American Water Works Company, Inc.
Form 10-Q
November 02, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016

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	51-0063696 (I.R.S. Employer
incorporation or organization)	Identification No.)
1025 Laurel Oak Road, Voorhees, NJ (Address of principal executive offices)	08043 (Zip Code)

(856) 346-8200

(Registrant's telephone number, including area code)

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 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 "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

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

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

Class	Outstanding as of October 27, 2016
Common Stock, $0.01 par value per share	178,003,367 shares
	(excludes 3,721,496 treasury shares as of October 27, 2016)

TABLE OF CONTENTS

AMERICAN WATER WORKS COMPANY, INC.

Quarterly REPORT ON FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2016

INDEX

FORWARD-LOOKING STATEMENTS

We have made statements in Part I, Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations and in other sections of this Quarterly Report on Form 10-Q (“Form 10-Q”), 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,” “ “objective,” “potential,” “continue,” “seek to,” “may,” “can,” “should,” “will” and “could” or the negative of such terms or oth variations or similar expressions. Forward-looking statements may relate to, among other things, our future financial performance, including our adjusted 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 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 chemical spill in West Virginia, including matters pertaining to the recently announced binding global agreement in principle to settle claims related to this chemical spill;
- 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 or water provided to our customers, and attacks on, or infiltration of or other disruptions to, 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 obtain, new customers in our market-based businesses;
-

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 laws 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;

1

- 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 risk factors and other statements contained in our Annual Report on Form 10-K for the year ended December 31, 2015 (“Form 10-K”), and in this Form 10-Q, and investors should refer to such risk factors and other statements in evaluating such forward-looking statements. Any forward-looking statements we make speak only as of the date this Form 10-Q was filed with the United States Securities and Exchange Commission. 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. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets (Unaudited)

(In millions, except share and per share data)

	September 30, 2016	December 31, 2015
ASSETS		
Property, plant and equipment	$ 19,376	$ 18,504
Accumulated depreciation	(4,817)	(4,571)
Property, plant and equipment, net	14,559	13,933
Current assets:		
Cash and cash equivalents	46	45
Restricted funds	23	21
Accounts receivable, net	302	255
Unbilled revenues	285	267
Materials and supplies	40	38
Other	105	31
Total current assets	801	657
Regulatory and other long-term assets:		
Regulatory assets	1,223	1,271
Goodwill	1,313	1,302
Other	75	78
Total regulatory and other long-term assets	2,611	2,651
TOTAL ASSETS	$ 17,971	$ 17,241

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

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Balance Sheets (Unaudited)

(In millions, except share and per share data)

	September 30, 2016	December 31, 2015
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock ($0.01 par value, 500,000,000 shares authorized, 181,720,136 and 180,907,483 shares issued, respectively)	$ 2	$ 2
Paid-in-capital	6,388	6,351
Accumulated deficit	(839)	(1,073)
Accumulated other comprehensive loss	(99)	(88)
Treasury stock, at cost (3,721,496 and 2,625,112 shares, respectively)	(214)	(143)
Total common stockholders' equity	5,238	5,049
Long-term debt	5,842	5,862
Redeemable preferred stock at redemption value	11	12
Total long-term debt	5,853	5,874
Total capitalization	11,091	10,923
Current liabilities:		
Short-term debt	951	628
Current portion of long-term debt	53	54
Accounts payable	135	126
Accrued liabilities	530	493
Taxes accrued	45	26
Interest accrued	96	62
Other	118	144
Total current liabilities	1,928	1,533
Regulatory and other long-term liabilities:		
Advances for construction	300	349
Deferred income taxes, net	2,524	2,310
Deferred investment tax credits	23	24
Regulatory liabilities	403	402
Accrued pension expense	342	342
Accrued postretirement benefit expense	72	169
Other	90	68
Total regulatory and other long-term liabilities	3,754	3,664
Contributions in aid of construction	1,198	1,121
Commitments and contingencies (see Note 9)		
TOTAL CAPITALIZATION AND LIABILITIES	$ 17,971	$ 17,241

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

American Water Works Company, Inc. and Subsidiary Companies

Consolidated Statements of Operations (Unaudited)

(In millions, except per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Operating revenues	$930	$896	$2,500	$2,376
Operating expenses:				
Operation and maintenance	432	364	1,131	1,024
Depreciation and amortization	119	111	350	327
General taxes	65	60	195	184
Gain on asset dispositions and purchases	(5)	—	(8)	(2)
Total operating expenses, net	611	535	1,668	1,533
Operating income	319	361	832	843
Other income (expense):				
Interest, net	(81)	(77)	(242)	(228)
Other, net	5	3	14	9
Total other income (expense)	(76)	(74)	(228)	(219)
Income from continuing operations before income taxes	243	287	604	624
Provision for income taxes	95	113	237	247
Net income attributable to common stockholders	$148	$174	$367	$377
Basic earnings per share:				
Net income attributable to common stockholders	$0.83	$0.97	$2.06	$2.10
Diluted earnings per share:				
Net income attributable to common stockholders	$0.83	$0.96	$2.05	$2.09
Weighted-average common shares outstanding:				
Basic	178	179	178	179
Diluted	178	180	179	180
Dividends declared per common share	$0.375	$0.34	$0.75	$0.68

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 (Unaudited)

(In millions)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income attributable to common stockholders	$ 148	$ 174	$ 367	$ 377
Other comprehensive income (loss), net of tax:				
Pension amortized to periodic benefit cost:				
Actuarial loss, net of tax of $1 for the three months and $3 for the nine months	1	1	4	4
Foreign currency translation adjustment	—	—	—	(1)
Unrealized loss on cash flow hedges, net of tax of $(3) and $0 for the three months and $(10) and $0 for the nine months	(4)	—	(15)	—
Net other comprehensive income (loss)	(3)	1	(11)	3
Comprehensive income attributable to common stockholders	$ 145	$ 175	$ 356	$ 380

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 (Unaudited)

(In millions)

	For the Nine Months Ended September 30, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$367	$377
Adjustments to reconcile to net cash flows provided by operating activities:		
Depreciation and amortization	350	327
Deferred income taxes and amortization of investment tax credits	223	236
Provision for losses on accounts receivable	18	22
Gain on asset dispositions and purchases	(8)	(2)
Pension and non-pension postretirement benefits	43	46
Other non-cash, net	(48)	(40)
Changes in assets and liabilities:		
Receivables and unbilled revenues	(83)	(147)
Pension and non-pension postretirement benefit contributions	(42)	(40)
Accounts payable and accrued liabilities	184	69
Other assets and liabilities, net	(79)	8
Net cash provided by operating activities	925	856
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(928)	(791)
Acquisitions	(29)	(176)
Proceeds from sale of assets and securities	5	5
Removal costs from property, plant and equipment retirements, net	(62)	(74)
Net funds restricted	—	(9)
Net cash used in investing activities	(1,014)	(1,045)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	2	564
Repayments of long-term debt	(20)	(88)
Proceeds from short-term borrowings with maturities greater than three months	—	60
Repayments of short-term borrowings with maturities greater than three months	—	(60)
Net short-term borrowings with maturities less than three months	322	(70)
Proceeds from issuances of employee stock plans and DRIP	22	32
Advances and contributions for construction, net of refunds of $17 and $17, respectively	16	20
Debt issuance costs	(1)	(7)
Dividends paid	(194)	(178)
Anti-dilutive stock repurchase	(65)	(39)
Tax benefit realized from equity compensation	8	7
Net cash provided by financing activities	90	241

