

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS-AMERICAN WATER COMPANY)
)
Petition for Issuance of an Expanded Certificate of)
Public Convenience and Necessity to Operate a Water)
Supply and Distribution System and Wastewater) Docket No. 06-_____
Collection and Treatment System; and for approval of)
certain provisions related to water and wastewater plant)
investment and refunds, a variance from the provisions)
of Rule 16, accounting entries, depreciation rates and)
water and wastewater rates.)

PETITION

Illinois-American Water Company (“Illinois American Water” or the “Company”), hereby requests, pursuant to Section 8-406 of the Illinois Public Utilities Act (the “Act”), 220 ILCS 5/8-406, that the Illinois Commerce Commission (“Commission”) enter an order issuing a Certificate of Public Convenience and Necessity (“Certificate”), which authorizes Illinois American Water to construct, operate and maintain a water supply and distribution system and a wastewater treatment and collection system, and in connection therewith, transact a public utility business in an area of McHenry County, Illinois, which is contiguous to the area (the “Original Terra Cotta Area”) for which the Company’s predecessor, Citizens Utilities Company of Illinois (“CUCI”), was granted a Certificate (“Original Certificate”) by the Commission in its Order dated April 25, 2001 in Docket No. 00-0194 (the “Docket 00-0194 Order”). Pursuant to the Order of the Commission in Docket 00-0476 (the “Docket 00-0476 Order”), Illinois American Water assumed CUCI’s rights and obligations under the Original Certificate. Illinois American Water presently provides water and wastewater service for the Original Terra Cotta Area through its Chicago-Metro Division (“Metro Division”). For administrative efficiency, Illinois American Water requests the Certificate granted in this proceeding (the “Expanded Certificate”) cover both the Original Terra Cotta Area and the additional area described herein (“Additional Area”), the

Original Terra Cotta Area and the Additional Area being together referred to herein as the “Expanded Area.”

Illinois American Water also requests approval of certain provisions of an Amended and Restated Asset Purchase Agreement between Illinois American Water and Terra Cotta Realty Co. (“Terra Cotta”) dated November 4, 2005 (“Agreement”), and of a variance from the provisions of the Metro Division’s Rule 16 (Ill. C.C. No. 5, Sheet Nos. 53-57) (“Rule 16”) with regard to the amount of the required construction deposit for additional wastewater treatment plant capacity. Illinois American Water further requests approval of certain provisions of an agreement (“Westminster Agreement”) between Illinois American Water and WS Land Partners - Prairie Grove II, LLC (“Westminster”), an entity which serves as the agent of the entities which have purchased portions of the land located in the Expanded Area (the “Westminster Land”), namely, Prairie Grove 1078 SPE, LLC, and Tall Grass Prairie Grove, LLC. Illinois American Water and Westminster are in the process of finalizing the Westminster Agreement as of the filing of this Petition. Illinois American Water will supplement this Petition with an executed copy of the Westminster Agreement. Illinois American Water also requests approval of accounting entries to record the net original cost of facilities that will be used to provide service in the Expanded Area, and of applicable depreciation rates. In addition, Illinois American Water requests approval to apply the rates of the Metro Division (as presently in effect or as subsequently revised) for water and wastewater service in the Expanded Area. In support of its Petition, Illinois American Water states as follows:

BACKGROUND

1. Illinois American Water provides public water and/or wastewater service in portions of the State of Illinois through twelve Districts: Alton, Cairo, Champaign, Chicago Metro, Interurban, Lincoln, Peoria, Pekin, Pontiac, South Beloit, Sterling and Streator. The

Chicago Metro District serves incorporated and unincorporated areas in portions of Cook, DuPage, Will, Kendall, Grundy, Kane and McHenry Counties.

2. In 1999, Terra Cotta requested that CUCI provide water and wastewater service to an area near the Village of Prairie Grove, McHenry County, Illinois. To serve the area, CUCI acquired water supply (backbone) facilities (“TC Water Backbone Plant”), water distribution mains (“TC Original Area Water Mains”), sewer backbone facilities (“TC Sewer Backbone Plant”), and sewer collection mains (“TC Original Area Sewer Mains”) under an Asset Purchase Agreement with Terra Cotta, which was dated February 16, 2000 (the “Original Agreement”). The TC Sewer Backbone Plant included a wastewater treatment plant (the “Original Wastewater Plant”) with a treatment capacity of 100,000 gallons per day (“g.p.d.”). The acquired water facilities (TC Water Backbone Plant and TC Original Area Water Mains) and sewer facilities (TC Sewer Backbone Plant and TC Original Area Sewer Mains) are referred to, respectively, as “Existing TC Water Facilities” and “Existing TC Sewer Facilities.” Certain water and wastewater mains now serving the Original Terra Cotta Area were constructed by other developers pursuant to CUCI’s Rules, Regulations and Conditions of Service (which were adopted by Illinois American Water), and were not acquired by CUCI under the Original Agreement.

