consolidated Balance Sheets. The future payments under the lease obligations are equal to and offset by the payments receivable under the IDBs.

As of December 31, 2015, the minimum annual future rental commitment under the operating leases for the portion of the facilities funded by the Partners that have initial or remaining non-cancelable lease terms in excess of one year included in the preceding minimum annual rental commitments are \$4 in 2016 through 2020, and \$69 thereafter.

Note 19: Segment Information

The Company's operating segments are comprised of the revenue-generating components of its businesses for which separate financial information is internally produced and regularly used by management to make operating decisions and assess performance. The Company operates its businesses primarily through one reportable segment, the Regulated Businesses segment. The Company also operates businesses that provide a broad range of related and complementary water and wastewater services in non-regulated markets, which includes four operating segments that individually do not meet the criteria of a reportable segment. These four non-reportable operating segments have been combined and are presented as Market-Based Businesses.

The Regulated Businesses segment is the largest component of the Company's business and includes 18 subsidiaries that provide water and wastewater services to customers in 16 states.

The Market-Based Businesses' four non-reportable operating segments are Military Services Group, Contract Operations Group, Homeowner Services Group and Keystone Operations. Military Services Group performs 50-year contracts with the U.S. Department of Defense for the operation and maintenance of the water and wastewater systems on certain military bases. Homeowner Services Group provides services to domestic homeowners and smaller commercial establishments to protect against the cost of repairing damaged or blocked pipes inside and outside their accommodations, as well as interior electric lines. Contract Operations Group performs contracts with municipalities, the food and beverage industry and other customers to operate and maintain water and wastewater facilities. Keystone Operations provides customized water sourcing, transfer services, pipeline construction, water and equipment hauling and water storage solutions, for natural gas exploration and production companies.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. See Note 2—Significant Accounting Policies. The Regulated Businesses segment and Market-Based Businesses include intercompany costs that are allocated by American Water Works Service Company, Inc. and intercompany interest that is charged by American Water Capital Corp., which are eliminated to reconcile to the consolidated results of operations. Inter-segment revenues, which are primarily recorded at cost plus a mark-up that approximates current market prices, includes leased office space, furniture and equipment provided by the Company's market-based subsidiaries to its regulated subsidiaries. "Other" includes corporate costs that are not allocated to the Company's operating segments, eliminations of inter-segment transactions, fair value adjustments and associated income and deductions related to the acquisitions that have not been allocated to the operating segments for evaluation of performance and allocation of resource purposes. The adjustments related to the acquisitions are reported in Other as they are excluded from segment performance measures evaluated by management.

The chief operating decision maker of the company, who is the President and Chief Executive Officer, uses income from continuing operations before income tax as the primary measure of profit and loss in assessing the results of each operating segment. The following tables include the Company's summarized segment information as of and for the years ended December 31:

	2015			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated
Operating revenues	\$ 2,743	\$ 434	\$ (18)	\$ 3,159
Depreciation and amortization	411	8	21	440
Total operating expenses, net	1,732	370	(18)	2,084
Interest, net	248	(2)	62	308
Income from continuing operations before income taxes	776	68	(62)	782
Provision for income taxes	303	26	(23)	306
Income from continuing operations	473	42	(39)	476
Total assets	15,258	496	1,487	17,241
Capital expenditures	1,143	17	—	1,160
	2014			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated
Operating revenues	\$ 2,674	\$ 355	\$ (18)	\$ 3,011
Depreciation and amortization	394	6	24	424
Total operating expenses, net	1,726	300	(18)	2,008
Interest, net	248	(2)	53	299
Income from continuing operations before income taxes	707	58	(55)	710
Provision for income taxes	273	18	(11)	280
Income from continuing operations	434	40	(44)	430
Total assets (b)	14,343	314	1,381	16,038
Capital expenditures	946	10	—	956
	2013			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated
Operating revenues (a)	\$ 2,594	\$ 303	\$ (18)	\$ 2,879
Depreciation and amortization (a)	376	6	25	407
Total operating expenses, net (a)	1,700	252	(21)	1,931
Interest, net	249	(2)	61	308
Income from continuing operations before income taxes (a)	655	53	(100)	608
Provision for income taxes	255	14	(32)	237
Income from continuing operations	400	39	(68)	371
Total assets (b)	13,448	286	1,330	15,064
Assets of discontinued operations (included in total assets above)	—	8	—	8
Capital expenditures	973	7	—	980
Capital expenditures of discontinued operations (included in capital expenditures above)	—	1	—	1

(a) The information has been revised to reflect the impact of discontinued operations, as applicable. See Note 3—Acquisitions and Divestitures for additional details on the Company's discontinued operations.