Net increase in cash and cash equivalents	1	52
Cash and cash equivalents as of beginning of period	45	23
Cash and cash equivalents as of end of period	$46	$75
Non-cash investing activity:		
Capital expenditures acquired on account but unpaid as of end of period	$182	$195

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 (Unaudited)

(In millions)

	Common Stock Shares	Common Stock Par Value	Paid-in-Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock Shares	Treasury Stock At Cost	Total Stockholders' Equity
Balance as of December 31, 2015	180.9	$ 2	$ 6,351	$ (1,073)	$ (88)	(2.6)	$ (143)	$ 5,049
Net income attributable to common stockholders	—	—	—	367	—	—	—	367
Direct stock reinvestment and purchase plan	—	—	4	—	—	—	—	4
Employee stock purchase plan	—	—	5	—	—	—	—	5
Stock-based compensation activity	0.8	—	28	—	—	(0.1)	(6)	22
Repurchases of common stock	—	—	—	—	—	(1.0)	(65)	(65)
Net other comprehensive income (loss)	—	—	—	—	(11)	—	—	(11)
Dividends	—	—	—	(133)	—	—	—	(133)
Balance as of September 30, 2016	181.7	$ 2	$ 6,388	$ (839)	$ (99)	(3.7)	$ (214)	$ 5,238

	Common Stock Shares	Common Stock Par Value	Paid-in-Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock Shares	Treasury Stock At Cost	Total Stockholders' Equity
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	—	—	—	377	—	—	—	377

Direct stock reinvestment and purchase plan	—	—	3	—	—	—	—	3
Employee stock purchase plan	—	—	4	—	—	—	—	4
Stock-based compensation activity	1.1	—	40	(1)	—	(0.1)	(7)	32
Repurchases of common stock	—	—	—	—	—	(0.8)	(39)	(39)
Net other comprehensive income (loss)	—	—	—	—	3	—	—	3
Dividends	—	—	—	(122)	—	—	—	(122)
Balance as of September 30, 2015	180.6	$ 2	$ 6,349	$ (1,050)	$ (79)	(1.1)	$ (57)	$ 5,165

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 (Unaudited)

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

Note 1: Basis of Presentation

The unaudited consolidated financial statements provided in this report include the accounts of American Water Works Company, Inc. and all of its subsidiaries (collectively, "American Water" or the "Company") in which a controlling interest is maintained after the elimination of intercompany accounts and transactions. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") for interim financial reporting and with the rules and regulations for reporting on Form 10-Q. Accordingly, they do not contain certain information and disclosures required by GAAP for comprehensive financial statements. In the opinion of management, all adjustments necessary for a fair statement of the financial position as of September 30, 2016 and results of operations and cash flows for all periods presented have been made. All adjustments are of a normal, recurring nature, except as otherwise disclosed.

The Consolidated Balance Sheet as of December 31, 2015 is derived from the Company's audited consolidated financial statements as of December 31, 2015. The unaudited financial statements and notes included in this report should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015 ("Form 10-K") which provides a more complete discussion of the Company's accounting policies, financial position, operating results and other matters. The results of operations for interim periods are not necessarily indicative of the results that may be expected for the year, due primarily to the seasonality of the Company's operations.

Note 2: New Accounting Pronouncements

The following accounting standard was adopted by the Company as of September 30, 2016:

Standard	Description	Date of Adoption	Application	Effect on the Consolidated Financial Statements (or Other Significant Matters)
Accounting for Fees Paid in a Cloud Computing Arrangement	Clarified accounting guidance for fees paid in a cloud computing arrangement. Software license elements in a cloud computing arrangement should be accounted for	January 1, 2016	Prospective	Adoption of this standard did not impact the Company's results of operations, financial position or cash flows.

consistent with other software licenses. A cloud computing arrangement without a software license is accounted for as a service contract.

The following recently issued accounting standards are not yet required to be adopted by the Company as of September 30, 2016:

Standard	Description	Date of Adoption	Application	Effect on the Consolidated Financial Statements (or Other Significant Matters)
Simplification of Employee Share-Based Payment Accounting	Simplified accounting and disclosure requirements for share-based payment awards. The updated guidance addresses: (i) the recognition of excess tax benefits and deficiencies; (ii) the classification of excess tax benefits and taxes paid on the Consolidated Statements of Cash Flows; (iii) election of an accounting policy for forfeitures; and (iv) the amount an employer can withhold to cover income taxes and still qualify for equity classification.	January 1, 2017; early adoption permitted	Alternative transition methods available	The cumulative effect to retained earnings prior to 2017 is expected to be an increase of approximately $23, with an offsetting decrease to deferred income taxes, net. The Company does not expect to early adopt.
Revenue from Contracts with Customers	Provided new accounting guidance for revenue recognition replacing most existing guidance, including industry-specific guidance. Upon adoption, a company will recognize revenue for the transfer of goods or services to customers equal to the amount 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; early adoption permitted	Alternative transition methods available	The Company is evaluating the effect on the financial statements, related disclosures and method of adoption. The Company does not expect to early adopt.
Classification of Certain Cash Receipts and Cash Payments on the Statement of	Provided guidance on the presentation and classification in the statement of cash flow for the following cash receipts and payments: (i) debt prepayment or debt extinguishment costs; (ii)	January 1, 2018; early adoption permitted	Retrospective	The Company is evaluating the effect on the Statements of Cash Flows and the timing of adoption.

Cash Flows	settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; (iii) contingent consideration payments made after a business combination; (iv) proceeds from the settlement of insurance claims; (v) proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; (vi) distributions received from equity method investees; (vii) beneficial interests in securitization transactions; and (viii) separately identifiable cash flows and application of the predominance principle.			
Accounting for Leases	Updated the accounting and disclosure guidance for leasing arrangements. Under this guidance, a lessee will be required to recognize the following for all leases, excluding short-term leases, at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the guidance, lessor accounting is largely unchanged.	January 1, 2019; early adoption permitted	Modified retrospective	The Company is evaluating the effect on the financial statements, related disclosures and the timing of adoption.
Measurement of Credit Losses	Updated the accounting guidance on reporting credit losses for financial assets held at amortized cost basis and available-for-sale debt securities. Under this guidance, expected credit losses are required to be measured based on historical experience, current conditions, and reasonable and supportable	January 1, 2020; early adoption permitted	Modified retrospective	The Company is evaluating the effect on the financial statements, related disclosures and the timing of adoption.

	forecasts that affect the collectability of the reported amount of financial assets. Also, this guidance requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a direct write-down.	

Note 3: Acquisitions

During the nine months ended September 30, 2016, the Company incurred $24 in acquisition costs for ten closed acquisitions of various regulated water and wastewater systems. Assets acquired, principally utility plant, totaled $30. Liabilities assumed totaled $17. The Company recorded additional goodwill of $11 associated with two of its acquisitions, which is reported in its Regulated Businesses segment and is expected to be fully deductible for tax purposes. The Company recognized a bargain purchase gain of $1 associated with two of its acquisitions, which was deferred as a regulatory liability. Also, our Regulated Businesses made a non-escrowed deposit of $5 related to the acquisition of the McKeesport, Pennsylvania’s wastewater system.