3. The Original Agreement provided, in part, for the following: (A) Existing TC Water Facilities - (i) TC Water Backbone Plant -- the Original Agreement required that Terra Cotta transfer ownership of the TC Water Backbone Plant, subject to required refunds on a per population equivalent (“P.E.”) basis as customers attach. The Original Agreement further required Terra Cotta’s consent for use of the TC Water Backbone Plant outside the Original Terra Cotta Area, (ii) TC Original Area Water Mains - the Original Agreement called for refunds

of the cost of service connections constructed by Terra Cotta (between the main and the curb stop), and one-and-one-half times estimated annual revenue from customers that attach to water mains constructed by Terra Cotta over a ten-year period. (B) Existing TC Sewer Plant - (i) TC Sewer Backbone Plant - the Original Agreement provided for transfer to CUCI of the Original Wastewater Plant, which had been constructed by Terra Cotta in 1973 and used by Terra Cotta since that time (with an upgrade in 1996-97), with no refund of costs related to the Original Wastewater Plant as customer attach; (ii) TC Original Area Sewer Mains - the Original Agreement provided for transfer to CUCI of the TC Original Area Sewer Mains, with no requirement for a refund of the associated cost. (C) Future Water and Sewer Facilities: (i) Future Water Supply - the Original Agreement contemplated that CUCI would finance construction of future water backbone facilities in the Original Terra Cotta Area; (ii) Future Sewer Backbone Facilities - under the Original Agreement, Terra Cotta was to pay the full cost of constructing future sewer supply (backbone) facilities with no refund obligation for CUCI. The Original Agreement did not address the construction of future water distribution or sewer collection mains.

4. CUCI filed the Original Agreement for approval by the Commission, to the extent required, in Commission Docket 00-0194. In the Docket 00-0194 Order, the Commission did not approve the Original Agreement, but did, inter alia: (i) grant the Original Certificate; and (ii) indicate that certain provisions of the Original Agreement which relate to the water facilities were reasonable.

5. In the Docket 00-0194 order, the Commission further determined that the Original Agreement was unreasonable in that it did not provide for a refund to Terra Cotta of the cost advanced for the TC Sewer Backbone Plant. The Commission concluded that, for the purposes

of Docket 00-0194, the principles of 83 Illinois Administrative Code Section 600.370(a) (which is applicable by its terms to water backbone plant) would apply in evaluating proposed levels of developer contribution for the TC Sewer Backbone Plant (Docket 00-0194 Order, page 6). The Commission found specifically (Docket 00-0194 Order, page 7, Finding No. 6) that CUCI should refund to Terra Cotta the cost advanced for the TC Sewer Backbone Plant.

6. CUCI filed an appeal of the Docket 00-0194 Order in the Appellate Court of Illinois, Second District. The Docket 00-0194 Order was ultimately affirmed on appeal in *Illinois-American Water Co. v. Commerce Comm.*, 331 Ill. App. 3d 1030 (3rd Dist. 2002) (the “Appellate Decision”). In the Appellate Decision, the Appellate Court determined that, although Section 600.370(a) by its terms applies only to water backbone plant, the Commission properly determined, based on the record in Docket 00-0194, that the principles of Section 600.370(a) should apply to sewer backbone plant for purposes of that case.

7. Pursuant to the Original Agreement and an agreement between Terra Cotta and CUCI dated June 13, 2001 (“June 13 Agreement”), Terra Cotta transferred to CUCI title to the Existing TC Water Facilities, Existing TC Sewer Facilities and related property rights. In the June 13 Agreement, Terra Cotta and CUCI agreed not to rescind or restructure the Original Agreement, except as required to comply with the Docket 00-0194 Order, as then in effect or as modified after appeal.

8. On January 15, 2002, pursuant to the Docket 00-0476 Order, Illinois American Water assumed CUCI's rights and obligations under the Original Certificate and acquired certain water and wastewater assets of CUCI, including, but not limited to, CUCI's rights and obligations under, inter alia, the Original Agreement and the June 13 Agreement. The areas served by CUCI, with certain other areas, now comprise the Metro Division.

9. In addition to the Original Terra Cotta Area, Terra Cotta has now acquired, or is under contract to acquire, certain additional land, which, when combined with the Original Terra Cotta Area, will total approximately 1,550 acres (the “TC Land”). Terra Cotta sold 1,077 acres of the TC Land to Prairie Grove 1078 SPE (the “TC Acres”). Furthermore, Tall Grass Prairie Grove, LLC acquired from another entity approximately 322 acres of land (the “WS Acres”) that is part of an area of approximately 368 acres known as Tall Grass (“Tall Grass”). Together, the TC Acres and the WS Acres comprise the “Westminster Land.” The Expanded Area includes both the TC Land and Tall Grass, and therefore includes both the Westminster Land and other land that Terra Cotta will retain and/or sell to other developers. In this proceeding, Illinois American Water seeks a Certificate authorizing it to serve the Expanded Area.