(b) The information has been revised to reflect the retrospective application of ASU 2015-15 Presentation of Debt Issuance Costs and ASU 2015-17 Income Taxes. See Note 2—Significant Accounting Policies for additional details.

Note 20: Unaudited Quarterly Data

The following table summarizes certain supplemental unaudited consolidated quarterly financial data for each of the four quarters in the years ended December 31, 2015 and 2014, respectively. The operating results for any quarter are not indicative of results that may be expected for a full year or any future periods.

<u>2015</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
	(In millions, except per share data)			
Operating revenues	\$ 698	\$ 782	\$ 896	\$ 783
Operating income	204	278	361	232
Net income attributable to common stockholders	80	123	174	99
Basic earnings per share:				
Net income attributable to common stockholders	0.45	0.69	0.97	0.55
Diluted earnings per share:				
Net income attributable to common stockholders	0.44	0.68	0.96	0.55
<u>2014</u>	<u>First Quarter</u>	<u>Second Quarter</u>	<u>Third Quarter</u>	<u>Fourth Quarter</u>
	(In millions, except per share data)			
Operating revenues	\$ 679	\$ 755	\$ 846	\$ 731
Operating income	187	255	337	224
Net income attributable to common stockholders	68	109	152	94
Basic earnings per share:				
Net income attributable to common stockholders	0.38	0.61	0.85	0.52
Diluted earnings per share:				
Net income attributable to common stockholders	0.38	0.61	0.85	0.52

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as such term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act as of the end of the period covered by this report.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of December 31, 2015, our disclosure controls and procedures were effective at a reasonable level of assurance. Our disclosure controls and procedures are designed to provide reasonable assurance that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act. Our internal control over financial reporting is a process designed by or under the supervision of our Chief Executive Officer and Chief Financial Officer to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of the financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management, including our Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting, as of December 31, 2015, using the criteria described in *Internal Control—Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based on our evaluation under the framework in *Internal Control—Integrated Framework (2013)*, our management concluded that our internal control over financial reporting was effective as of December 31, 2015.

The effectiveness of our internal control over financial reporting as of December 31, 2015 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report appearing in Item 8—Financial Statements and Supplementary Data of this Annual Report on Form 10-K.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

NONE

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE

The information required by this item and not given below, is incorporated by reference from the Company's Proxy Statement for the 2016 Annual Meeting of Stockholders, to be filed with the Securities and Exchange Commission within 120 days following the end of the fiscal year covered by this report, under the captions entitled "Board of Directors and Corporate Governance," Proposal 1-Election of Directors" and "Certain Stockholder Matters—Section 16(a) Beneficial Ownership Reporting Compliance."

We have adopted a Code of Ethics, which applies to directors, officers and employees. The full text of the Code of Ethics is publicly available on our website at <http://www.amwater.com>. We intend to post on our website any amendments to our Code of Ethics and any waivers of such provisions granted to principal officers.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this item is incorporated by reference in the Company's Proxy Statement for the 2016 Annual Meeting of Stockholders, under the captions entitled "Executive Compensation," "Compensation Discussion and Analysis," "Compensation Committee Report" and "Board of Directors and Corporate Governance—Director Compensation."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this item setting forth the security ownership of certain beneficial owners and management is incorporated by reference in the Company's Proxy Statement for the 2016 Annual Meeting of Stockholders, under the captions entitled "Certain Stockholder Matters—Security Ownership of Principal Stockholders and Management" and "Equity Compensation Plan Information."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

Information required by this item is incorporated by reference in the Company's Proxy Statement for the 2016 Annual Meeting of Stockholders, under the captions entitled "Board of Directors and Corporate Governance—Certain Relationships and Related Transactions" and "Proposal 1-Election of Directors—Director Independence."

