

DIRECT TESTIMONY
OF
ROCHELLE PHIPPS

FINANCE DEPARTMENT
FINANCIAL ANALYSIS DIVISION
ILLINOIS COMMERCE COMMISSION

AQUA ILLINOIS, INC.

PETITION FOR THE ISSUANCE OF A CERTIFICATE OF PUBLIC CONVENIENCE
AND NECESSITY TO OPERATE A WATER SUPPLY AND DISTRIBUTION SYSTEM
IN CHAMPAIGN COUNTY, ILLINOIS; AND FOR THE ISSUANCE OF AN ORDER
APPROVING RATES, ACCOUNTING ENTRIES AND TARIFF LANGUAGE

DOCKET NO. 04-0362

DECEMBER 10, 2004

1 **1. Q. Please state your name and business address.**

2 A. My name is Rochelle Phipps. My business address is 527 East Capitol
3 Avenue, Springfield, Illinois 62701.

4 **2. Q. By whom are you employed and in what capacity?**

5 A. I am employed by the Illinois Commerce Commission (“Commission”) as a
6 Senior Financial Analyst with the Finance Department of the Financial
7 Analysis Division.

8 **3. Q. Describe your qualifications and background.**

9 A. In May 1998, I received a Bachelor of Arts degree in Finance from Illinois
10 College, Jacksonville, Illinois. In May 2000, I received a Master of
11 Business Administration degree from the University of Illinois at
12 Springfield. I have been employed by the Commission since June 2000.

13 **4. Q. What is the purpose of your testimony in this proceeding?**

14 A. Pursuant to Section 8-406(b) of the Illinois Public Utilities Act (“Act”), for
15 the Commission to determine that proposed construction will promote the
16 public convenience and necessity, a utility must satisfy three criteria. I will
17 present my evaluation of Aqua Illinois, Inc.’s (“Aqua”) financial ability to
18 construct, operate and maintain a water supply and distribution system
19 (“Water System”) for the Village of Philo (“Village”) pursuant to Section

20 8-406(b)(3) of the Act. Further, since Staff witness William Marr testifies
21 that Illinois-American Water Company (“IAWC”) might actually be the
22 least-cost provide of water service to the Village,¹ I also evaluated IAWC’s
23 financial ability to construct, operate and maintain the Water System for
24 the Village pursuant to Section 8-406(b)(3) of the Act.

25 **5. Q. Please summarize your conclusions.**

26 A. The estimated cost of construction for both Aqua and IAWC is diminutive
27 in relation to the respective utility’s financial resources. Thus, in my
28 judgment, both Aqua and IAWC have the financial ability to construct,
29 operate and maintain the Water System for the Village.

30 **6. Q. What are the requirements of Section 8-406(b)(3) of the Act?**

31 A. Section 8-406(b)(3) of the Act requires the Commission to determine that
32 the proposed construction will promote the public convenience and
33 necessity only if a utility demonstrates that it is capable of financing the
34 proposed construction without significant adverse financial consequences
35 for the utility or its customers.²

36 **AQUA ILLINOIS, INC.**

37 **7. Q. Describe the proposed construction and estimated cost for Aqua.**

¹ ICC Staff Exhibit 1.0, p. 6.

² 220 ILCS 5/8-406(b)(3).

38 A. Pursuant to an Agreement that was provided as Exhibit A to Aqua's
39 Petition, Aqua will purchase and use the Water System that serves the
40 Village for a purchase price of \$425,000.³ Aqua will also incur
41 transaction-related expenses (i.e., inspection and engineering, legal costs
42 and fees due to GPM Associates) totaling \$32,500,⁴ and transaction fees
43 due to the Village upon closing totaling \$42,500.⁵ Pursuant to the
44 Agreement, Aqua commits to making various capital improvements to the
45 Water System. For years 2005 through 2009, Aqua estimates that the total
46 capital investment for the Water System improvements as specified in the
47 Agreement will total \$1,125,856.⁶