10. In this proceeding, Illinois American Water seeks approval of the Agreement to the extent discussed herein. The purpose of the Agreement is to: (i) establish arrangements for provision of public water and sanitary sewer service in the Expanded Area, and for the construction of additional and/or expanded water and wastewater facilities needed to serve expected customer growth in the Expanded Area; (ii) comply with the terms of the June 13 Agreement; and (iii) address, inter alia, matters covered by the Original Agreement in a manner consistent with the relevant portions of the Docket 00-0194 Order (as affirmed by the Appellate Decision) and the applicable rules, regulations and policies of the Commission. A copy of the Agreement (without appended exhibits) is attached hereto as Exhibit A.

11. Illinois American Water also seeks approval of provisions of the Westminster Agreement that relate to: (i) construction and financing of water backbone plant for Tall Grass (the “Tall Grass Water Backbone Plant”); and (ii) construction and financing of water and

wastewater collection mains for the Westminster Land. Illinois American will file a copy of the Westminster Agreement with the Commission promptly after it is executed.

**CERTIFICATE OF
PUBLIC CONVENIENCE AND NECESSITY**

12. Illinois American Water seeks the Expanded Certificate to provide water and wastewater service to customers in the Expanded Area. The Expanded Area includes the following: (i) the Original Terra Cotta Area which consists of approximately 1440 acres; (ii) approximately 110 additional acres that Terra Cotta has now acquired, or is under contract to acquire (those 110 acres in combination with the Original Terra Cotta Area comprising the TC Land, which consists in total of approximately 1550 acres); and (iii) approximately 368 acres of land in an area known as Tall Grass (322 acres of which are the WS Acres). The Expanded Area is shown in Exhibit B, and legally described in Exhibit C. Exhibits B and C designate separately: the Original Terra Cotta Area, the additional 110 acres acquired by Terra Cotta and Tall Grass.

13. At present, in the Original Terra Cotta Area, 231 residential units have been constructed: 170 of such units being in the Cobblestone Woods Subdivision (“Cobblestone”); and 61 of such units being in the Oak Grove Subdivision (“Oak Grove”). These residences receive water and wastewater service from the Existing TC Water Facilities and the Existing TC Sewer Facilities, respectively (and through certain additional mains constructed by the developers of Cobblestone and Oak Grove). An additional 34 residential units are expected to be constructed in the Oak Grove Subdivision at some future time.

14. In the Expanded Area (which includes all of the TC Land and Tall Grass), Illinois American Water anticipates that approximately 2,449 additional residential units will be constructed, approximately 400 of which are to be constructed by Terra Cotta, and

approximately 2,049 of which are to be constructed by Westminster (including 1,405 units in the TC Acres and 644 units in the WS Acres). The occupants of the Expanded Area will require public water and wastewater service, and Terra Cotta and Westminster have contracted with Illinois American Water to provide that service pursuant to the Agreement and Westminster Agreement. Including the existing units in Oak Grove and Cobblestone, the Expanded Area is presently expected to include a total of approximately 2,680 residential units.

15. Illinois American Water also anticipates that governmental (schools), retail and other commercial entities will be developed within the Expanded Area, as residential development occurs. However, Illinois American Water presently has no basis to project a precise level of such governmental, retail and commercial development.

16. Except as provided by Illinois American Water, there is currently no public water or wastewater service provided in the Expanded Area. Other than Illinois American Water, no municipal corporation or other entity owns a water supply and distribution system or wastewater collection system within a reasonable proximity to the Expanded Area, or is able to render water or sewer utility service to the Expanded Area. As required by 83 Illinois Administrative Code § 200.150(b), a copy of this Petition will be served on each municipality located partly or wholly within the Expanded Area, or with a corporate boundary that is within one and one-half miles of the Expanded Area.

17. Illinois American Water has the technical, financial and managerial ability to construct, operate and maintain a public water supply and distribution system, and a sewage treatment and collection system for the Expanded Area, without adverse financial consequences for existing customers. The provision of public water and sewer service in the Expanded Area, will impose no financial burden on either Illinois American Water or its existing customers.

Also, existing customers would experience benefits from growth of the Illinois American Water system as common costs are spread over a larger customer base.

18. Illinois American Water has taken steps to assure that any construction processes and supervision thereof will be adequate and efficient, and that the cost it will incur for constructed facilities is the least-cost means of providing the required water/wastewater service.

19. Under the Agreement, Illinois American Water has, subject to certain contingencies, agreed to seek approval to serve certain additional land (not currently within the TC Land or Tall Grass) in the event that such land is ultimately acquired by Terra Cotta and/or Westminster. No such land, however, has been acquired at the time that this Petition is filed, and Illinois American Water does not seek authorization to serve any such land in this Petition. In the event that Illinois American Water proposes to seek authorization to provide water and/or wastewater service for additional land in accordance with the Agreement, an appropriate Petition will be filed with the Commission.

WATER AND WASTEWATER FACILITIES

20. Pursuant to the Original Agreement, the June 13 Agreement and other documents, Terra Cotta transferred to CUCI title to the Existing TC Water Facilities and Existing TC Sewer Facilities.