Note 4: Stockholders' Equity

Accumulated Other Comprehensive Loss

The following table presents changes in accumulated other comprehensive loss by component, net of tax, for the nine months ended September 30, 2016 and 2015, respectively:

	Defined Benefit Plans					Accumulated
	Employee Benefit Plan Funded Status	Amortization of Prior Service Cost	Amortization of Actuarial Loss	Foreign Currency Translation	Loss on Cash Flow Hedges	Other Comprehensive Loss
Beginning balance as of January 1, 2016	$(126)	$ 1	$ 36	$ 2	$ (1)	$ (88)
Other comprehensive loss before reclassifications	—	—	—	—	(15)	(15)
Amounts reclassified from accumulated other comprehensive loss	—	—	4	—	—	4
Net other comprehensive income (loss)	—	—	4	—	(15)	(11)
Ending balance as of September 30, 2016	$(126)	$ 1	$ 40	$ 2	$ (16)	$ (99)
Beginning balance as of January 1, 2015	$(116)	$ 1	$ 31	$ 3	$ (1)	$ (82)
Other comprehensive loss before reclassifications	—	—	—	(1)	—	(1)
Amounts reclassified from accumulated other comprehensive loss	—	—	4	—	—	4
Net other comprehensive income (loss)	—	—	4	(1)	—	3
Ending balance as of September 30, 2015	$(116)	$ 1	$ 35	$ 2	$ (1)	$ (79)

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. These accumulated other comprehensive income (loss) components are included in the computation of net periodic pension cost. (See Note 8)

The amortization of the loss on cash flow hedges is reclassified to net income attributable to common stockholders during the period incurred and is included in interest, net in the accompanying Consolidated Statements of Operations. (See Note 6)

Anti-dilutive Stock Repurchase Program

In February 2015, the Company's Board of Directors authorized an anti-dilutive stock repurchase program, which allowed the Company to purchase up to 10.0 shares of its outstanding common stock over an unrestricted period of time. During the nine months ended September 30, 2016, the Company repurchased 1.0 shares of common stock in the open market at an aggregate cost of $65 under the program. As of September 30, 2016, there were 6.8 shares of common stock available for repurchase under the program.

Note 5: Stock Based Compensation

Stock Options

During the nine months ended September 30, 2016, the Company granted non-qualified stock options to certain employees under the Company's 2007 Omnibus Equity Compensation Plan (the "2007 Plan"). Stock options have a maximum term of seven years, are granted with exercise prices equal to the fair market value of the Company's common stock on the date of grant, vest ratably over a three-year service period beginning January 1 of the year of the grant and generally are subject to the employee's continued employment with the Company. Stock options granted are valued using the Black-Scholes option-pricing model.

The following table presents the weighted-average assumptions used in the Black-Scholes option-pricing model and the resulting weighted-average grant date fair value per share of stock options granted during the nine months ended September 30, 2016:

Dividend yield	2.09 %
Expected volatility	15.89 %
Risk-free interest rate	1.15 %
Expected life (years)	4.0
Exercise price	$ 65.26
Grant date fair value per share	$ 6.61

The grant date fair value is amortized through expense over the requisite service period using the straight-line method. As of September 30, 2016, $2 of total unrecognized compensation cost related to the non-vested stock options is expected to be recognized over the weighted-average period of 1.7 years.

The table below summarizes stock option activity for the nine months ended September 30, 2016:

	Shares (in thousands)	Weighted-Average Exercise Price (per share)	Weighted-Average Remaining Life (years)	Aggregate Intrinsic Value
Options outstanding as of January 1, 2016	1,187	$ 39.70	3.9	$ 24
Granted	341	65.26		
Forfeited or expired	(49)	58.90		
Exercised	(431)	32.85		
Options outstanding as of September 30, 2016	1,048	$ 49.96	4.4	$ 26
Exercisable as of September 30, 2016	491	$ 40.26	3.0	$ 17

The following table summarizes additional information regarding stock options exercised for the nine months ended September 30, 2016 and 2015:

	2016	2015
Intrinsic value	$ 16	$ 16
Exercise proceeds	14	25
Income tax benefit	6	5

Restricted Stock Units ("RSUs")

During the nine months ended September 30, 2016, the Company granted RSUs, both with and without performance conditions, to certain employees and RSUs without performance conditions to non-employee directors under the 2007 Plan. The RSUs without performance conditions generally vest ratably over a three-year service period beginning January 1 of the year of grant and are valued at the market value of the Company's common stock on the date of grant. The RSUs with performance conditions include those with internal performance measures, and separately, certain market thresholds, and vest ratably over a three-year performance period beginning January 1 of the year of 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. The RSUs with internal performance measures are valued at the market value of the Company’s common stock on the date of grant. The RSUs granted with market conditions are valued using the Monte Carlo simulation model.

The following table presents the weighted-average assumptions used in the Monte Carlo simulation model for RSUs with market conditions granted during the nine months ended September 30, 2016:

Expected volatility	15.90	%
Risk-free interest rate	0.91	%
Expected life (years)	3.0	
Grant date fair value per share	$77.16	

12

During 2013, the Company granted selected employees RSUs with performance conditions (the “2013 RSUs”) comprised of internal performance measures and, separately, market thresholds expressed in the form of a relative total shareholder return. An aggregate of 128 thousand of the 2013 RSUs vested in January 2016. The terms of the 2013 RSUs specified that, so long as the participant continued to be employed by the Company during the Performance Period and to the extent the performance conditions were achieved, the RSUs would vest at target; if the performance conditions were surpassed, up to 175% of the target number of shares would be distributed; and to the extent that the performance thresholds were not met, the award would be forfeited. In January 2016, an additional 74 thousand RSUs were granted and immediately vested because performance thresholds associated with the 2013 RSUs were exceeded.

The table below summarizes RSU activity for the nine months ended September 30, 2016:

	Shares (in thousands)	Weighted-Average Grant Date Fair Value (per share)
Non-vested total as of January 1, 2016	436	$ 46.97
Granted	143	69.73
Performance share adjustment	74	39.89
Vested (a)	(251)	42.60
Forfeited	(24)	60.84
Non-vested total as of September 30, 2016	378	$ 56.19

(a) Includes 202 thousand shares related to the 2013 RSUs and 49 thousand shares related to RSUs without performance conditions that vested during the nine months ended September 30, 2016.

The following table summarizes additional information regarding RSUs issued during the nine months ended September 30, 2016 and 2015:

	2016	2015
Intrinsic value	$ 17	$ 17
Income tax benefit	2	2

The grant date fair value of the 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. As of September 30, 2016, $5 of total unrecognized compensation cost related to the non-vested RSUs is expected to be recognized over the weighted-average remaining life of 1.1 years.

Note 6: Long-Term Debt

The following long-term debt was issued during the nine months ended September 30, 2016:

Company	Type	Rate	Maturity	Amount
Other American Water subsidiaries	Private activity bonds and government funded debt—fixed rate	1.36%	2026	$ 2

13

The following long-term debt was retired through sinking fund provisions, optional redemptions or payment at maturity during the nine months ended September 30, 2016:

Company	Type	Rate	Maturity	Amount
American Water Capital Corp. (a)	Private activity bonds and government funded debt—fixed rate	1.79%-2.90%	2021-2031	$ 1
Other American Water subsidiaries	Private activity bonds and government funded debt—fixed rate	0.00%-5.30%	2016-2041	18
Other American Water subsidiaries	Mandatorily redeemable preferred stock	8.49%	2036	1
Total retirements and redemptions				$ 20

(a) American Water Capital Corp., which is a wholly owned subsidiary of the Company, has a support agreement with the Company that, under certain circumstances, is the functional equivalent of a guarantee. This indebtedness is considered "debt" for purposes of this support agreement.