48 **8. Q. How will Aqua finance the cost of the proposed construction?**

49 A. Aqua will pay cash to the Village for the Water System.⁷ Aqua indicates
50 that sources of capital funding for the five-year capital requirements will be
51 internally generated funds, debt and equity capital such that Aqua's overall
52 capital structure remains approximately 50% debt and 50% equity.⁸

53 **9. Q. How does the estimated cost of the proposed construction compare**
54 **to Aqua's water utility assets and revenue?**

55 A. As reported in Aqua's 2003 Form 22 ILCC annual report, at December 31,
56 2003, Aqua's net plant totaled \$151,931,727. Aqua's total utility revenue

³ Aqua Petition, par. 12; Aqua Petition, Exhibit A, Section 1.4.

⁴ Aqua response to ICC Staff data request FD-4.

⁵ Aqua Petition, par. 13; Aqua Petition, Exhibit A, Section 6a.

⁶ Aqua response to ICC Staff data request FD-3.

⁷ Aqua response to ICC Staff data request FD-6.

⁸ Aqua response to ICC Staff data request FD-3.

57 for the twelve months ended December 31, 2003, totaled \$29,544,206. In
58 comparison, the purchase price for the Water System (i.e., \$425,000),
59 plus the transaction-related expenses (i.e., \$32,500), plus the transaction
60 fees due to the Village upon closing the transaction (i.e., \$42,500) equals
61 \$500,000. For years 2005 through 2009, Aqua estimates capital
62 improvements will cost an additional \$1,125,856. Thus, the total cost of
63 purchasing and improving the Water System is \$1,625,856 or 1.07% of
64 total plant and 5.50% of total utility revenue. In my judgment, the
65 estimated cost of construction to the Aqua is diminutive in relation to its
66 financial resources.

67 **10. Q. Aqua indicates that it will finance the capital improvements with debt**
68 **and equity in addition to internally generated funds. Does Aqua have**
69 **access to the capital markets on reasonable terms?**

70 A. Yes. Aqua obtains equity capital through its parent company, Aqua
71 America, Inc., whose assets total approximately \$2.1 billion.⁹ Aqua
72 America, Inc. has access to the capital markets on reasonable terms.
73 Standard & Poor's ("S&P") categorizes debt securities on the basis of the
74 risk that a company will default on its interest or principal payment
75 obligations. The resulting credit rating reflects both the operating and
76 financial risks of a utility.¹⁰ S&P rates Aqua's affiliate, Aqua Pennsylvania,
77 Inc. A+. According to S&P, an A-rated utility has a strong capacity to meet
78 its financial obligations.¹¹ This credit rating reflects the consolidated credit

⁹ Aqua America, Inc. Form 10-K for year ended December 31, 2003.

¹⁰ Standard & Poor's Utilities Rating Service, "Utilities Rating Criteria," May 20, 1996, p. 1.

¹¹ Standard & Poor's Ratings Definitions, December 10, 2002, pp. 1-2.

79 profile of Aqua America, Inc.¹² Given Aqua's parent company, Aqua
80 America, Inc. is a financially strong company and ultimately responsible
81 for providing Aqua with equity capital, in my judgment, Aqua has access to
82 the capital markets on reasonable terms.

83 **11. Q. What is your recommendation regarding Aqua?**

84 A. In my judgment, the proposed transaction meets the requirements of
85 Section 8-406(b)(3) of the Act. Therefore, I recommend the Commission
86 find that Aqua is capable of financing the proposed construction without
87 significant adverse financial consequences for the utility or its customers.

88 **ILLINOIS-AMERICAN WATER COMPANY**

89 **12. Q. Describe the proposed construction and estimated cost for IAWC.**

90 A. IAWC offered to purchase the Water System that serves the Village for
91 \$225,000 and to pay the Village \$25,000 for engineering and legal
92 expenses.¹³ IAWC also offered to make various capital improvements to
93 the Water System during years 2005 through 2009, for which the
94 estimated cost totals \$770,000.¹⁴

95 **13. Q. How would IAWC finance the proposed construction?**

¹² Standard & Poor's, "Summary: Aqua Pennsylvania, Inc.," August 5, 2004.