21. On January 15, 2002, Illinois American Water acquired title to the Existing TC Water Facilities and Existing TC Sewer Facilities from CUCI, as approved by the Commission in Docket 00-0476. In addition, as successor to CUCI, Illinois American Water is the lessee of property on which the Original Wastewater Plant is located (the "Property"). Under the lease agreement between Terra Cotta and CUCI, dated June 13, 2001 ("Lease"), Illinois American Water (as successor to CUCI) is permitted use of the Property for wastewater treatment plant purposes, including use for additions and expansions of the Original Wastewater Plant.

Water Backbone Facilities

22. The TC Water Backbone Facilities have a projected capacity of 4,950 P.E. This capacity is sufficient to accommodate the existing developments (Oak Grove and Cobblestone), and anticipated development in the TC Land over the next several years.

23. Pursuant to the Agreement (Section IV, pages 7-9), Illinois American Water will provide future water backbone plant for the TC Land (including, but not limited to, the TC Acres), as required to provide water public utility service that is adequate, reliable, efficient and environmentally safe, in accordance with the Agreement and requirements of the Illinois Public Utilities Act. Under the Westminster Agreement, water backbone facilities for the TC Acres will include, inter alia, a portion of the capacity of the Existing TC Water Facilities and such new wells, storage and other facilities as Illinois American Water constructs in accordance with the terms of the Agreement.

24. For Tall Grass, construction of a separate water supply plant is the least-cost approach (as compared to extension of a transmission water main connecting the water systems serving the TC Land to the Tall Grass distribution system). Under the Westminster Agreement, Westminster will construct the Tall Grass Water Backbone Plant, subject to approval by Illinois American Water of the plans and specifications for such facilities. Illinois American Water will monitor and inspect the construction. Under the Westminster Agreement, Westminster will transfer title to the Tall Grass Water Backbone Plant to Illinois American Water. The Tall Grass Water Backbone Plant will include two wells, a pumping station and a 650,000 gallon ground storage reservoir.

25. Pursuant to the Agreement (Sections V through IX, pages 9-18), Terra Cotta, by itself or together with Westminster (collectively the "TC Land Entities"), will construct an expansion of the Original Wastewater Plant to increase the design average flow from 100,000

gallons per day (g.p.d.) to 1.0 million g.p.d. (the “Initial Plant Expansion”). Terra Cotta has entered into an agreement with Lintech Engineering, LLC and Joseph J. Henderson & Son (“Design/Build Agreement”) for construction of the Initial Plant Expansion. The Design/Build Agreement updates an agreement initially signed by Terra Cotta in 2003. Construction of the Initial Plant Expansion will be subject to inspection and monitoring by Illinois American Water. Illinois American Water has approved the engineering specifications for the Initial Plant Expansion, and, under the Agreement, has the right to approve any future changes to such specifications.

26. Under the Agreement (Section VII, pages 15-18), after completion of the Initial Plant Expansion and subject to approval of the Commission, Terra Cotta and Illinois American Water will conduct a closing to confirm that ownership and control of the Initial Plant Expansion is held by Illinois American Water. In addition, the Agreement provides that, if Terra Cotta fails to complete the Initial Plant Expansion within twelve months after the date on which the Commission's Order in this proceeding becomes final and no longer subject to appeal (the “Twelve Month Period”), Illinois American Water may elect to assume control of the construction before its completion. Funding for the Initial Plant Expansion shall be provided by Terra Cotta, by itself or together with other TC Land Entities, through establishment of a cash construction escrow or a letter of credit in a form and from an institution satisfactory to Illinois American Water. Illinois American Water will provide an investment in the Initial Plant Expansion in an amount discussed below.

27. To accommodate expected growth in the Expanded Area, Illinois American Water intends to construct a further 600,000 g.p.d. of wastewater treatment plant capacity (“Second Plant Expansion”), in addition to the 1,000,000 g.p.d capacity of the Initial Plant Expansion.

Illinois American Water will commence construction of the Second Plant Expansion either upon Terra Cotta's consent to such expansion with the Twelve Month Period; or, if Terra Cotta does not so consent, after transfer of the Initial Plant Expansion to Illinois American Water under the terms of the Agreement. Construction of the Second Phase Plant Expansion will be designed and managed in a manner that will not delay or disrupt completion of the Initial Plant Expansion.

28. Under the Agreement (Section VII.B, page 15), the Lease will be amended upon transfer to Illinois American Water of the Initial Plant Expansion to expand the covered land area.