The Company has four forward starting swap agreements with an aggregate notional amount of $300 to reduce interest rate exposure on debt expected to be issued in 2017. The forward starting swap agreements terminate in December 2017 and have an average fixed rate of 2.20%. The Company has designated the forward starting swap agreements as cash flow hedges and the initial fair value, in addition to any subsequent changes in fair value, are recognized in accumulated other comprehensive loss. Upon termination, the cumulative gain or loss recorded in accumulated other comprehensive loss will be amortized through interest, net over the term of the issued debt.

The Company has an interest rate swap to hedge $100 of its 6.085% fixed-rate debt maturing in 2017. The Company pays variable interest of six-month LIBOR plus 3.422% and the interest rate swap matures with the fixed-rate debt in 2017. The Company has designated the interest rate swap as a fair value hedge accounted for at fair value with gains or losses, as well as the offsetting gains or losses on the hedged item, recognized in interest, net. The net loss recognized by the Company was $1 for the three and nine months ended September 30, 2016 and 2015.

The Company has employed interest rate swaps to fix the interest cost on a portion of its variable-rate debt with an aggregate notional amount of $8. The Company has designated these instruments as economic hedges accounted for at fair value with gains or losses recognized in interest, net. The gain recognized by the Company was de minimis for the three and nine months ended September 30, 2016 and 2015.

No ineffectiveness was recognized for the three and nine months ended September 30, 2016 and 2015 related to hedging instruments.

The following table provides a summary of the gross fair value for the Company's derivative asset and liabilities, as well as the location of the asset and liability balances in the Consolidated Balance Sheets:

Derivative Instruments	Derivative Designation	Balance Sheet Classification	September 30, 2016	December 31, 2015
Asset Derivative				
Interest rate swap	Fair value hedge	Other long-term assets	$ 1	$ 2

Liability Derivatives				
Forward starting swaps	Cash flow hedge	Other long-term liabilities	$ 25	$ —
Interest rate swap	Economic hedge (non-designated)	Other long-term liabilities	1	1

Note 7: Income Taxes

During the third quarter the Company reduced its gross liability for unrecognized tax benefits by $68 related to the Company's change in tax accounting method for repair and maintenance costs on its utility plant. This change had no impact on the Company's estimated effective tax rate. Previously established tax positions were netted with net operating losses.

Note 8: Pension and Other Postretirement Benefits

On July 31, 2016, the other postretirement benefit plan was remeasured to reflect an announced plan amendment, which capped benefits for certain non-union plan participants. The remeasurement included a $156 reduction in future benefits payable to plan participants, $60 increase in the fair value of plan assets and $127 increase in actuarial losses, which resulted in a $89 reduction to the net accrued postretirement benefit obligation. The plan amendment will be amortized over 10.02 years, the average future working lifetime to full eligibility age for all plan participants. The following table provides the significant assumptions related to the Company's other postretirement benefit plan:

	September 30, 2016	December 31, 2015
Weighted-average assumptions used to determine benefit obligations		
Discount rate	3.66%	4.67%
Expected return on plan assets	5.37%	5.20%
Medical trend	6.50% in 2016 and graded from 7.00% in 2017 to 5.00% in 2021+	graded from 6.50% in 2015 to 5.00% in 2021+

The following table provides the components of net periodic benefit costs:

	For the Three Months Ended September 30, 2016	2015	For the Nine Months Ended September 30, 2016	2015
Components of net periodic pension benefit cost				
Service cost	$8	$9	$24	$28
Interest cost	20	19	60	56
Expected return on plan assets	(24)	(24)	(72)	(73)
Amortization of actuarial loss	7	6	21	19
Net periodic pension benefit cost	$11	$10	$33	$30
Components of net periodic other postretirement benefit cost				
Service cost	$3	$3	$9	$10

Interest cost	7	7	22	22
Expected return on plan assets	(7)	(6)	(20)	(19)
Amortization of prior service credit	(3)	—	(4)	(1)
Amortization of actuarial loss	1	1	3	4
Net periodic other postretirement benefit cost	$1	$5	$10	$16

The Company contributed $25 to its defined benefit pension plans in the first nine months of 2016 and expects to contribute $8 during the remainder of 2016. In addition, the Company contributed $17 for the funding of its other postretirement plans in the first nine months of 2016 and does not expect to make any additional contributions during the remainder of 2016.

Note 9: Commitments and Contingencies

Commitments

On March 29, 2016, Pennsylvania-American Water Company (“PAWC”) entered into an asset purchase agreement with the Sewer Authority of the City of Scranton (“SSA”) to acquire substantially all of the wastewater collection and treatment system assets of the SSA’s system for a total stated purchase price of $195, which includes approximately $38 in assumed cash to be transferred at closing. The SSA is currently subject to a consent decree with the U.S. Environmental Protection Agency (“EPA”) and the Pennsylvania Department of Environmental Protection (“PaDEP”), which requires the SSA to complete significant upgrades to its sewer system at an estimated cost of $140. As a part of the purchase, PAWC will be required to cause the consent decree to be amended to allow it to assume the obligations and liabilities of the SSA thereunder. The Pennsylvania Public Utility Commission approved the acquisition on October 6, 2016 and will determine recovery of the investment and the related ratemaking treatment in PAWC’s next general rate case proceeding. The amendment of the consent decree is subject to the consent of the EPA, PaDEP, the U.S. Department of Justice and the U.S. District Court for the Middle District of Pennsylvania. The Company is working to close this transaction in the fourth quarter of 2016.

Contingencies

The Company is routinely involved in legal actions in the normal conduct of its business. As of September 30, 2016, the Company has accrued approximately $136 of probable loss contingencies and has estimated that the maximum amount of losses associated with reasonably possible loss contingencies is $48. For certain matters, the Company is unable to estimate possible losses.

West Virginia Elk River Freedom Industries Chemical Spill

Background

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") Kanawha Valley Treatment Plant ("KVTP") intake in Charleston, West Virginia. After having been alerted to the leak of MCHM by the West Virginia Department of Environmental Protection, 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 KVTP. 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 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 73 pending cases against WVAWC with respect to this matter in the U.S. 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, and, as discussed below, on September 16, 2016, four new individual complaints were filed against WVAWC in West Virginia Circuit Court in Kanawha County.

Additionally, investigations with respect to the matter have been initiated by, among other agencies, 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.

The Company believes that the causes of action asserted against the American Water Defendants in these cases are without merit. A summary of the proceedings associated with the Freedom chemical spill is set forth below.

Federal Court Litigation

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 chemical 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 the 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 chemical spill.

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 Company, the manufacturer of MCHM, 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 originally entered a scheduling order that provided 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. On March 25, 2016, the court in the Federal action entered an order extending the schedule for events through briefing related to dispositive motions and expert challenges and noting that further events in the case would be set by additional orders to be issued by the court in due course. On May 10, 2016, each of the parties in the Federal action filed motions for summary judgment and motions to exclude experts, followed by responses on June 3, 2016 and final reply memoranda on June 16, 2016. On July 7, 2016, the court in the Federal action rescheduled the trial to begin on October 25, 2016, but the court delayed the start of the trial pending ongoing settlement negotiations between the parties, and has since granted a continuance of the trial until December 5, 2016. See " – WVAWC Binding Global Agreement in Principle to Settle Claims" below.

Court-directed mediations were held at the end of September 2015 and June 2016 with the assistance of private mediators. Representatives of the American Water Defendants, Eastman Chemical, and the plaintiffs in both the Federal action and the state actions, as well as insurance carriers for certain of the defendants, participated in these mediation sessions. No resolution was reached.

