

DIRECT TESTIMONY

OF

Thomas Q. Smith

Water Department

Financial Analysis Division

Illinois Commerce Commission

Illinois-American Water Company and South Beloit Water Gas & Electric Company

Petition for Approval of Proposed Reorganization

Docket No. 05-0724

March 31, 2006

1 WITNESS IDENTIFICATION

2 Q. Please state your name and business address.

3 A. My name is Thomas Q. Smith. My business address is 527 East Capitol Avenue,
4 Springfield, Illinois 62701.

5
6 Q. Please describe your present position and related responsibilities.

7 A. I am presently employed as an Economic Analyst in the Water Department of the
8 Financial Analysis Division of the Illinois Commerce Commission (“ICC” or the
9 “Commission”). My responsibilities include reviewing and analyzing tariff filings
10 related to rates, rules, regulations, and conditions of utility service; reviewing
11 applications for certificates of public convenience and necessity; reviewing
12 information regarding the prudence of Qualifying Infrastructure Plant (“QIP”)
13 investment costs; conducting inspections of water and sewer public utilities;
14 reviewing requests for general increases in rates for water and sewer service;
15 reviewing tariff filings related to purchased water surcharge riders and
16 information sheets; and presenting expert witness testimony in docketed
17 proceedings before the Commission. Prior to my transfer to the Water
18 Department, I served as an auditor in the Commission’s Accounting Department.

19
20 Q. Please describe your background and professional qualifications.

21 A. In 1974, I received a Bachelor of Arts Degree in Accounting from Michigan State
22 University. I am a Certified Public Accountant licensed to practice in Illinois,
23 Michigan, and Wisconsin. My prior experience includes seven years as an

24 auditor with the Michigan Public Service Commission. Subsequently, I was
25 employed for three years by Wisconsin Southern Gas Company in the initial
26 capacity of Senior Accountant - Rate Specialist and later as Controller. I am a
27 member of the American Institute of Certified Public Accountants.

28

29 Q. Have you previously testified before regulatory bodies?

30 A. Yes, I have testified on many occasions before the Illinois Commerce
31 Commission, the Michigan Public Service Commission, and the Public Service
32 Commission of Wisconsin. During the course of various rate proceedings I have
33 testified to accounting, rate, cost of service, finance, and operational issues.

34

35 PURPOSE OF TESTIMONY

36 Q. What is the purpose of this proceeding?

37 A. The purpose of this proceeding is to consider the request of Illinois-American
38 Water Company ("IAWC") and South Beloit Water Gas & Electric Company
39 ("South Beloit") (jointly "Joint Applicants") for approval of the sale of water system
40 assets from South Beloit to IAWC; to consider the request of IAWC for a
41 Certificate of Public Convenience and Necessity to provide water service in the
42 area currently served by South Beloit; to consider the request of South Beloit to
43 abandon the provision of water service in Illinois; to consider IAWC's request for
44 approval of various accounting entries related to the transfer of assets; to
45 consider IAWC's request to serve current South Beloit customers under South
46 Beloit's schedule of rates and rules for water service, Ill. C. C. No. 9; and to

47 consider IAWC's proposal to assume South Beloit's rights and obligations under
48 the Agreement to Provide Wholesale Water Services to South Beloit Water Gas,
49 and Electric Company.

50

51 Q. What is the purpose of your testimony?

52 A. The purpose of this testimony is to present my recommendations to the
53 Commission regarding the proposed transfer of the South Beloit water system to
54 IAWC, the issuance of a Certificate of Public Convenience and Necessity to
55 IAWC, abandonment of the South Beloit Water system by South Beloit, and rules
56 and regulations to be applicable to the South Beloit water system following its
57 transfer.