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this item is incorporated by reference in the Company's Proxy Statement for the 2016 Annual Meeting of Stockholders, under the caption entitled "Independent Registered Public Accounting Fees and Services" and "Policy on the Approval of Services Provided by the Independent Auditor."

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

- (a) The following documents have been filed as a part of this Form 10-K:
1. The financial statements listed in the "Index to Consolidated Financial Statements" contained in Part II, Item 8. "Financial Statements and Supplementary Data" of this Form 10-K are hereby incorporated by reference in response to this Item 15(a).

2. Financial statement schedules have been omitted since they are either not required or are not applicable as the information is otherwise included in the financial statements or notes thereto.
3. Exhibits. The list of documents contained in “Exhibit Index” to this Form 10-K is incorporated by reference in response to this Item 15(a). The warranties, representations and covenants contained in any of the agreements included or incorporated by reference herein or which appear as exhibits hereto should not be relied upon by buyers, sellers or holders of the Company’s or its subsidiaries’ securities and are not intended as warranties, representations or covenants to any individual or entity except as specifically set forth in such agreement.

The responses to Items 15(b) and (c) of Form 10-K are included above in response to Item 15(a).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on the 24th day of February, 2016.

AMERICAN WATER WORKS COMPANY, INC.

BY: /s/ SUSAN N. STORY
Susan N. Story
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed on the 24th day of February, 2016 by the following persons in the capacities indicated.

 /s/ SUSAN N. STORY
Susan N. Story
President and Chief Executive Officer
(Principal Executive Officer and Director)

 /s/ RICHARD R. GRIGG
Richard R. Grigg
(Director)

 /s/ LINDA G. SULLIVAN
Linda G. Sullivan
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

 /s/ JULIA L. JOHNSON
Julia L. Johnson
(Director)

 /s/ MARK CHESLA
Mark Chesla
Vice President and Controller
(Principal Accounting Officer)

 /s/ WILLIAM J. MARRAZZO
William J. Marrazzo
(Director)

 /s/ GEORGE MacKENZIE
George MacKenzie
(Director)

 /s/ PAUL J. EVANSON
Paul J. Evanson
(Director)

 /s/ MARTHA CLARK GOSS
Martha Clark Goss
(Director)

 /s/ KARL F. KURZ
Karl F. Kurz
(Director)

 /s/ JULIE A. DOBSON
Julie A. Dobson
(Director)

EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Exhibit Description</u>
3.1	Restated Certificate of Incorporation of American Water Works Company, Inc. (incorporated by reference to Exhibit 3.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed November 6, 2008).
3.2	Amended and Restated Bylaws of American Water Works Company, Inc. (incorporated by reference to Exhibit 3.2 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).
4.1	Indenture, dated as of October 22, 2007 between American Water Capital Corp. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.4 to American Water Capital Corp.'s Registration Statement on Form S-4, File No. 333-148284, and American Water Works Company, Inc.'s Registration Statement on Form S-4, File No. 333-148284-01, filed December 21, 2007).
4.2	Indenture, dated as of December 4, 2009, between American Water Capital Corp. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed December 3, 2010).
4.3	Officers' Certificate, dated December 15, 2010, establishing the 6.00% Senior Monthly Notes due 2040 (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed December 15, 2010).
4.4	Officers' Certificate, dated December 17, 2012, establishing the 4.300% Senior Notes due 2042 (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed December 17, 2012).
4.5	Officers' Certificate, dated November 20, 2013, establishing the 3.850% Senior Notes due 2024 (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed November 20, 2013).
4.6	Officers' Certificate, dated August 14, 2014, establishing the 3.400% Senior Notes due 2024 (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed August 14, 2014).
4.7	Officers' Certificate, dated August 14, 2014, providing for a further issuance of the 4.300% Senior Notes 2042 (incorporated by reference to Exhibit 4.3 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed August 14, 2014).
4.8	Officers' Certificate, dated August 13, 2015, establishing the 4.300% Senior Notes due 2045 (incorporated by reference to Exhibit 4.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed August 13, 2015).
4.9	Officers' Certificate, dated August 13, 2015, providing for a further issuance of the 3.400% Senior Notes due 2025 (incorporated by reference to Exhibit 4.3 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed August 13, 2015).
4.10	Note Purchase Agreement, as amended, dated December 21, 2006, between American Water Capital Corp. and the purchasers party thereto (incorporated by reference to Exhibit 4.2 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007) with respect to the 5.52% Series B Senior Notes due December 21, 2016, 5.62% Series C Senior Notes due December 21, 2018 and 5.77% Series D Senior Notes due December 21, 2021.