29. Under the Agreement (Section V.G, pages 12-13), Illinois American Water will reserve 1.0 m.g.d. of wastewater treatment capacity from the Initial Plant Expansion exclusively for the TC Land and Tall Grass (including the Westminster Land) (the "Reserved Area"). Also, under the Agreement (Section II.B, page 4; V.G, pages 12-13), certain other land purchased by Terra Cotta and/or Westminster within two miles of the boundary of the Expanded Area can (subject to the terms of the Agreement) be included in the Reserved Area (for ten years following the end of the Twelve Month Period), provided that Illinois American Water concludes that such land can reasonably be served based on an engineering review, and that all applicable governmental approvals are obtained, including, but not limited to, approval of the Commission. The 1.0 m.g.d. of reserved capacity is intended to provide 10,000 P.E. of capacity for the Reserved Area. Under the Agreement, neither Terra Cotta, Westminster for Tall Grass nor TC Land Entities are required to pay Illinois American Water a connection or other capacity fee for use of the reserved 1.0 m.g.d. of capacity within the Reserved Area. Terra Cotta has agreed that development of the Reserved Area may only utilize a combined level of up to 10,000 P.E. of capacity from the 1.0 m.g.d. of reserved capacity. If development of the Reserved Area requires

a level of capacity above 10,000 P.E., arrangements for additional capacity will be made under Rule 16 (or on such other terms as the Commission may approve).

Water and Wastewater Mains

30. Under the Agreement (Section III.B(2) and (3), pages 5-6), water mains may be extended by Terra Cotta in the Original Terra Cotta Area pursuant to terms substantially similar to those of the Original Agreement, as approved in the Docket 00-0194 Order (and also substantially similar to the terms set forth in the Metro Division's Rules, Regulations and Conditions of Service (Water) (ILL. C. C. No. 4, Sheet Nos. 25-31) ("Standard Water Rules")). Aside from minor language changes made for clarification of the provisions (e.g., substituting Illinois American Water as the utility in place of CUCI) these provisions are the same as the comparable provisions of the Original Agreement (Original Agreement, Section 6(B) and (C), pages 2-3). To the extent that the provisions of Section III.B (2) and (3) of the Agreement, applicable to the Original Terra Cotta Area, differ in minor respects from the comparable provisions of the Original Agreement, Illinois American Water seeks approval of those provisions in this Petition.

31. Under the Westminster Agreement, Westminster will construct water and wastewater mains for the Westminster Land, in accordance with provisions consistent with terms of the Standard Water Rules and Rule 11 of the Metro Division's Rules, Regulations and Conditions of Service (Sewer) (Ill. C.C. No. 5, Sheet Nos. 25-27) (the "Standard Sewer Rules"). The applicable provisions of the Westminster Agreement will be discussed below.

32. Except as otherwise expressly provided in the Agreement (for the Original Terra Cotta Area) or the Westminster Agreement (for the Westminster Land), water and wastewater mains will be extended in the Expanded Area in accordance with the Standard Water Rules and Standard Sewer Rules, respectively.

33. All construction performed by Terra Cotta (under the Agreement) or by Westminster (under the Westminster Agreement) will be in accordance with plans and specifications approved by Illinois American Water. In addition, Illinois American Water will monitor and inspect all construction.

34. Terra Cotta and Westminster will provide property rights and/or rights-of-way for water and wastewater facilities. At present, Illinois American Water is not aware of a need to acquire additional rights-of-way from private landowners. If it becomes necessary for Illinois American Water to acquire additional rights-of-way, Illinois American Water will follow the requirements of Part 300 of the Commission's Rules (83 Illinois Administrative Code, Part 300).

FUNDING OF FACILITIES

Water Backbone Plant

35. Section 600.370(a) of the Commission's Rules establishing Standards for Water Service, 83 Ill. Admin. Code § 600.370(a), provides that:

The utility will provide all supply plant (backbone plant) at its cost and expense without requiring contributions or tap-on-fees from customers, developers or promoters, except in those unusual cases where extensive plant additions are required before customers can be attached. In such instances the utility may require the customer, developer and/or promoter to advance funds, subject to refund as customers are attached, or require a revenue guarantee in lieu of customers being attached. Each contract for such an advance or revenue guarantee shall be filed with the Commission for approval.

36. In the case of extensive plant additions, Section 600.370(a) allows a utility to seek contributions from developers in appropriate circumstances.

37. In Orders applying Section 600.370(a), the Commission has determined that the utility's investment in new plant should be at a level under which the investment in rate base per customer for the area affected is comparable to that of other areas served by the utility. As the Commission has recognized, a higher level of investment would increase revenue requirement per customer to an unreasonably high level. As explained by the Commission in *Aqua Illinois*,

Inc., Dockets 03-0455 and 03-0550 (consolidated) (Oct. 13, 2004), when extensive plant additions are required, the amount of a utility's investment in new facilities should result in a reasonable revenue requirement per customer for the affected area, which is comparable to the per customer revenue requirement in the utility's other rate areas. Dockets 03-0455 and 03-0550, Order, pp. 19-20; *see also, Illinois-American Water Co.*, Docket 05-0253, Order, p. 14 (Sept. 28, 2005) (Commission approved water supply plant contribution at a per customer level of water supply plant investment consistent with level applicable in other areas served by the Company); *Consumers Illinois Water Co.*, Docket 01-0606, Order, pp. 4-7 (Jan. 3, 2002) (Commission approved water supply plant contribution under Section 600.370(a) with no refund requirement, where evidence showed that a developer contribution was needed to ensure that plant expansion was not subsidized by other customers); *Consumer Illinois Water Co.*, Docket 00-0591, Order, p. 4 (Nov. 21, 2000) (Commission noted that, under Section 600.370, consideration of project's revenue requirement effect is important in determining utility investment, "because if revenues from a large project requirement extensive plant additions are insufficient to cover those costs that are ultimately borne by the utility, then there are adverse impacts on existing customers . . .").