58

59 Q. Have you reviewed the Joint Applicants' positions in this proceeding?

60 A. Yes, I have. I have reviewed the Verified Second Amended Application. I have
61 read the Direct Testimonies of Michael J. Hoffman, IAWC EXHIBIT NO. MJH-1.0;
62 Bob Khan, IAWC EXHIBIT NO. BK-1.0; Barbara A. Siehr, SBWGE Exhibit (BAS-
63 1); and Richard E. Potter, SBWGE Exhibit (REP-1). I have reviewed the
64 Supplemental Direct Testimony of Richard E. Potter, SBWGE Exhibit (REP-2). I
65 have reviewed the Revised Supplemental Direct Testimony of Bob Khan, IAWC
66 EXHIBIT NO. BK-2.0R. I have analyzed the Joint Applicants' responses to
67 various data requests. I also conducted an on-site inspection of the South Beloit
68 water distribution system January 10, 2006.

69

70 JOINT APPLICANTS' REQUESTS

71 Q. What are the Joint Applicants to this proceeding requesting?

72 A. The Joint Applicants are requesting approval of a transfer of South Beloit's water
73 assets to IAWC under Sections 7-102 and 7-204 of the Illinois Public Utilities Act
74 (the "Act"). Additionally, South Beloit is requesting approval to abandon its water
75 operations under Section 8-508 of the Act, and IAWC is requesting a Certificate
76 of Public Convenience and Necessity ("Certificate") to operate a water system
77 under Section 8-406 of the Act.

78

79 SECTION 7-102 OF THE ACT

80 Q. Are you familiar with the requirements of Section 7-102 of the Act?

81 A. Yes, I am. Section 7-102 requires Commission consent and approval prior to
82 one public utility transferring or selling assets and/or operations to any other
83 public utility. In this proceeding it is my opinion that South Beloit and IAWC must
84 obtain the approval of the Commission prior to executing the provisions of the
85 Joint Applicants' contract to transfer South Beloit's water assets and operations
86 to IAWC. The specific requirements that must be achieved in order to obtain the
87 Commission's approval are enumerated in subsequent portions of my Direct
88 Testimony.

89

90 SECTION 7-204 OF THE ACT

91 Q. What requirements of Section 7-204 of the Act are you addressing?

92 A. I am addressing Section 7-204(b)(1), Section 7-204(b)(5), and Section 7-
93 204(b)(6) of the Act.

94

95 Q. Section 7-204(b)(1) of the Act states, “the proposed reorganization will not
96 diminish the utility’s ability to provide adequate, reliable, efficient, safe and least-
97 cost public utility service.” Are you aware of any evidence that indicates that
98 ownership by IAWC diminishes the ability of the public utility to provide adequate,
99 reliable, efficient, safe and least-cost service to its customers?

100 A. I am aware of no evidence that indicates that the reorganization will hinder the
101 utility’s ability to provide high quality service as defined in Section 7-204(b)(1) of
102 the Act. IAWC is the largest investor-owned water utility in the state. It currently
103 provides water service to more than 250,000 customers in approximately 20
104 separate operating systems. It is reasonable to expect that IAWC can provide
105 water service as required by Section 7-204(b)(1) to the approximately 2,300
106 customers in the South Beloit service area. Additionally, Company witness Khan
107 has indicated in his Direct Testimony, IAWC EXHIBIT NO. BK-1.0, lines 98
108 through 106, that IAWC is capable of providing service as required by Section 7-
109 204(b)(1).

110

111 Q. Section 7-204(b)(5) of the Act requires that all utilities “...remain subject to
112 applicable laws, regulations, rules, decisions and policies governing the
113 regulation of Illinois public utilities.” Do you expect that the South Beloit water

114 system will remain subject to the laws regulating water utilities when the transfer
115 to IAWC is complete?

116 A. I know of no reason why the South Beloit water system under IAWC ownership
117 would cease to be subject to Illinois regulatory law. Additionally, Mr. Khan's
118 Direct Testimony, lines 79 through 82, indicates that IAWC expects the South
119 Beloit system to remain subject to Illinois regulatory law.