<u>Exhibit Number</u>	<u>Exhibit Description</u>
4.11	Note Purchase Agreement, as amended, dated March 29, 2007, between American Water Capital Corp. and the purchasers party thereto (incorporated by reference to Exhibit 4.3 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007) with respect to 5.62% Series E Senior Notes due March 29, 2019 and 5.77% Series F Senior Notes due March 29, 2022.
4.12	Note Purchase Agreement, dated May 15, 2008, between American Water Capital Corp. and the purchasers party thereto (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed May 19, 2008) with respect to the 6.25% Series G Senior Notes due May 15, 2018 and the 6.55% Series H Senior Notes due May 15, 2023.
10.1	Amended and Restated Credit Agreement, dated as of June 30, 2015, by and among American Water Works Company, Inc., American Water Capital Corp., each of the lenders party thereto, Wells Fargo Bank, National Association, as administrative agent, JPMorgan Chase Bank, N.A., as syndication agent, and Mizuho Bank, Ltd. and PNC Bank, National Association, as co-documentation agents (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Current Report on Form 8-K, File No. 001-34028, filed on July 7, 2015).
10.2	Support Agreement, dated June 22, 2000, together with First Amendment to Support Agreement, dated July 26, 2000, by and between American Water Works Company, Inc. and American Water Capital Corp. (incorporated by reference to Exhibit 10.3 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007).
10.3*	Employment Letter Agreement between Linda G. Sullivan and American Water Works Company, Inc. dated March 10, 2014 (incorporated by reference to Exhibit 10.2 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.4*	Amended and Restated Letter Agreement between Loyd Warnock and American Water Works Company, Inc. dated May 7, 2014 (filed herewith).
10.5*	Letter, dated December 12, 2014, by and between American Water Works Company, Inc. and Brenda J. Holdnak, Ph.D. (incorporated by reference to Exhibit 10.5 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).
10.6*	Severance Agreement and General Release, dated December 22, 2014, by and between American Water Works Company, Inc. and Leonard Crane (incorporated by reference to Exhibit 10.6 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).
10.7*	Severance Agreement and General Release, dated January 6, 2015, by and between American Water Works Company, Inc. and Kellye L. Walker (incorporated by reference to Exhibit 10.3 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).
10.8*	Letter, dated February 17, 2015, by and between American Water Works Company, Inc. and Michael A. Sgro (incorporated by reference to Exhibit 10.4 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).
10.9*	Severance Agreement and General Release, dated March 27, 2015, by and between American Water Works Company, Inc. and John Bigelow (filed herewith).