On September 26, 2016, the court in the Federal action granted the Company's motion for summary judgment and its renewed motion to dismiss all claims against it for lack of personal jurisdiction. The court in the Federal action examined the factual claims asserted by the plaintiffs and held that the plaintiffs failed to provide any evidence that the Company committed a tortious act in connection with the Freedom Industries chemical spill. Also, the court in the Federal action held that it had no personal jurisdiction over the Company, since there was no evidence of a tortious act, and the relationship between the Company and WVAWC was that of a typical parent and subsidiary. As a result of this decision, the Company is no longer a defendant in the Federal action, although the plaintiffs' claims against AWWSC and WVAWC remain.

On September 27, 2016, the court in the Federal action denied competing motions filed by the plaintiffs and WVAWC for summary judgment on the plaintiffs' breach of contract claims against WVAWC. The court in the Federal action stated that the implementation of the Do Not Use order and the delivery of water containing MCHM subject to such an order constituted a breach of WVAWC's contract with customers. However, the court denied the plaintiffs' motion for summary judgment because the court identified genuine issues of fact to be decided by a jury with respect to WVAWC's assertion that its contractual performance was impracticable due to the lack of available information as to the contaminants in the water after the Freedom Industries chemical spill, the unexpected nature of Freedom Industries' criminal negligence and the resulting contamination of the water supply, and WVAWC's lack of fault for Freedom Industries' actions in causing the chemical spill.

On October 6, 2016, the court in the Federal action granted the American Water Defendants' motion for summary judgment related to the members of the class comprised of hourly employees who worked for businesses served by the KVTP on January 9, 2014. The court stated that these class members, who were not customers of WVAWC, did not have a "sufficiently close nexus" to WVAWC to give rise to a "special relationship" that would allow them to recover lost wages absent physical injury or property damage. This ruling does not impact the remaining class members.

On October 25, 2016, the court in the Federal action dismissed all claims against AWWSC, leaving WVAWC as the remaining American Water Defendant in the lawsuit.

West Virginia State Court Litigation

On January 28, 2016, all of the then-filed state court cases were referred to West Virginia's Mass Litigation Panel for further proceedings. On June 6, 2016, plaintiffs filed a second amended consolidated class action complaint. The second amended consolidated class action complaint names only WVAWC as a defendant and alleges claims of, among other things, negligence, public and private nuisance, trespass, strict liability for abnormally dangerous activity, breach of contract, breach of statutory implied warranty, violation of the West Virginia Consumer Credit Protection Act, strict liability for failure to warn, negligent infliction of emotional distress, medical monitoring and punitive damages. On July 6, 2016, the defendants filed an answer in response to these claims. On July 25, 2016, plaintiffs filed a class certification motion seeking certification for liability and damage classes, including businesses and residents who were customers of the KVTP on January 9, 2014, all West Virginia persons who suffered wage loss as a result of the Freedom Industries chemical spill and personal injury and medical monitoring for West Virginia residents within the affected counties that were exposed to contaminated water as a result of the chemical spill.

On September 14, 2016, WVAWC filed a motion to dismiss the second amended consolidated class action complaint. On September 16, 2016, four new individual complaints were filed in West Virginia Circuit Court in Kanawha County stating the same claims as in the second amended consolidated class action complaint but also seeking a judicial determination as to whether the American Water Defendants and Eastman Chemical have insurance coverage under their respective policies for the claims asserted in the complaints. Plaintiffs have also sought to transfer these complaints to the Mass Litigation Panel. The complaints include as defendants all of the insurance carriers identified by Eastman Chemical and the American Water Defendants. West Virginia law generally permits plaintiffs in civil litigation to seek a determination as to whether insurance coverage exists for claims prior to trial on the merits. The American Water Defendants are currently analyzing and considering their responses to the allegations and claims raised in these four complaints.

WVAWC Binding Global Agreement in Principle to Settle Claims

On October 31, 2016, the court in the Federal action approved the preliminary principles, terms and conditions of an agreed-upon settlement of claims (the "Settlement") among the American Water Defendants, and all class members, putative class members, claimants and potential claimants (collectively, the "Plaintiffs"), arising out of the Freedom Industries chemical spill. The terms of the Settlement propose a global federal and state resolution of all litigation and potential claims against the American Water Defendants and their insurers. A claimant may elect to opt out of any final settlement agreement, in which case such claimant will not receive any benefit from or be bound by the terms of the Settlement. Under the terms and conditions of the Settlement and any subsequent final settlement agreement, the American Water Defendants have not admitted, and will not admit, any fault or liability for any of the allegations made by the Plaintiffs in any of the actions to be resolved.

The proposed aggregate pre-tax amount of the Settlement is $126, of which $65 would be paid by WVAWC, and the remainder would be paid by certain of the Company's general liability insurance carriers. The Company has general liability insurance under a series of policies underwritten by a number of individual carriers. Two of these insurance carriers, which provide an aggregate of $50 in insurance coverage to the Company under these policies, were requested, but presently have not agreed, to participate in the Settlement. The Company and WVAWC intend to vigorously pursue their rights to insurance coverage from these non-participating carriers for any losses to be paid by WVAWC in the Settlement. In this regard, WVAWC has filed a lawsuit against one of these carriers alleging that the carrier's failure to agree to participate in the Settlement constitutes a breach of contract, and the Company will pursue mandatory arbitration against the other non-participating carrier.

As a result of these events, WVAWC has determined that a loss contingency with respect to this matter is probable and in the third quarter of 2016 recorded a charge to earnings of $65 ($39 after-tax), comprised of the aggregate pre-tax settlement amount of $126, net of insurance receivables of $61. Furthermore, under the terms of the Settlement, WVAWC has agreed that it will not seek rate recovery from the Public Service Commission of West Virginia for approximately $4 in direct response costs expensed in 2014 by WVAWC relating to the Freedom Industries chemical spill as well as for amounts that may be paid by WVAWC under the Settlement.

The preliminary terms of the Settlement intend to establish a two-tier settlement fund for the payment of claims, comprised of (i) a guaranteed fund of $76, of which $51 will be contributed by WVAWC, including insurance deductibles, and $25 would be contributed by one of the Company's general liability insurance carriers, and (ii) a claims-based payment fund of up to $50, of which up to $14 would be contributed by WVAWC and $36 would be contributed by a number of the Company's general liability insurance carriers. Separately, $25 would be contributed to the guaranteed fund through a settlement by another defendant to the Settlement.

The Company's insurance policies operate under a layered structure where coverage is generally provided in the upper layers after claims have exhausted lower layers of coverage. The $36 contributed by a number of the Company's general liability insurance carriers to the claims-based fund, as noted above, were from higher layers of the insurance structure than the two insurance carriers that were requested, but presently have not agreed, to participate in the Settlement. Any recovery by WVAWC or the Company from the non-participating carriers would reimburse WVAWC for its contributions to the guaranteed fund.

The court in the Federal action has given the parties 30 days to finalize, and obtain the court's preliminary approval of, the terms of the Settlement. As a result, the court in the Federal action has ordered a continuance of the trial date to December 5, 2016. If preliminary approval of the Settlement is obtained, notice of the terms of the Settlement would then be provided to members of the settlement class. Following the notice period, the court in the Federal action would hold a fairness hearing to consider final approval of the Settlement.