120

121 Q. Section 7-204(b)(6) of the Act allows for a reorganization if it "...is not likely to
122 have a significant adverse effect on competition in those markets over which the
123 Commission has jurisdiction." Is this reorganization likely to have a significant
124 adverse effect on competition?

125 A. No. The South Beloit Water System bills approximately \$540,000 in revenues
126 annually. The Commission regulates utilities with a total of approximately
127 \$190,000,000 in revenues. Because of South Beloit's size, the potential impact,
128 if any, on competition resulting from its sale to IAWC would be *de minimis*.
129 Additionally, Mr. Khan's Direct Testimony, lines 107-113, states that due to the
130 geographical separation of the service areas, there is no significant competition
131 for water sales between South Beloit and IAWC. As such, Mr. Khan indicates
132 that market conditions in Illinois after the consummation of the reorganization will
133 be substantially the same as they currently exist.

134

135

136

137 SECTION 8-406 OF THE ACT

138 Q. Item 7 of the Verified Second Amended Application indicates that the Joint
139 Applicants are requesting that a Certificate of Public Convenience and Necessity
140 be granted to IAWC to operate a water system to serve customers currently
141 being served by South Beloit. Do you agree that a Certificate must be granted to
142 IAWC before it can operate the South Beloit system?

143 A. Yes, I do. Section 8-406 of the Public Utilities Act requires:

144 No public utility not owning any city or village franchise nor
145 engaged in performing any public service or in furnishing any
146 product or commodity within this State as of July 1, 1921 and
147 not possessing a certificate of public convenience and
148 necessity from the Illinois Commerce Commission, the State
149 Public Utilities Commission or the Public Utilities
150 Commission, at the time this amendatory Act of 1985 goes
151 into effect, shall transact any business in this State until it
152 shall have obtained a certificate from the Commission that
153 public convenience and necessity require the transaction of
154 such business.
155

156 It is clear that IAWC must possess a Certificate in order to legally operate the
157 South Beloit Water system.

158
159 Q. Are you familiar with the area for which a Certificate is being sought?

160 A. Based on the physical inspection that I performed, I am generally familiar with the
161 service area. Additionally, Mr. Bob Khan in his Revised Supplemental Direct
162 Testimony, IAWC EXHIBIT NO. BK-2.0R, page 1, describes the area for which
163 IAWC requests a Certificate as corresponding to the area in which South Beloit
164 currently provides water service, plus areas abutting the current service area.
165 The area for which a Certificate is being requested is more completely described

166 by a map, and a metes and bounds description, attached to Mr. Khan's Revised
167 Supplemental Direct Testimony as IAWC Exhibit No. BK-2.1 and IAWC Exhibit
168 No. BK-2.2, respectively.

169

170 Q. Do any other water utilities provide water utility service to the area for which a
171 Certificate is being requested?

172 A. Based on my knowledge and understanding, as supported by the Joint
173 Applicants' representations, I am aware of no utility that is currently providing
174 water service in the South Beloit service territory that has an interest in providing
175 water utility service in the area, or that has a least cost capability of providing
176 water utility service in the area.

177

178 Q. Do you believe that it is reasonable for the Commission to approve a Certificate
179 of Public Convenience and Necessity for IAWC to provide water service in the
180 area identified in IAWC Exhibit No. 2.1 and IAWC Exhibit No. 2.2 as attached to
181 Mr. Khan's Revised Supplemental Direct Testimony?

182 A. Yes, I do. South Beloit is requesting authority to abandon service, and IAWC is
183 requesting authority to provide service. IAWC is capable of operating and
184 managing the South Beloit system, no other entity is reasonably capable of
185 providing service in the South Beloit service area. Therefore, it is reasonable
186 that IAWC be granted a Certificate under Section 8-406 of the Act to provide
187 water service in the current South Beloit Water service area as that area is
188 defined by the map and the metes and bounds description, contained in IAWC

189 Exhibit No. 2.1 and IAWC Exhibit 2.2 as attached to Mr. Khan's Revised
190 Supplemental Direct Testimony.

191
192 Q. Why is it necessary for IAWC to request a Certificate under Section 8-406 of the
193 Act; rather than transferring the Certificate currently held by South Beloit, as is
194 normally done when one utility acquires the operating system of a second utility?