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.10*	Amended and Restated American Water Works Company, Inc. Executive Retirement Plan, dated as of March 1, 2007 (incorporated by reference to Exhibit 10.8 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007).
10.11.1*	American Water Works Company, Inc. Nonqualified Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.15 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145725, filed March 31, 2008).
10.11.2*	Amendment 2010-1 to the American Water Works Company, Inc. Nonqualified Employee Stock Purchase Plan, dated as of December 10, 2010 (incorporated by reference to Exhibit 10.12 to American Water Works Company, Inc.'s Annual Report on Form 10-K, File No. 001-34028, filed February 28, 2011).
10.12*	American Water Works Company, Inc. Executive Severance Policy, dated as of December 16, 2008 (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed November 3, 2010).
10.13.1*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan, as amended (incorporated by reference to Appendix B to American Water Works Company, Inc.'s Definitive Proxy Statement, File No. 001-34028, filed March 27, 2015).
10.13.2*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2011 Nonqualified Stock Option Grant for ML1 – L5 Employees (incorporated by reference to Exhibit 10.3 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 4, 2011).
10.13.3*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2012 Nonqualified Stock Option Grant for ML1 – L5 Employees (incorporated by reference to Exhibit 10.2 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 2, 2012).
10.13.4*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Nonqualified Stock Option Grant Form for ML2 – L5 (incorporated by reference to Exhibit 10.13 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2013).
10.13.5*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Nonqualified Stock Option Grant Form for Jeffrey E. Sterba (incorporated by reference to Exhibit 10.9 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2013).
10.13.6*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Nonqualified Stock Option Grant Form for ML2 – L5 (incorporated by reference to Exhibit 10.6 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.7*	Amendment to the American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Nonqualified Stock Option Grant Form for ML2 – L5 (incorporated by reference to Exhibit 10.6A to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.8*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Nonqualified Stock Option Grant Form for Jeffrey E. Sterba (incorporated by reference to Exhibit 10.8 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.13.9*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan May 2014 Nonqualified Stock Option Grant Form for Susan N. Story (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 6, 2014).
10.13.10*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Nonqualified Stock Option Grant (filed herewith).
10.13.11*	Amendment to American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Nonqualified Stock Option Grant (filed herewith).
10.13.12*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Nonqualified Stock Option Grant (for certain executives) (filed herewith).
10.13.13*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Restricted Stock Unit Grant Form for ML2 – L5 (incorporated by reference to Exhibit 10.3 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.14*	Amendment to the American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Restricted Stock Unit Grant Form for ML2 – L5 (incorporated by reference to Exhibit 10.3A to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.15*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Restricted Stock Unit Grant Form for Jeffrey E. Sterba (incorporated by reference to Exhibit 10.7 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.16*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan May 2014 Restricted Stock Unit Grant Form for Susan N. Story (incorporated by reference to Exhibit 10.4 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 6, 2014).
10.13.17*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Restricted Stock Unit Grant (filed herewith).
10.13.18*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Restricted Stock Unit Grant (for certain executives) (filed herewith).
10.13.19*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan Restricted Stock Unit Grant for Brenda J. Holdnak, dated December 10, 2015 (filed herewith).
10.13.20*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Performance Stock Unit Grant Form A for ML2 – L5 (incorporated by reference to Exhibit 10.4 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.21*	Amendment to the American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Performance Stock Unit Grant Form A for ML2 – L5 (incorporated by reference to Exhibit 10.4A to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.22*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Performance Stock Unit Grant Form B for ML2 – L5 (incorporated by reference to Exhibit 10.5 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.13.23*	Amendment to the American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Performance Stock Unit Grant Form B for ML2 – L5 (incorporated by reference to Exhibit 10.5A to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.24*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Performance Stock Unit Grant Form A for Jeffrey E. Sterba (incorporated by reference to Exhibit 10.9 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.25*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Performance Stock Unit Grant Form B for Jeffrey E. Sterba (incorporated by reference to Exhibit 10.10 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed May 7, 2014).
10.13.26*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan May 2014 Performance Stock Unit Grant Form A for Susan N. Story (incorporated by reference to Exhibit 10.2 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 6, 2014).
10.13.27*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan May 2014 Performance Stock Unit Grant Form B for Susan N. Story (incorporated by reference to Exhibit 10.3 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 6, 2014).
10.13.28*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Performance Stock Unit Grant Form A-1 (filed herewith).
10.13.29*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Performance Stock Unit Grant Form A-2 (filed herewith).
10.13.30*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Performance Stock Unit Grant Form B-1 (filed herewith).
10.13.31*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Performance Stock Unit Grant Form B-2 (filed herewith).
10.13.32*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Conditional Performance Stock Unit Grant Form A for certain executive officers (filed herewith).
10.13.33*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Conditional Performance Stock Unit Grant Form B for certain executive officers (filed herewith).
10.13.34*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2010 Stock Unit Grant Form for Non-Employee Directors (incorporated by reference to Exhibit 10.3 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 4, 2010).
10.13.35*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2011 Stock Unit Grant Form for Non-Employee Directors (incorporated by reference to Exhibit 10.3 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 3, 2011).
10.13.36*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2012 Stock Unit Grant Form for Non-Employee Directors (incorporated by reference to Exhibit 10.2 to American Water Works Company, Inc.’s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 2, 2012).