38. Under the Agreement (Section III.B.1 (pages 5-6)), Illinois American Water's refunds for the TC Water Backbone Plant would continue to be made pursuant to the methodology approved by the Commission in the Docket 00-0194 Order (and affirmed by the Appellate Decision). The amount of such reimbursement payments is determined by dividing the actual cost of the TC Water Backbone Facilities by the number of population equivalents ("P.E.s") that can be served by the backbone facilities. Under the Agreement, the actual number of P.E.s that could be served by the backbone facilities is 4,950 P.E. Under the Original

Agreement (Section 6.A, pages 2-3), the per P.E. refund is made as customers attach to the TC Water Backbone Plant in the Original Terra Cotta Area. Under the Agreement, subject to the approval of the Commission, the per P.E. refund would be paid as customers attach to the TC Water Backbone Plant in the TC Land. Illinois American Water seeks approval for this change.

39. As expanded water supply facilities are needed for the TC Land, Illinois American Water would, pursuant to the Agreement (Section IV, pages 7-9), construct such water backbone plant without any requirement that Terra Cotta (or TC Land Entities) provide a construction deposit or any other funding or collateral.

40. The Original Agreement provides that Illinois American Water will construct expanded water backbone in the Original Terra Cotta Area, and this approach was approved by the Commission in the Docket 00-0194 Order. The Original Agreement (Section 9, Page 3), however, requires Terra Cotta's consent for use of the TC Water Backbone Plant outside the Original Terra Cotta Area. In return for Illinois American Water's agreement to provide additional water backbone plant for the TC Land without investment by Terra Cotta or TC Land Entities, Terra Cotta has consented in the Agreement to use of the TC Water Backbone Facilities to serve any portion of the Expanded Area (to the extent that the capacity of such facilities is adequate). Illinois American Water believes that the resulting flexibility in the use of the TC Water Backbone Plant will allow it to more efficiently serve customers in the Expanded Area.

41. Under the Agreement (Section IV.A, page 8), for those portions of the Expanded Area that are not a part of the TC Land (*i.e.*, Tall Grass), Illinois American Water will provide additional water backbone in accordance with Section 600.370(a). Consistent with this approach, the Westminster Agreement requires that, subject to the approval of the Commission, Westminster will construct the Tall Grass Water Backbone Plant at its expense and transfer it to

Illinois American Water. Because there will be only a few customers in Tall Grass when water service is first provided and extensive supply plant additions are required to serve the Tall Grass area, receipt of this contribution with respect to the Tall Grass Water Backbone Plant is necessary to avoid undue risk for Illinois American Water and its customers and is appropriate under 83 Ill. Admin. Code 600.370(a). Illinois American Water will provide to Westminster a refund of the cost of the Tall Grass Water Backbone Plant of \$1,082 for each new customer connection (as defined in the Westminster Agreement). This amount is approximately equivalent to the average per customer investment in the Metro Division for “wells and springs.” As a result, Illinois American Water’s investment in “wells and springs” backbone plant for Tall Grass will be consistent with the level of investment in such plant for the Metro Division. The Commission approved use of this approach in *Illinois-American Water Company*, Docket 05-0253. Accordingly, Illinois American Water’s proposed level of investment is reasonable and consistent with the principles of Section 600.370(a).

42. In this Petition, Illinois American Water seeks approval of Section III.B.1 of the Agreement, which modifies the water refund methodology approved in the Docket 00-0194 Order for the TC Water Backbone Plant to permit per P.E. refunds as customers attach throughout the Expanded Area rather than in only the Original Terra Cotta Area. Illinois American Water further seeks approval of the above-described provisions of Section IV of the Agreement, which describe the agreed arrangements for the funding of future water backbone plant. Illinois-American Water also seeks approval of the provisions of the Westminster Agreement that provide for a contribution of the Tall Grass Water Backbone Plant, with related refunds.