195 A. As discussed in Mr. Potter's Supplemental Direct Testimony, SBWGE Exhibit
196 (REP-1), page 3, South Beloit, after conducting a thorough search, is not aware
197 of any existing Certificate that identifies the area that is currently being served by
198 South Beloit. As Mr. Potter further explains, because of grandfathering
199 provisions in the Act, it is reasonable to expect that no Certificate has been
200 granted to South Beloit, and in any case, the Joint Applicants and Commission
201 Staff are unaware of the existence of any Certificate that could be transferred. In
202 my opinion, it is necessary that IAWC be granted a Certificate to serve the area
203 currently served by South Beloit prior to transacting business.

204

205 SECTION 8-508 OF THE ACT

206 Q. Item 8 of the Verified Second Amended Application indicates that the Joint
207 Applicants are requesting that South Beloit be permitted to abandon its water
208 service operations in South Beloit. Do you agree that approval of the
209 Commission is required prior to the abandonment of water operations by South
210 Beloit?

211 Q. Yes, I do agree. Section 8-508 of the Act states in part, “[e]xcept as provided in
212 Section 12-306, no public utility shall abandon or discontinue any service
213 ...without first having secured the approval of the Commission...” The approval
214 of the Commission is axiomatic.

215

216 Q. Do you believe that it is appropriate for the Commission to grant its approval for
217 South Beloit to abandon its water system?

218 A. Yes, I do. South Beloit is selling its water system to IAWC which will in turn
219 operate that water system. Thus, there is no need for South Beloit to operate the
220 water system and authority for South Beloit to abandon that system should be
221 granted.

222

223 APPLICABLE RULES AND REGULATIONS

224 Q. In IAWC EXHIBIT NO. BK-1.0, lines 73 through 78, IAWC proposes to serve
225 customers in the current South Beloit service territory under the rules and
226 regulations under which those customers are currently served. Do you agree
227 with this proposal?

228 A. Yes, I do. I have seen no evidence to indicate that South Beloit’s customers are
229 ill-served by the current rules and regulations. It is my opinion that IAWC should
230 assume the rules and regulations contained in Ill. C. C. No. 9 and currently
231 applicable to South Beloit’s water customers, and that those rules and
232 regulations remain in effect until such time that the Commission might authorize
233 new rules and regulations.

234 RECOMMENDATIONS AND CONCLUSION

235 Q. Are you expressing an opinion on the financial resources of IAWC relative to its
236 ability to acquire and operate South Beloit's water operations?

237 A. No, I am not. Staff witness Mike McNally is testifying to the financial resources of
238 IAWC.

239

240 Q. Are you addressing accounting and rate issues at issue in this proceeding?

241 A. No, I am not. Staff witness Mary Everson is addressing accounting issues,
242 including the proposed transfer of the Agreement to Provide Wholesale Water
243 Services, and Staff witness Mike Luth is addressing rate issues.

244

245 Q. What is your recommendation at this time?

246 A. I recommend that the proposed sale of the South Beloit water system by South
247 Beloit to IAWC be approved, that a Certificate of Public Convenience and
248 Necessity be granted to IAWC to operate the South Beloit water system, that
249 South Beloit be granted authority to abandon the South Beloit water system, and
250 that the rules and regulations currently applicable to the South Beloit water
251 system under applicable tariffs continue to be applicable to the South Beloit
252 water system after it is transferred to IAWC.

253

254 Q. Does this conclude your direct testimony?

255 A. Yes, it does.