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.13.37*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2013 Stock Unit Grant Form for Non-Employee Directors (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 7, 2013).
10.13.38*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2014 Stock Unit Grant Form for Non-Employee Directors (incorporated by reference to Exhibit 10.5 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 6, 2014).
10.13.39*	American Water Works Company, Inc. 2007 Omnibus Equity Compensation Plan 2015 Stock Unit Grant Form for Non-Employee Directors (incorporated by reference to Exhibit 10.1 to American Water Works Company, Inc.'s Quarterly Report on Form 10-Q, File No. 001-34028, filed August 5, 2015).
10.14.1*	American Water Works Company, Inc. Annual Incentive Plan (incorporated by reference to Appendix C to American Water Works Company, Inc.'s Definitive Proxy Statement, File No. 001-34028, filed March 27, 2015).
10.14.2*	Amendment 2016-1 to American Water Works Company, Inc. Annual Incentive Plan, effective January 1, 2016 (filed herewith).
10.15*	Amended and Restated American Water Works Company, Inc. Deferred Compensation Plan, dated as of January 1, 2001 (incorporated by reference to Exhibit 10.9 to American Water Capital Corp.'s Registration Statement on Form S-1, File No. 333-145757-01, and American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-145757, filed October 11, 2007).
10.16*	Nonqualified Savings and Deferred Compensation Plan for Employees of American Water Works Company, Inc. and Its Designated Subsidiaries, as amended and restated, effective as of January 1, 2009 (incorporated by reference to Exhibit 10.37 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-155245, filed November 18, 2008).
10.17*	Nonqualified Deferred Compensation Plan for Non-Employee Directors of American Water Works Company, Inc., as amended and restated, effective as of January 1, 2009 (incorporated by reference to Exhibit 10.38 to American Water Works Company, Inc.'s Registration Statement on Form S-1, File No. 333-155245, filed November 18, 2008).
21.1	Subsidiaries of American Water Works Company, Inc. (filed herewith).
23.1	Consent of PricewaterhouseCoopers LLP (filed herewith).
31.1	Certification of Susan N. Story, President and Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
31.2	Certification of Linda G. Sullivan, Executive Vice President and Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act (filed herewith).
32.1	Certification of Susan N. Story, President and Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith).
32.2	Certification of Linda G. Sullivan, Executive Vice President and Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act (furnished herewith).

**Exhibit
Number**

Exhibit Description

101 The following financial statements from American Water Works Company, Inc.'s Annual Report on Form 10-K for the period ended December 31, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Operations; (iii) the Consolidated Statements of Comprehensive Income; (iv) the Consolidated Statements of Cash Flows; (v) the Consolidated Statements of Changes in Stockholders' Equity; and (vi) the Notes to Consolidated Financial Statements (filed herewith).

* Denotes a management contract or compensatory plan or arrangement.

Instruments defining the rights of holders of certain issues of long-term debt of the Company and certain of its consolidated subsidiaries have not been filed as exhibits to this report because the authorized principal amount of any one of such issues does not exceed 10% of the Company's consolidated total assets. The Company agrees to furnish a copy of each such instrument to the SEC upon request.

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-168543 and 333-150381) and Form S-3 (Nos. 333-187120 and 333-203949) of American Water Works Company, Inc. of our report dated February 24, 2016 relating to the financial statements and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP
Philadelphia, Pennsylvania
February 24, 2016

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER

I, Susan N. Story, certify that:

1. I have reviewed this annual report on Form 10-K of American Water Works Company, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2016

By: /s/ SUSAN N. STORY

Susan N. Story
President and Chief Executive Officer
(Principal Executive Officer)

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER

I, Linda G. Sullivan, certify that:

1. I have reviewed this annual report on Form 10-K of American Water Works Company, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2016

By: /s/ LINDA G. SULLIVAN

Linda G. Sullivan
Executive Vice President and Chief Financial Officer

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION PURSUANT TO
RULE 13a-14(b) UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Susan N. Story, President and Chief Executive Officer of American Water Works Company, Inc. (the “Company”), hereby certify that, based on my knowledge:

(1) The Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ SUSAN N. STORY

Susan N. Story
President and Chief Executive Officer
(Principal Executive Officer)

February 24, 2016

AMERICAN WATER WORKS COMPANY, INC.