Wastewater Backbone Plant

43. Under the Agreement (Section VIII, page 18), Illinois-American Water would provide an investment in the amount of \$322,202 for the Existing TC Sewer Backbone Facilities and Initial Plant Expansion. This amount is intended to cover the obligation that Illinois-American Water (as successor to CUCI) has to refund the cost advanced to CUCI for the TC Sewer Backbone Plant under the terms of the Docket 00-0194 Order (and related Appellate Decision), and provide a reasonable level of investment in the Initial Plant Expansion. Terra Cotta constructed the Original Wastewater Plant in 1973 (with an upgrade in 1996-97) at a cost of approximately \$449,221. Over the years that these facilities were in use, Terra Cotta recorded depreciation in the approximate amount of \$362,912. Accordingly, under the Uniform System of Accounts for Wastewater Utilities (83 Ill. Admin Code, Part 650) (“Sewer -- USOA”) the amount of the cost advanced for sewer backbone plant that is part of the Existing TC Sewer Facilities is \$86,309, as shown in accounting entries submitted by Illinois-American Water in Docket 00-0194. (See Sewer-USOA Accounting Instruction 18.D) The \$322,202 investment amount specified in the Agreement consists of the \$86,309 refund of the cost advanced for the TC Sewer Backbone Plant, and a \$235,893 investment in the Initial Plant Expansion.

44. Unless other terms are approved by the Commission, the financing of wastewater backbone plant is subject to Rule 16. Pursuant to Rule 16.04(c), Terra Cotta (and/or Westminster), as developer of Reserved Area, would be required to pay a deposit in an amount equal to the cost of the Initial Plant Expansion. Under Rule 16.04(c)(ii), Illinois American Water would pay a refund to the Reserved Area developer(s) as customers connect to the expanded wastewater plant capacity inside the development area. The per customer refund amount is equivalent to the estimated amount of Annual Treatment Revenue to be received from each customer (estimated to be \$327.48 in the case of each residential customer). Assuming that there

are approximately 2,449 new residential customers in the Reserved Area, the potential amount of the refund that Terra Cotta could receive under Rule 16, if the anticipated development were to occur as expected, would be approximately \$802,000. This amount would be paid under Rule 16, as customers attach.

45. As an alternative to this approach, Illinois-American Water and Terra Cotta agreed to the fixed payment discussed above, which includes a fixed component of \$235,893 for the Initial Plant Expansion. Under the agreed approach, Illinois American Water is able to provide a fixed investment in the Initial Plant Expansion at a reasonable level, which is below the level of amount of investment that Metro Division customers might otherwise be required to support in rates (if full build-out were to occur). Terra Cotta, on the other hand, receives a fixed certain investment now rather than the uncertainty that would exist under Rule 16. Illinois-American Water believes that either the approach under Rule 16 or the agreed refund terms would be consistent with the finding in the Docket 00-0194 Order that the utility should provide an investment in sewer backbone plant. Under the circumstances of this transaction, however, Illinois American Water believes that the agreed approach is reasonable and should be approved.

46. The Second Plant Expansion would be constructed in accordance with the terms of Rule 16 (or on such other terms as the Commission may approve).

47. In this Petition, Illinois American Water seeks approval of the above-described provisions of the Agreement which relate to construction of the Initial Plant Expansion and the funding approach for the TC Sewer Backbone Facilities and the Initial Plant Expansion, which varies from the provisions of Rule 16.

Water and Wastewater Mains

48. Under the Westminster Agreement, Westminster will construct, at its expense, water distribution mains within the Westminster Land (“WM Water Mains”) and transfer those

WM Water Mains to Illinois American Water. Illinois American Water will refund to Westminster, for each new customer (as defined in the Westminster Agreement) that connects to a WM Water Mains and taking water service within the Westminster Land, during the first ten (10) year period following construction of WM Water Mains, an amount equal to one and one half (1½) times the average annual water revenue paid to Illinois-American Water by other similarly situated customers. Such refunds will be paid to Westminster during the first ten year period following transfer of WM Water Mains. The total amount refunded will not exceed the total cost to Westminster the constructing the WM Mains. Illinois-American Water also will refund to Westminster the cost of the Company Service Line for each new customer.

49. The provisions of the Westminster Agreement that relate to sewer mains are a “special contract” under Rule 11.01(m) of the Standard Sewer Rules. Under the Westminster Agreement, Westminster will construct, at its expense, wastewater collection mains within the Westminster Land (“WM Wastewater Mains”) and transfer those WM Wastewater Mains to Illinois American Water. The Westminster Agreement will provide that Illinois American Water will refund to Westminster an amount equal determined in accordance with the sewer collection main refund methodology (“Sewer Refund Methodology”) approved by the Illinois Commerce Commission (“Commission”) in *Illinois-American Water Company*, Docket 01-0645. In accord with the Sewer Refund Methodology, ILAWC will refund to Developer one and one-half times the amount of estimated per customer annual sewer collection service revenue from a customer similarly situated to each “Original Prospective Customer,” as defined in Docket 01-0645 (a customer who connects to a sewer main constructed by Westminster (“WM Wastewater Main”) and contracts for at least one year of sewer service, commencing within 30 days after the date that service from the Sewer Collection Main is first available). In no event shall the total amount

of sewer main refunds paid to Westminster exceed the total cost of constructing the WM Wastewater Mains.

50. As noted above, certain provisions of the Agreement regarding Terra Cotta's construction of water mains for the Original Terra Cotta Area differ in minor respects from the comparable provisions of the Original Agreement.

51. Except as provided in the Agreement and Westminster Agreement, the contribution/refund provisions of the Standard Water Rules and Standard Sewer Rules will apply in connection with the construction of water and sewer mains, respectively, for the Expanded Area.