¹³ IAWC Response to ICC Staff data request FD-7.

¹⁴ IAWC Response to ICC Staff data request FD-9.

96 A. IAWC would have purchased the Water System with cash.¹⁵ IAWC
97 indicated that the sources of capital funding for the five-year capital
98 requirements would be have been short-term debt and retained earnings
99 such that IAWC's capital structure would remain comprised of
100 approximately 55% debt and 45% equity.¹⁶

101 **14. Q. How does the estimated cost of the proposed construction compare**
102 **to IAWC's water utility assets and revenue?**

103 A. As reported in IAWC's 2003 Form 22 ILCC annual report, at December
104 31, 2003, IAWC's net plant totaled \$576,948,121. IAWC's total utility
105 revenue for the twelve months ended December 31, 2003, totaled
106 \$151,989,695. In comparison, to purchase the Water System, IAWC
107 would have paid the Village \$250,000 (*i.e.*, the purchase price of
108 \$225,000, plus engineering and legal fees totaling \$25,000). For years
109 2005 through 2009, IAWC estimates the capital improvements would cost
110 an additional \$770,000. Thus, the total cost for IAWC to purchase and
111 improve the Water System would have been \$1,020,000, or 0.18% of its
112 total utility plant and 0.67% of its total utility revenue. In my judgment,
113 IAWC's estimated cost of construction is diminutive in relation to its
114 financial resources.

¹⁵ IAWC Response to ICC Staff data request FD-8.

¹⁶ IAWC Response to ICC Staff data request FD-9.

115 **15. Q. IAWC would finance the capital improvements with short-term debt**
116 **and retained earnings.¹⁷ Does IAWC have access to the capital**
117 **markets on reasonable terms?**

118 A. Yes. IAWC obtains equity capital through its parent company, American
119 Water, who, in turn, obtains equity capital through its parent company,
120 RWE AG. RWE AG also provides substantially all debt funding to another
121 of American Water's wholly-owned subsidiaries, American Water Capital
122 Corporation ("AWCC").¹⁸ AWCC provides IAWC with debt capital, as
123 authorized in Docket No. 00-0306.¹⁹ S&P rates AWCC "A,"²⁰ and
124 considers A-rated utilities to have a strong capacity to meet financial
125 obligations. In determining AWCC's credit rating, S&P considered the
126 stand-alone credit profile of its parent company, American Water. That is,
127 as a result of the support agreement between AWCC and American
128 Water, they have the same credit quality. In turn, American Water's credit
129 quality reflects the consolidated credit profiles of its operating subsidiaries,
130 including IAWC.²¹ Given IAWC's parent company, American Water, is a
131 financially strong company and responsible for providing IAWC with equity
132 capital, in my judgment, IAWC has access to the capital markets on
133 reasonable terms.

134 **16. Q. What is your recommendation regarding IAWC?**

¹⁷ IAWC Response to ICC Staff data request FD-9.

¹⁸ Standard & Poor's, "Research: American Water Capital Corp.," September 2, 2004.

¹⁹ Order, Docket No. 00-0306, May 16, 2000.

²⁰ Standard & Poor's, "Research: American Water Capital Corp.," September 2, 2004.

²¹ Standard & Poor's, "Research: American Water Capital Corp.," September 2, 2004.

135 A. In my judgment, IAWC's proposal to acquire the Water System also meets
136 the requirements of Section 8-406(b)(3) of the Act. That is, my analysis
137 reveals that IAWC is also capable of financing the proposed construction
138 without significant adverse financial consequences for the utility or its
139 customers.

140 **17. Q. Does this conclude your direct testimony?**

141 A. Yes.