PSC General Investigation

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 chemical 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 Freedom Industries chemical spill and is subject to discovery from PSC staff and the intervenors as part of the General Investigation. Several disputes have arisen between 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 chemical spill, and WVAWC has asserted that some of the testimony is outside the scope of the PSC proceeding. On May 23, 2016, the PSC entered an order setting a procedural schedule and ruling on outstanding motions related to discovery and the scope of testimony. On October 13, 2016, the PSC entered an order continuing the General Investigation hearings until December 2016. On October 18, 2016, an intervening party in the case requested, with no parties objecting, that the hearings be further continued until the first quarter of 2017.

Missouri Infrastructure System Replacement Surcharge Litigation

On March 8, 2016, the Western District of the Missouri Court of Appeals ruled that the Missouri Public Service Commission ("MoPSC") did not have statutory authority to issue an order in June 2015 approving an infrastructure system replacement surcharge ("ISRS") for Missouri-American Water Company ("MAWC"), a wholly owned subsidiary of the Company. The court held that the MoPSC's June 2015 order authorizing the ISRS increase was invalid because St. Louis County did not have a population of at least one million residents, as required by the statute. MAWC believes that the MoPSC's June 2015 order authorizing the collection of ISRS revenues was lawful and will continue to challenge the ruling of the Court of Appeals. On June 28, 2016, the Missouri Supreme Court granted MAWC's application to transfer the case from the Court of Appeals to the Missouri Supreme Court, and as a result of that order, the March 8, 2016 ruling of the Court of Appeals has been vacated. Oral argument in this case was heard on November 1, 2016. As of September 30, 2016, the Company has determined the range of reasonably possible loss associated with this matter to be zero to $26.

Other than as described in the “Contingencies” subsection of this Note 9, the Company believes that damages or settlements to be paid by the Company, if any, in claims or actions will not, individually or in the aggregate, have a material adverse effect on the Company.

Note 10: 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 Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator				
Net income attributable to common stockholders	$148	$174	$367	$377
Denominator				
Weighted-average common shares outstanding—Basic	178	179	178	179
Effect of dilutive common stock equivalents	—	1	1	1
Weighted-average common shares outstanding—Diluted	178	180	179	180

The effect of dilutive common stock equivalents is related to the RSUs and non-qualified stock options granted under the 2007 Plan, and shares purchased under the Company’s Nonqualified Employee Stock Purchase Plan.

Note 11: Fair Value of Financial Assets and Liabilities

Fair Value of Financial Instruments

The Company used the following methods and assumptions to estimate its fair value disclosures for financial instruments:

Current assets and current liabilities—The carrying amounts reported in the accompanying 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 portion 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: (i) an average of the Company's own publicly-traded debt securities and (ii) 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	At Fair Value as of September 30, 2016			
		Level 1	Level 2	Level 3	Total
Preferred stock with mandatory redemption requirements	$ 12	$—	$—	$ 18	$ 18
Long-term debt (excluding capital lease obligations)	5,893	3,609	1,441	1,978	7,028

	Carrying Amount	At Fair Value as of 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

Recurring Fair Value Measurements

The following table presents assets and liabilities measured and recorded at fair value on a recurring basis and their level in the fair value hierarchy:

	At Fair Value as of September 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets:				
Restricted funds	$28	$—	$ —	$ 28
Rabbi trust investments	13	—	—	13
Deposits	4	—	—	4
Mark-to-market derivative asset	—	1	—	1
Other investments	4	—	—	4
Total assets	49	1	—	50
Liabilities:				
Deferred compensation obligation	13	—	—	13
Mark-to-market derivative liabilities	—	26	—	26
Total liabilities	13	26	—	39
Total net assets (liabilities)	$36	$(25)	$ —	$ 11

	At Fair Value as of 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

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 $4 were included in other long-term assets as of September 30, 2016 and

December 31, 2015.

Rabbi trust investments—The Company's rabbi trust investments consist primarily of equity and fixed income indexed 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 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 and forward starting interest rate swaps, classified as economic hedges and cash flow hedges, respectively, in order to fix the interest cost on existing or forecasted 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. The Company includes the mark-to-market derivative assets and liability in other long-term assets and other long-term liabilities, respectively.

Other investments—Other investments primarily represent money market funds used for active employee benefits. The Company includes other investments in other current assets.

Note 12: Segment Information

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 are collectively presented as our "Market-Based Businesses". "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 acquisitions that have not been allocated to the operating segments for evaluation of performance and allocation of resource purposes. The following tables include the Company's summarized segment information:

	As of or for the Three Months Ended September 30, 2016			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated
Operating revenues	$826	$ 109	$(5)	$ 930
Depreciation and amortization	111	4	4	119
Total operating expenses, net	521	98	(8)	611
Interest, net	(64)	—	(17)	(81)
Income from continuing operations before income taxes	246	12	(15)	243
Provision for income taxes	94	5	(4)	95
Net income attributable to common stockholders	152	7	(11)	148
Total assets	16,020	545	1,406	17,971

	As of or for the Three Months Ended September 30, 2015			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated

Operating revenues	$781	$ 121	$(6)	$ 896
Depreciation and amortization	104	2	5	111
Total operating expenses, net	439	101	(5)	535
Interest, net	(63)	—	(14)	(77)
Income from continuing operations before income taxes	283	20	(16)	287
Provision for income taxes	109	8	(4)	113
Net income attributable to common stockholders	174	12	(12)	174
Total assets (a)	15,091	498	1,396	16,985

	As of or for the Nine Months Ended September 30, 2016			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated
Operating revenues	$2,176	$ 338	$(14)	$ 2,500
Depreciation and amortization	328	11	11	350
Total operating expenses, net	1,385	300	(17)	1,668
Interest, net	(191)	1	(52)	(242)
Income from continuing operations before income taxes	610	44	(50)	604
Provision for income taxes	236	18	(17)	237
Net income attributable to common stockholders	374	26	(33)	367
Total assets	16,020	545	1,406	17,971

	As of or for the Nine Months Ended September 30, 2015			
	Regulated Businesses	Market-Based Businesses	Other	Consolidated
Operating revenues	$2,083	$ 308	$(15)	$ 2,376
Depreciation and amortization	306	4	17	327
Total operating expenses, net	1,291	260	(18)	1,533
Interest, net	(185)	1	(44)	(228)
Income from continuing operations before income taxes	616	50	(42)	624
Provision for income taxes	239	19	(11)	247
Net income attributable to common stockholders	377	31	(31)	377
Total assets (a)	15,091	498	1,396	16,985

(a) 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, which were early adopted in 2015.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read together with the unaudited consolidated financial statements and the notes thereto included elsewhere in this Form 10-Q. 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-Q should be read as applying to all related forward-looking statements whenever they appear in this Form 10-Q. Our actual results may differ materially from those currently anticipated and expressed in such forward-looking statements as result of a number of factors, including those we discuss under "Forward Looking Statements," Part II, Item 1A—Risk Factors, and elsewhere in this Form 10-Q.

General

American Water Works Company, Inc. ("American Water" or the "Company") 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 revenue and population served. Our primary business involves the ownership of water and wastewater utilities that provide water and wastewater services to residential, commercial, industrial and other customers. Our utilities are generally subject to economic regulation by state regulatory agencies in the states in which they operate. We report the financial results of our utilities in our Regulated Businesses segment. We also provide other services through businesses that are not subject to economic regulation by state regulatory agencies. We present the results of these businesses as our "Market-Based Businesses". For further description of our businesses, see Part I, Item 1—Business in our Form 10-K.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this Form 10-Q and in our Form 10-K.

Financial Results

Income attributable to common stockholders was $148 million, or $0.83 per diluted share for the third quarter of 2016, a decrease of 13.5%, over the same period in 2015. For the nine months ended September 30, 2016, income attributable to common stockholders was $367 million, or $2.05 per diluted share, a decrease of 1.9%, over the same period in 2015.