CERTIFICATION PURSUANT TO
RULE 13a-14(b) UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Linda G. Sullivan, Executive Vice President and Chief Financial Officer of American Water Works Company, Inc. (the "Company"), hereby certify that, based on my knowledge:

(1) The Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ LINDA G. SULLIVAN

Linda G. Sullivan
Executive Vice President and Chief Financial Officer

February 24, 2016

Investor Inquiries

Stockholders with questions, or who wish to obtain a copy of the company's reports filed with the Securities and Exchange Commission without charge, should visit American Water's Investor Relations page at www.amwater.com, or contact:

Investor Relations

1025 Laurel Oak Road
Voorhees, NJ 08043
Investor Relations Line:
856-566-4005

Investor Relations Fax:
856-782-2782

E-mail:
aw.investorrelations@amwater.com

Headquarters

1025 Laurel Oak Road
Voorhees, NJ 08043
Phone: 856-346-8200

Internet Address

www.amwater.com

Stock Market

Common stock of American Water Works Company, Inc. is traded on the New York Stock Exchange (NYSE) under the symbol AWK.

Annual Meeting

The annual meeting of stockholders is scheduled for 10:00 a.m. ET on Friday, May 13, 2016, to be held at The Mansion, 3000 Main Street, Voorhees, New Jersey, 08043. All holders of our outstanding common stock at the close of business March 21, 2016, are entitled to vote at the meeting. Notice of the meeting and proxy materials will be distributed to stockholders and are accessible to the public on our Investor Relations webpage at www.amwater.com. Management encourages all investors to participate and vote.

Executive Certifications

American Water Works has included as exhibits to its 2015 Annual Report on Form 10-K filed with the Securities and Exchange Commission certifications of the chief executive officer and chief financial officer of the company regarding the company's public disclosures contained therein. The company also provides annually to the NYSE a certificate of the CEO certifying that, among other things, it is not aware of any violation by the company of NYSE corporate listing standards.

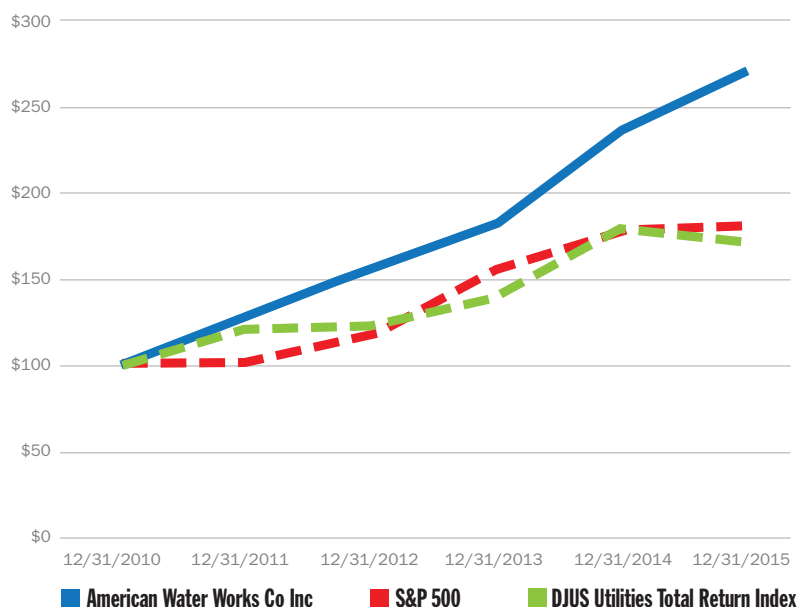
Stock Performance Graph

The company's common stock began trading publicly on April 23, 2008. The graph below compares the cumulative total return on American Water's common stock with the cumulative total return of the Standard & Poor's 500 Index and the Dow Jones U.S. Utilities Total Return Index from December 31, 2010, through December 31, 2015. The comparison assumes \$100 was invested on December 31, 2010, and that dividends were reinvested.

Dividends

Dividends paid on the company's common stock in 2015 were:

March 2, 2015	\$0.31
June 1, 2015	\$0.34
September 1, 2015	\$0.34
December 1, 2015	\$0.34





AMERICAN WATER

amwater.com

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