ACCOUNTING FOR TRANSACTION

52. In accordance with Commission policy and the Uniform System of Accounts for Water Utilities ("Water -- USOA") (83 Ill. Admin. Code, Part 605) and the Sewer-USOA, Illinois American Water proposes to record the original cost of all water and wastewater facilities for the Expanded Area in the applicable Utility Plant In Service accounts (Account 101 - for water and sewer service, separately). The original cost of the water and wastewater facilities for the Expanded Area will be the gross cost of the facilities.

53. Where a developer will make a contribution or deposit for water facilities, and the Company will make refunds as customers attach, the Company proposes to record the anticipated amount of the refunds for water facilities in Account 252 - Advances for Construction. The difference between the actual construction costs for water facilities and the amount recorded in Advances for Construction will be recorded in Account 271 - Contributions-in-Aid-of-Construction. As refunds are paid, the amount of the refunds would be entered as a debit to Account 252. Where a deposit is non-refundable, it would be recorded in Account 271 -- Contributions-in-Aid-of-Construction.

54. Where a developer will make a contribution or deposit for sewer facilities, the accounting entries for the sewer assets would be the same as those for water in that the actual cost for construction of sewer assets would be recorded as Utility Plant In Service (Account 101), and the anticipated amount for refunds would be recorded in Account 252. The difference between the construction cost and the amount of Advances for Construction would be recorded in Account 271 - Contributions In Aid of Construction. As refunds are paid, the amount of the refunds would be entered as a debit to Account 252. As in the case of water facilities, where a construction deposit is non-refundable, it would be recorded in Account 271.

55. The accounting entries proposed by Illinois American Water for the Initial Plant Expansion, the Tall Grass Water Backbone Plant, the WM Water Mains, and the WM Wastewater Mains will be provided by Illinois American Water during this proceeding.

DEPRECIATION RATES

56. For the Expanded Area, Illinois American Water proposes use of the depreciation rates presently in effect in the Original Terra Cotta Area and other portions of the Metro Division. The Commission last evaluated these depreciation rates in the Company's last rate case, Docket 02-0690.

WATER/WASTEWATER RATES

57. In the Original Terra Cotta Area, Illinois American Water currently applies for water service and wastewater service the rates set forth in the tariffs of the Metro Division (as now in effect or as such rates may be subsequently modified by Order of the Commission). (Ill. C.C. No. 4, Sheet Nos. 36 and 37 (water service); Ill. C.C. No. 5, Sheet Nos. 37 and 38 (wastewater service)). Illinois American Water proposes to apply these same rates throughout the Expanded Area. In addition, all other applicable water and wastewater charges for the Metro Division would apply to service within the Expanded Area, including, but not limited to, public

and private fire protection charges, returned check charges, late-payment fees and State and municipal add-on taxes or fees. As shown on attached Exhibit D, if the proposed water rates and sewer service rates are charged within the Expanded Area, the expected rates of return on the water and sewer rate bases on an average basis for the 5th year after initiation of service in the Area are comparable to the rate of return on rate base allowed by the Commission in Illinois American Water's last rate proceeding, Docket 02-0690. The proposed rates are, therefore, not in excess of reasonable rates.

WHEREFORE, Illinois American Water requests that the Commission enter an Order: (1) issuing a Certificate of Public Convenience of Necessity, which authorizes the Company to construct, operate and maintain a water supply and distribution system and a sewage treatment and collection system within the Expanded Area, and to transact in connection therewith a public utility business; (2) approving the above-described provisions of the Agreement which relate to water facilities (Sections III and IV, pages 5-9); (3) approving the provisions of the Westminster Agreement that relate to contribution of the Tall Grass Water Backbone Plant, and related refunds; (4) approving the provisions of the Agreement that relate to the Initial Plant Expansion and to funding of the TC Sewer Backbone Facilities and Initial Plant Expansion (Sections V-VIII, pages 9-18), including approval for a variance from the provisions of Rule 16 with regard to the amount of the required developer contribution for wastewater backbone capacity; (5) approving the provisions of the Agreement and the Westminster Agreement that relate to funding water and/or wastewater mains; (6) approving the accounting entries proposed herein to record the original cost of water and wastewater facilities; (7) approving application in the Expanded Area of the proposed water and wastewater depreciation rates; (8) approving application in the Expanded Area of the proposed

water/wastewater rates; and (9) granting such other relief as is necessary and consistent with the above.

Respectfully submitted,

ILLINOIS-AMERICAN WATER COMPANY

By: /s/ Albert D. Sturtevant

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Of Counsel:

Boyd J. Springer
Mark A. Whitt
Albert D. Sturtevant
JONES DAY
77 West Wacker Drive
Chicago, IL 60601-1692
Phone: (312) 782-3939
Facsimile: (312) 782-8585
E-mail: bjspringer@jonesday.com
 mawhitt@jonesday.com
 adsturtevant@jonesday.com