Included in both the quarter and year-to-date was an after-tax charge of $39 million, or $0.22 per diluted share. This after-tax charge resulted from the binding global agreement in principle as to settlement for claims arising out of the January 9, 2014 Freedom Industries, Inc. chemical spill, which was entered into on October 31, 2016. See Note 9—Commitments and Contingencies in the Notes to Consolidated Financial Statements included in Part I, Item 1—Consolidated Financial Statements and Part II, Item 1—Legal Proceedings in this Form 10-Q.

Excluding the impact from this binding global agreement, we continued to experience growth in our Regulated Businesses segment from additional authorized revenue from investment growth, acquisitions and organic growth, partially offset by lower net income in our Market-Based Businesses for both the quarter and year-to-date periods. The lower net income in the Market-Based Businesses was mainly from lower capital upgrade revenue in our Military Services Group compared to the prior year due to the completion of certain large projects in mid-2016 and reduced military base infrastructure budgets in 2016.

See "Comparison of Consolidated Results of Operations" and "Segment Results of Operations" below for further discussion on the consolidated results of operations, as well as our business segments.

24

Focusing on Central Themes

For 2016, our focus continues to be anchored on our five central themes: 1) Safety, 2) Customers, 3) People, 4) Growth and 5) Technology and Operational Efficiency. We continue our focus on operating our business responsibly and managing our operating and capital costs in a manner that benefits our customers and produces long-term value for our stockholders. Additionally, we continue to execute on our ongoing strategy that ensures a safe workplace for our employees, emphasizes public safety for our customers and communities, and leverages our human resources, processes and technology innovation to make our business more effective and efficient. The progress that we have made in the first nine months of 2016 with respect to growth and improvement in our operational efficiency ratio is described below.

Growth—Infrastructure improvements, acquisitions and strategic capital investments

During the first nine months of 2016, we made capital investments of approximately $905 million, focused in two key areas:

- $876 million of which the majority was in our Regulated Businesses primarily to improve infrastructure; and
- $29 million for acquisitions in our Regulated Businesses, which added approximately 7,600 water and wastewater customers.

For the full year of 2016, our total capital investment, including acquisitions, is expected to be in the range of $1.4 billion to $1.5 billion, most of which is allocated to improving infrastructure in our Regulated Businesses. Included in this range is the proposed acquisition by Pennsylvania-American Water Company (“PAWC”) of substantially all of the wastewater collection and treatment assets of the Sewer Authority of the City of Scranton (“SSA”). The SSA currently serves approximately 31,000 wastewater customers in the City of Scranton and Dunmore Borough, Pennsylvania. On October 6, 2016, the Pennsylvania Public Utility Commission (the “PaPUC”) approved the acquisition, and will determine recovery of the investment and related ratemaking treatment in PAWC’s next general rate case proceeding. Closing of the transaction remains subject the approvals of the U.S. Environmental Protection Agency, the Pennsylvania Department of Environmental Protection, the U.S. Department of Justice and the U.S. District Court for the Middle District of Pennsylvania. We are working to close this transaction in the fourth quarter of 2016.

On August 2, 2016, we agreed to acquire all of the capital stock of Shorelands Water Company (“Shorelands”) in exchange for an equivalent value of our common stock. The maximum number of shares of our common stock to be exchanged upon closing of this acquisition will be less than 500,000 and will be based upon the average price of our common stock. Shorelands currently provides water service to approximately 11,000 customers in Monmouth County, New Jersey. The closing of this acquisition is subject to the satisfaction of various conditions and compliance by the parties with certain covenants, including obtaining the approval of the New Jersey Board of Public Utilities. The Company is seeking to close the acquisition in the first half of 2017.

On September 9, 2016, PAWC signed an asset purchase agreement to acquire substantially all of the wastewater collection and treatment system assets of the Municipal Authority of the City of McKeesport, Pennsylvania for approximately $156 million, subject to certain adjustments provided in the agreement. The closing of this acquisition is subject to the satisfaction of various conditions and covenants, including obtaining the approval of the PaPUC. In connection with the execution of the asset purchase agreement, PAWC made a $5 million non-escrowed deposit to the seller and agreed to pay upon the seller’s request an additional $2 million as a similar deposit, on or about January 2, 2017. The system currently represents approximately 22,000 wastewater customers. We are seeking to close this acquisition in the first quarter of 2017.

Technology & Operational Efficiency—Continuing Improvement in Adjusted O&M Efficiency Ratio for our Regulated Businesses

We continued to improve on our adjusted O&M efficiency ratio (a non-GAAP measure). Our adjusted O&M efficiency ratio for the twelve months ended September 30, 2016 was 34.9%, compared to 35.8% for the twelve months ended September 30, 2015. The improvement in the 2016 O&M efficiency ratio over this period was attributable to an increase in revenue and the timing of O&M expenses, as we expect higher O&M expenses in the fourth quarter of 2016.

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 adjusted O&M efficiency ratio is defined as our regulated O&M expense divided by regulated operating revenues, where both O&M expense and operating revenues were adjusted to eliminate purchased water expenses. Additionally, from the O&M expenses, we excluded the allocable portion of non-O&M support services expenses, mainly depreciation and general taxes that are reflected in the Regulated Businesses segment as O&M costs but for consolidated financial reporting purposes are categorized within other line items in the accompanying Consolidated Statement of Operations, as well as the impacts of the binding global agreement to settle the Freedom Industries chemical spill claims.

The following table provides the calculation and reconciliation that compares O&M and operating revenues, as determined in accordance with GAAP, to those amounts utilized in the calculation of our adjusted O&M efficiency ratio for the twelve months ended September 30, 2016 as compared to the same period in 2015.

	For the Twelve Months Ended September 30,					
(In millions)	2016			2015		
Total operation and maintenance expenses	$	1,511		$	1,369	
Less:						
Operation and maintenance expenses—Market-Based Businesses		391			337	
Operation and maintenance expenses—Other		(42	)		(53	)
Total operation and maintenance expenses—Regulated Businesses		1,162			1,085	
Less:						
Regulated purchased water expenses		120			118	
Allocation of non-operation and maintenance expenses		29			37	
Impacts of the binding global agreement in principle		65			—	
Adjusted operation and maintenance expenses—Regulated Businesses (a)	$	948		$	930	
Total operating revenues	$	3,283		$	3,108	
Less:						
Operating revenues—Market-Based Businesses		464			409	
Operating revenues—Other		(17	)		(19	)
Total regulated operating revenues—Regulated Businesses		2,836			2,718	
Less:						
		120			118	

Regulated purchased water revenues*						
Adjusted operating revenues—Regulated Businesses (b)	$	2,716		$	2,600	
Adjusted operation and maintenance efficiency ratio—Regulated Businesses (a)/(b)		34.9	%		35.8	%

*Calculation assumes purchased water revenues approximate purchased water expenses.

26

Regulatory Matters

The table below provides rate authorizations by state, which became effective during the three and nine months ended September 30, 2016. The table depicts annualized incremental revenues resulting from general rate cases, assuming a constant water sales volume, and infrastructure surcharge mechanisms that became effective during the periods:

(In millions)	For the Three Months Ended September 30, 2016	For the Nine Months Ended September 30, 2016
General rate cases by state:		
Kentucky (August 28)	$ 7	$ 7
Missouri (July 20 & July 22)	5	5
West Virginia (February 25)	—	18
California (January 1)	—	2
Indiana (January 29)	—	2
Total general rate cases	$ 12	$ 34
Infrastructure surcharges by state:		
Pennsylvania (January 1, April 1 & July 1)	$ 6	$ 19
Illinois (January 1 & August 1)	6	7
New Jersey (June 1)	—	9
Indiana (May 4)	—	3
Tennessee (March 15)	—	2
Total infrastructure surcharges	$ 12	$ 40

Interim Rates Subject to Refund

On April 1, 2016, our Virginia subsidiary implemented interim rates under bond and subject to refund, resulting in additional annualized revenues of $9 million.

On May 9, 2016, $2 million in additional annualized revenues of the $5 million requested in our Iowa rate case, which was filed in April 2016, were also put into effect as interim rates under bond and subject to refund.

Pending and Filed Rate Cases

On July 1, 2016, our California subsidiary filed a general rate case requesting to increase revenues by $51 million over three years. This increase includes additional annualized revenue of $35 million, which is expected to become effective on January 1, 2018 as well as a step rate and attrition rate increase of $8 million in both 2019 and 2020.

On October 14, 2016, our New Jersey subsidiary filed for an infrastructure surcharge requesting additional revenues of $10 million.

As of November 2, 2016, including the California filing discussed above, we are awaiting final general rate case orders in five states, requesting additional annualized revenue of $97 million. We are also awaiting approval from two states, including the New Jersey filing discussed above, for additional annualized surcharges of $13 million. There is no assurance that all or any portion of these requests will be granted.

Infrastructure Surcharge Effective After Quarter Close

Additional annualized revenue of $9 million resulting from infrastructure surcharges in our Pennsylvania subsidiary became effective on October 1, 2016.

Consolidated Results of Operations

(In millions)	For the Three Months Ended September 30, 2016	2015	Increase (Decrease)	%	For the Nine Months Ended September 30, 2016	2015	Increase (Decrease)	%
Operating revenues	$930	$896	$34	3.8	$2,500	$2,376	$124	5.2
Operating expenses:								
Operation and maintenance	432	364	68	18.7	1,131	1,024	107	10.4
Depreciation and amortization	119	111	8	7.2	350	327	23	7.0
General taxes	65	60	5	8.3	195	184	11	6.0
Gain on asset dispositions and purchases	(5)	—	(5)	—	(8)	(2)	(6)	300.0
Total operating expenses, net	611	535	76	14.2	1,668	1,533	135	8.8
Operating income	319	361	(42)	(11.6)	832	843	(11)	(1.3)
Other income (expenses):								
Interest, net	(81)	(77)	(4)	5.2	(242)	(228)	(14)	6.1
Other, net	5	3	2	66.7	14	9	5	55.6
Total other income (expenses)	(76)	(74)	(2)	2.7	(228)	(219)	(9)	4.1
Income from continuing operations before income taxes	243	287	(44)	(15.3)	604	624	(20)	(3.2)
Provision for income taxes	95	113	(18)	(15.9)	237	247	(10)	(4.0)
Net income attributable to common stockholders	$148	$174	$(26)	(14.9)	$367	$377	$(10)	(2.7)

Comparison of Consolidated Results of Operations

Operating revenues. For the three months ended September 30, 2016, operating revenues increased primarily due to a:

- $45 million increase in our Regulated Businesses segment primarily due to authorized rate increases to fund investment growth, acquisitions and organic growth when compared to the same period in 2015; and
- $12 million decrease in our Market-Based Businesses primarily due to lower revenue from capital upgrade projects in our Military Services Group due to the completion of certain large projects in mid-2016 and reduced military base infrastructure budgets in 2016. Partially offsetting this decrease were incremental revenues from our Homeowner Services and Contract Operations Groups.

For the nine months ended September 30, 2016, operating revenues increased primarily due to a:

- $93 million increase in our Regulated Businesses segment due to authorized rate increases to fund investment growth, acquisitions, organic growth and incremental revenues from surcharges and balancing accounts when compared to the same period in 2015; and
- $30 million increase in our Market-Based Businesses with the majority attributable to our acquisition of Keystone Clearwater Solutions LLC, (“Keystone”) in the third quarter of 2015, and incremental revenues from our Homeowner Services and Contract Operations Groups; partially offset by a decrease in our Military Services Group revenues.

Operation and maintenance. For the three months ended September 30, 2016, operation and maintenance expense increased compared to the same period last year, primarily due to a:

- $65 million charge in our Regulated Businesses attributable to the binding global agreement in principle as to settlement of claims arising out of the Freedom Industries chemical spill in West Virginia; and
- $8 million increase in our Regulated Businesses operation and maintenance expenses, including a $5 million write-off related to timekeeping system costs that were capitalized under construction work in process; partially offset by a
- $6 million of lower expenses in our Market-Based Businesses due to lower capital upgrades in our Military Services Group corresponding with the decreased revenue; partially offset by higher expenses related to growth in our Homeowner Services Group and Contract Operations Groups.

For the nine months ended September 30, 2016, operation and maintenance expense increased primarily due to a:

- $65 million charge in our Regulated Businesses attributable to the binding global agreement in principle as to settlement of claims associated with the Freedom Industries chemical spill in West Virginia;
- $33 million increase in our Market-Based Businesses with $17 million attributable to the acquisition of Keystone and the remaining $16 million primarily due to incremental costs in our Homeowner Services Group and Contract Operations Group corresponding with the increases in operating revenues discussed above; and
- $6 million increase in our Regulated Businesses operations and maintenance expenses principally due to higher employee-related costs, including higher medical and prescription drug group insurance costs of $7 million and the write-off related to timekeeping system costs discussed above, partially offset by lower insurance claims and uncollectible accounts expense.

Depreciation and amortization. For the three and nine months ended September 30, 2016, depreciation and amortization expense increased primarily as a result of additional utility plant placed in service. Also, included in the nine months ended September 30, 2016 is incremental depreciation and amortization expense in 2016 resulting from the acquisition of Keystone in the third quarter of 2015.

General Taxes. For the three and nine months ended September 30, 2016, general taxes increased primarily as a result of higher gross receipts taxes in our Regulated Businesses segment.

Other income (expenses). For the three and nine months ended September 30, 2016, other expenses increased principally due to an increase in interest expense from the issuance of incremental long-term debt in the last six months of 2015. Partially offsetting the increase in interest expense for the nine months ended September 30, 2016, were proceeds from the settlement of a contract dispute in our Market-Based Businesses and a favorable outcome associated with the finalization of the Missouri rate case, both of which were recognized in the second quarter of 2016.

Segment Results of Operations

Our segments are determined based on how we assess our performance and allocate our resources. We evaluate the performance of our segments and allocate resources based on several factors, with the primary measure being net income attributable to common stockholders.

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 include four operating segments that individually do not meet the criteria of a reportable segment. These four non-reportable segments are presented as our “Market-Based Businesses”.

Regulated Businesses Segment

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

	For the Three Months Ended September 30,	For the Nine Months Ended September 30,

(In millions)	2016	2015	Increase (Decrease)	%	2016	2015	Increase (Decrease)	%
Operating revenues	$826	$781	$45	5.8	$2,176	$2,083	$93	4.5
Operation and maintenance	350	277	73	26.4	881	814	67	8.2
Total operating expenses, net	521	439	82	18.7	1,385	1,291	94	7.3
Net income attributable to common stockholders	152	174	(22)	(12.6)	374	377	(3)	(0.8)

29

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

For the Three Months Ended September 30, &nbs